

“Delaware is Not a State”: An Empirical Analysis of Jurisdictional Competition in Bankruptcy

Marcus Cole *

Over the last twelve years, the United States District Court for the District of Delaware has experienced exponential growth in the number of bankruptcy filings for large corporate debtors. Bankruptcy scholars are divided about whether this development is a positive one. Since 1978, the bankruptcy code has expressly permitted a corporate debtor to file in either its “principal place of business” or its place of incorporation.¹ Until the 1990's, most publicly held corporate debtors chose to

* Associate Professor of Law, Stanford Law School, and Visiting Associate Professor of Law, Northwestern University School of Law. I thank the Honorable John C. Akard, John Armour, Joseph Bankman, Richard Brooks, G. Eric Brunstad, Jr., Hannah Buxbaum, Steven G. Calabresi, the Honorable Kevin J. Carey, David Dana, Robert Dehney, Robert L. Friedman, Tracey George, Ted Janger, the Honorable Ed Jellen, Harold Kaplan, Tobias Keller, Michael Klausner, Debbie Langehennig, Robert Lawless, Richard B. Levin, Jonathan Lipson, Ronald Mann, the Honorable Margaret A. Mahoney, Harvey Miller, Richard Miller, John Pottow, Robert Rasmussen, the Honorable Marjorie Rendell, the Honorable Steven Rhodes, Edward B. Rock, William H. Schorling, David A. Skeel, Jr., the Honorable Leo Strine, Jr., Jeff Strnad, David Sykes, Michael Temin, Myron Trepper, Bernie Trujillo, Fred Tung, Michael Wachter, the Honorable Eugene Wedoff, Jay Lawrence Westbrook, the Honorable Judith H. Wizmur, participants in the Arthur Moller Bankruptcy Workshop at the University of Texas at Austin School of Law, the Florida State University School of Law Faculty Workshop, and the University of Pennsylvania Institute for Law and Economics Business Bankruptcy Roundtable for their comments and suggestions during the formative stages of this research. I deeply indebted to the attorneys, judges, and other professionals whose comments, insights, and impressions form the substance of this project. Several attorneys and judges agreed to answer questions on condition of anonymity. In an effort to promote frankness and candor, interviewees were promised confidentiality, and that any quotes would be without attribution.

¹ The actual language of the bankruptcy venue provision in Title 28 of the U.S. Code actually states that a bankruptcy case may be filed in the United States District Court for the district:

(1) in which the domicile, residence, principal place of business in the United States, or

file where their corporate headquarters were located. In fact, only one such company filed in Delaware during the entire decade of the 1980's.² That trend changed abruptly after the filing of the second Continental Airlines case in 1990.³ The swift and successful reorganization of Continental, particularly when cast upon the backdrop of its rocky first bankruptcy proceeding in the Southern District of Texas just a few years earlier, catapulted the District of Delaware to the front of the race for corporate reorganization filings. Since then, well over 80% of reorganizations of large, publicly held companies take place in the Delaware bankruptcy court.⁴

The choice of Delaware as a location for a bankruptcy proceeding cannot, on its face, be explained by Delaware's preeminence in the race for corporate charters. Bankruptcy law is federal, not state, law. Bankruptcy judges are not chosen from the among the highly respected and

principal assets in the United States, of the person or entity that is the subject of such case have been located for the one hundred and eighty days immediately preceding such commencement, or for a longer portion of such one-hundred-and-eighty-day period than the domicile, residence, or principal place of business, in the United States, or principal assets in the United States, of such person were located in any other district; or

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

28 U.S.C. § 1408 (2001). Courts interpreting section 1408 have construed the "domicile" of a corporation to be its "place of incorporation." *See In re Ocean Properties of Del., Inc.*, 95 B.R. 304, 305 (Bankr. D. Del. 1988) (Balick, B.J.) (holding that a corporation's "residence or domicile" for purposes of bankruptcy venue is its place of incorporation).

2

³See Mark D. Collins, *Why Delaware?*, DEL. LAW., Fall 1997, at 38.

4

sophisticated chancellors on the Delaware state court bench. They do not even need to be members of the influential Delaware bar. In fact, the most recent appointee, Judge Mary F. Walrath, was a Philadelphia bankruptcy attorney when she was tapped by the United States Court of Appeals for the Third Circuit to replace the retiring Judge Helen S. Balick.⁵ The Third Circuit appointment of bankruptcy judges points to another distinction between the bankruptcy bench and the Delaware state courts: bankruptcy judges are not directly accountable to the state bar. Furthermore, while they do not, as Article I judges, enjoy life tenure, they do receive the shelter afforded by 14 year terms.⁶

Even if there were some substantive state law explanation for the choice of the District of Delaware, then why did it take until the 1990's for the state's hospitality to manifest itself, given that Delaware has been the leader in the corporate charter race since 1919?⁷

Bankruptcy scholars are divided about the merits of this development. The "Delaware Skeptics," to use Professor David Skeel's nomenclature, include Professor Lynn LoPucki of UCLA, and his coauthor, Professor Theodore Eisenberg of Cornell. The Skeptics believe that the choice of Delaware is evidence of a pernicious race to the bottom. LoPucki and Eisenberg, for instance, argue that the choice of Delaware is a product of judicial laxity on the part of the two Delaware bankruptcy judges with respect to the details of plans of reorganization, as well as the refusal to scrutinize attorneys'

⁵28 U.S.C. § 152 provides that the United States court of appeals for the circuit shall appoint bankruptcy judges for the districts within its circuit.

⁶*See* 28 U.S.C. § 152 (a) (2001).

⁷

fee applications.⁸ LoPucki and Sara Kalin attribute the increased number of failed plans emanating from Delaware proceedings as proof of this claim.⁹ The Skeptics advocated the inclusion of an “Anti-Delaware” provision in the bankruptcy reform bill, largely through the efforts of Professor Elizabeth Warren, the official reporter to the National Bankruptcy Reform Commission.¹⁰ This effort appears doomed, however, as Senator Joseph Biden of Delaware has vowed to kill any bankruptcy bill with such a provision.¹¹

The “Delaware Enthusiasts,” among whom Skeel numbers himself, Professors Bob Rasmussen and Randall Thomas of Vanderbilt, and Douglas Baird of Chicago, all attribute Delaware’s emergence to the efficiency and sophistication of the two Delaware bankruptcy judges, and the pressures they experience within the Delaware legal culture.¹² Skeel champions the move to Delaware as a product of market forces that seek efficient restructuring of financially distressed corporations, and points to the dramatic rise in the employment of prepackaged bankruptcies as evidence of this positive

⁸Theodore Eisenberg and Lynn M. LoPucki, *Shopping for Judges: An Empirical Analysis of Venue Choice in Large Chapter 11 Reorganizations*, 84 CORNELL L. REV. 967 (1999).

⁹Lynn M. LoPucki and Sara D. Kalin, *The Failure of Public Company Bankruptcies in Delaware and New York: Empirical Evidence of a “Race to the Bottom,”* 54 VANDERBILT L. REV. 309 (2001).

¹⁰

¹¹DAVID A. SKEEL, JR., *DEBT’S DOMINION* 231 (2001).

¹²David A. Skeel, Jr., *Bankruptcy Judges and Bankruptcy Venue: Some Thoughts on Delaware*, 1 DELAWARE L. REV. 1 (1998).

development.¹³ Rasmussen, Thomas and Baird view Delaware's emergence as the first step toward the "contractualization" and privatization of corporate reorganizations, and perhaps back toward the equity receiverships that distinguished American corporate reorganization one hundred years ago.¹⁴

Although the normative battle lines on the Delawarization of corporate bankruptcy have been drawn, no one has undertaken an effort to document and analyze the articulated motives underlying the actions of the parties that produce this curious development. In order to determine whether Congress ought to follow through on or reject the anti-Delaware provisions before them, we need to know why this jurisdictional competition is taking place. This paper attempts to unravel the mystery by exploring the explanations proffered by the key decision makers: debtors' counsel, creditors' counsel, and bankruptcy judges. I have talked with over thirty lawyers and judges, and have assembled their, often unexpected, explanations for the Delaware bankruptcy explosion, as well as their forecasts for the future of "Delawarization."

This Article proceeds in three parts. In part one, I provide a chronological and factual account of the Delawarization of corporate bankruptcy, and detail the normative positions that have been staked out by proponents and critics of the development. In Part II, I present my findings with regard to the explanations provided by debtors' and creditors' counsel, and the factors that they believe drive the

¹³See David A. Skeel, Jr., *What's So Bad About Delaware?* 54 *Vanderbilt L. Rev.* 309 (2001).

¹⁴Douglas G. Baird and Robert K. Rasmussen, *Control Rights, Priority Rights, and the Conceptual Foundations of Corporate Reorganizations*, 87 *Va. L. Rev.* 921; Robert K. Rasmussen and Randall S. Thomas, *Wither the Race? A Comment on the Effects of the Delawarization of Corporate Reorganizations*, 54 *VANDERBILT L. REV.* 283 (2001).

choice of District of Delaware. In Part III, I then look at the “supply side” of the jurisdictional competition equation, surveying the opinions of bankruptcy and other judges about why a court might participate in a competition for cases. Finally, in Part IV, I analyze these explanations in light of the literature on jurisdictional competition in order to determine whether the Delawarization of corporate bankruptcy is a desirable development. I conclude by highlighting the differences between what Roberta Romano refers to as the “genius of American corporate law,” and the jurisdictional competition that we have witnessed in bankruptcy over the last twelve years. These differences stem from the fact that, for purposes of the jurisdictional competition we seem to be witnessing in bankruptcy, and in the words of one California bankruptcy attorney, “Delaware is not a state; it’s a district.”¹⁵ The fact that the District of Delaware is a sub-component of a larger, competitive court system, may actually cause concern for champions of federalism and the jurisdictional competition that federalism fosters. Unlike the genius that is American corporate law, the evidence presented here seems to suggest that the “Delawarization” of bankruptcy is a coincidence; a happy one perhaps, but a coincidence nevertheless. This analysis suggests that the real debate regarding jurisdictional competition, then, is not one between the District of Delaware and other bankruptcy courts, but between reorganizations governed by federal bankruptcy law and those governed by the state law of contract.

An introductory note about methodology and exposition is in order. The explanations presented in this article were compiled through interviews with over thirty bankruptcy lawyers and more than a dozen judges, although some of the explanations offered by judges were in response to a short

15

questionnaire. Many of the interviews and informal conversations were conducted during the National Conference of Bankruptcy Judges Annual Meeting in Orlando, Florida, from October 16 to 18, 2001, and at the University of Pennsylvania Institute for Law and Economics Business Bankruptcy Roundtable on December 7, 2001. Surveys were circulated in December 2001 and January 2002. Many of the explanations offered by the bankruptcy and other judges interviewed in this study mirrored those put forth by lawyers. For purposes of analysis, however, the explanations bearing on lawyer motives are presented first, followed by the explanations offered by judges with regard to the judicial mind-set.

I The Rise of Delaware Bankruptcy

While Delaware has long been the jurisdiction of choice for the filing of corporate charters, the state's pre-eminence as a bankruptcy haven is a recently acquired one. A corporation or entity considering filing a chapter 11 petition may be confronted with a number of venue choices. Delaware became an option because a business may file its petition in any district where it maintains its principal place of business or principal assets, where it is "domiciled" or incorporated, or where there is an already pending bankruptcy case of an affiliate, general partner, or partnership.¹⁶ Prior to 1990, most

¹⁶See 28 U.S.C. § 1408 (2001).

bankruptcy cases were brought in the district in which the debtor's principal place of business or assets were located. When a venue other than principal place of business was sought for a complex bankruptcy case, the Southern District of New York was the preferred venue throughout the 1980's.¹⁷

Then, in 1990, one case changed everything. Continental Airlines was confronting the possibility of bankruptcy for the second time in two years.¹⁸ Instead of filing in Houston, where the company was headquartered, and where it had filed a chapter 11 petition just a few years earlier, the lawyers for Continental availed themselves of the option afforded by the venue provision of the bankruptcy code and chose to file in Delaware.¹⁹ The success of Continental's second reorganization captured the imagination of bankruptcy attorneys around the country. By 1993, 40 percent of large chapter 11 cases were filed in Delaware.²⁰ By 1996, the District of Delaware had become the venue for 86 percent of these cases.²¹

The emergence of Delaware as the preferred venue for bankruptcy has been accompanied by a parallel development: the increase in the use of "prepackaged" chapter 11 cases. "Prepacks" are cases where the debtor's bankruptcy filing takes place in conjunction with a plan of reorganization that has

¹⁷

¹⁸ Robert K. Rasmussen and Randall S. Thomas, Timing Matters: Promoting Forum Shopping By Insolvent Corporations, 94 Nw. U.L. Rev. 1357, 1366 (2000).

¹⁹

²⁰LoPucki

²¹Id. at

been negotiated with and agreed to by the debtor's creditors prior to the filing.²² Between 1986 and 1990, only 8, or 1.2%, of the 633 publicly held corporations that filed for bankruptcy filed a prepackaged plan.²³ That number increased to 70, or 11.3%, of the 622 public companies that filed for bankruptcy between 1991 and 1997.²⁴ Of that number, roughly half of the prepackaged plans were filed in Delaware.²⁵ This preference for Delaware in the filing of prepackaged chapter 11 cases is greater than the general preference for Delaware in the filing of traditional chapter 11 cases.²⁶

The Delawarization of corporate bankruptcy has been met with controversy and alarm. The reaction to the onslaught of cases hitting the Delaware court's docket was not isolated to academic circles. By order dated January 31, 1997, Chief Judge Joseph Farnan of the United States District Court for the District of Delaware, withdrew the order that automatically referred bankruptcy cases to the Delaware bankruptcy judges.²⁷ In his order, he stated that the number of bankruptcy cases had caused it to be appropriate and necessary for district judges to participate in these cases.²⁸ Under the Judiciary Act, Title 28 of the United States Code, federal district courts are given exclusive and original

22

²³See *id.* at 1375.

24

25

26

27

28

jurisdiction over bankruptcy cases.²⁹ This jurisdiction has been determined to be Constitutionally required by Article III.³⁰ Title 28 also, however, authorizes a district court automatically to refer bankruptcy cases to bankruptcy judges within its district.³¹ Prior to 1997, and pursuant to this authority, the district court in Delaware automatically referred bankruptcy cases to the bankruptcy judges of that district.³² The Delaware district court's withdrawal of the automatic reference meant that bankruptcy cases would now be assigned by the Chief Judge of the District Court, and be heard by both bankruptcy judges and district court judges.³³

The move to Delaware has placed a strain on that court's resources. Approximately 40% of the Delaware docket is comprised of large chapter 11 cases, as well as large chapter 7 cases that were converted from chapter 11 cases.³⁴ In December 2000, the Bankruptcy Committee of the Judicial Conference of the United States had a study undertaken to examine the Delaware bankruptcy workload, which concluded that the court needed eight or nine judges to handle the filings.³⁵ The strain has been alleviated somewhat by help from the outside. For several years, all consumer cases in Delaware have been heard by Judge Judith K. Fitzgerald of Pittsburgh, who sits in Wilmington two

²⁹28 U.S.C. § 1334

³⁰

³¹

³²

³³

³⁴

³⁵

days per month. The chapter 11 load has been shared, from time to time, by seven visiting judges “sitting by designation.”³⁶ As an additional aid to case administration, the District of Delaware’s Chief Judge Sue Robinson, by an order dated December 15, 2000 that became effective on February 3, 2001, reinstated the automatic reference to the bankruptcy judges.³⁷

One of the seven visiting judges sitting by designation was Bankruptcy Judge Randall Newsome of the United States Bankruptcy Court for the Northern District of California.³⁸ In three separate chapter 11 cases automatically referred to him, Judge Newsome, *sua sponte*, asked the parties in each case to brief him on why venue in Delaware was appropriate.³⁹ On April 6, 2001, four days after the W.R. Grace filing, a case which, incidentally, was one of the cases assigned to Judge Newsome, Chief Judge Robinson withdrew the automatic reference once again.⁴⁰ In her order, Judge Robinson stated that “the judges of the District Court have determined that the workload of the bankruptcy judges is threatening the administration of justice in the bankruptcy court, and therefore, that it is once again appropriate and necessary that judges of the District Court participate in the handling of such cases.”⁴¹ Five months later, on September 6, 2001, Chief Judge Robinson once again reinstated the automatic

³⁶United States District Judges Judith H. Wizmer of Camden, New Jersey, and Raymond T. Lyons of Trenton, New Jersey, have sat frequently in Wilmington to hear several of the larger cases.

³⁷28 U.S.C. § 155 provides for the temporary transfer of bankruptcy judges.

³⁸

³⁹

⁴⁰

⁴¹

reference, which became effective October 6, 2001. As an explanation for this action, David Bird, the Clerk of the Bankruptcy Court in Delaware, said publicly that the two sitting bankruptcy judges in Delaware had not had “new cases since April of 2001,” and have thus “had an opportunity to clear their calendars.”⁴²

The explosion of the bankruptcy docket in Delaware has raised more than just the eyebrows of the Chief Judges of the District Court. Delaware venue was becoming a problem in the eyes of the National Bankruptcy Review Commission (“the NBRC”), and its Official Reporter, Professor Elizabeth Warren. The NBRC was established under the Bankruptcy Reform Act of 1994 to investigate issues relating to the Bankruptcy Code and evaluate proposals for change in the future.⁴³ Delaware venue had been on the agenda of the NBRC early on, in large part because of studies by the Federal Judicial Center, as well as by Professors Lynn Lopucki and William Whitford, that suggested that large chapter 11 cases were characterized by widespread forum-shopping.⁴⁴ The NBRC, consistent with this conclusion, crafted a report that addressed these concerns.⁴⁵

In its report to Congress, the NBRC recommended that the debtor's state of incorporation be expressly eliminated as a basis for venue in a bankruptcy case.⁴⁶ Although the commissioners stated

42

43

⁴⁴Lynn M. LoPucki and William C. Whitford, *Venue Choice and Forum Shopping in the Bankruptcy Reorganization of Large, Publicly Held Companies*, 1991 Wisc. L.Rev. 11 (1991).

45

46

that this proposed change “is not directed at the bankruptcy courts in the Southern District of New York, those in Delaware, or in any other specific bankruptcy venue,”⁴⁷ commentators and news reports clearly interpreted the change as a frontal attack on Delaware’s emergence as the frontrunner in the race for chapter 11’s.⁴⁸

The shift in the political winds that blew through Washington with the Republican Revolution in 1994, however, doomed the NBRC’s position on most of its proposals, including its “anti-Delaware” provision. Instead, the proposed Bankruptcy Reform Act of 1999 (House Bill H.R. 833), as introduced, did not include a provision which would affect the corporate bankruptcy venue provision.⁴⁹ However, during the House Judiciary Committee’s mark-up session on the bill, Representative Howard L. Berman from California, inserted an “anti-Delaware” amendment in the bill on a voice vote.⁵⁰ The amendment stated that a corporation’s domicile would be its principal place of business, effectively eliminating the state of incorporation alternative.⁵¹ The House passed the bill containing this amendment.⁵² Both of Delaware’s senators protected the status quo in Delaware, and the final bill as passed by the Senate did not contain an “anti-Delaware” amendment.⁵³ This final draft of this

47

48

49

50

51

52

53

legislation was vetoed by President Clinton.⁵⁴ The Bankruptcy Reform Act of 2002 in the House currently has only one proposed change to the venue provisions of the Bankruptcy Code. In Section 1409(b) of title 28, the bill would require adversary proceedings for a non-consumer debt against a non-insider of less than \$10,000 to be in the district where the defendant resides.⁵⁵ Additionally, the proposed legislation in both the House and Senate provides an additional bankruptcy judgeship to the District of Delaware.⁵⁶ There are currently no proposed changes to the venue statutes in the Senate version of the Bankruptcy Reform Act of 2002.⁵⁷ In fact, Senator Joseph Biden of Delaware has publicly stated that as long as he is on the Senate Judiciary Committee, it is unlikely that any so-called “anti-Delaware” amendment will be incorporated into the Bankruptcy Code.⁵⁸

Other courts have taken notice of the developments in Delaware, too. The Southern District of New York, the dethroned heavyweight champion of chapter 11 venue, and Delaware’s chief rival in the race for bankruptcy petitions, promulgated formal guidelines governing prepackaged reorganization cases.⁵⁹ Prior to these guidelines, prepacks were structured to comply with the rules governing traditional chapter 11’s.⁶⁰ In January of 2000, the Southern District of Texas (which encompasses

54

55

56

57

58

59

60

Houston), revamped its bankruptcy procedures with respect to a Chapter 11 cases designated as “complex.” To be deemed “complex,” a case must be “of sufficient scope.”⁶¹ Once a case is deemed complex, a judge must hear emergency hearings and other “first day” motions no later than two days after a request for a hearing has been filed.⁶²

In response to this development in the Southern District of Texas, bankruptcy Judge Mary Walrath of the District of Delaware sent the case of Apple Orthodontix Inc., a Houston-based provider of orthodontic services which had filed for bankruptcy under chapter 11 in Delaware, back to Houston.⁶³ In explaining her actions, Judge Walrath’s order stated that she was “aware of the new rules in the Houston Court regarding seeking to solve the problem articulated by the debtor about prompt scheduling of hearings ... quite frankly, comparing it to my own calendar, I think [Houston] may be able to give the debtor a little better service.”⁶⁴

Despite the occasional transfer of venue back to corporate headquarter districts, the fact is that if there is a battle for bankruptcy venue, “[t]he war is over and Delaware has won.”⁶⁵ In recognition of this fact, many large national law firms have opened offices in Wilmington within the past three years, often staffed exclusively with bankruptcy practitioners.⁶⁶

61

62

63

64

⁶⁵Rasmussen and Thomas, *Whither the Race?* *Supra* note ____, at 283.

66

While much controversy has arisen concerning the perceived forum shopping by corporations, very little research has been done to understand what motivates the venue selection decision by lawyers, and what might lead judges to attract cases to their own district. In order to know whether the alarm expressed by the NBRC and the Delaware skeptics is justified, and whether Congress ought to take seriously the efforts aimed at curbing Delaware venue, some understanding of the underlying motives is necessary. The next two parts of this Article explore the motivations on both sides of the jurisdictional competition equation, through the lens of the explanations offered by lawyers and judges. Part II examines the factors that lead debtors' counsel to choose Delaware for the filing of a chapter 11 petition. After these explanations are laid bare, Part III will explore why judges might welcome or even attempt to attract chapter 11 cases. These explanations are then followed by an examination of how they fit within current understandings of jurisdictional competition.

II Lawyers' Explanations for Choosing Delaware

The venue selection decision for any large, publicly held company ultimately rests upon the judgment of the debtor's counsel. It is true that these entities face the possibility of being forced into bankruptcy and a concomitant bankruptcy venue through the filing of an involuntary petition by its creditors, but creditor incentives and bankruptcy code discouragements make such an occurrence unlikely.⁶⁷ In reality, virtually all proceedings involving a publicly held debtor commence voluntarily, and

67

the overwhelming majority of those voluntary petitions are now filed in the District of Delaware. In order to gain an understanding of why Delaware has become the venue of choice for publicly held companies, it is necessary to understand why debtors' counsel see Delaware as a superior choice given the alternatives.

A. The Factors for Debtors' Counsel

1. Predictability

The prominent debtors' counsel with whom I have spoken list several factors as the most important in their choice of Delaware as a forum. Leading their list is "predictability." While virtually every lawyer and most of the judges used this word, all of them referred to at least one of two different types of predictability. First, most lawyers interviewed said that the choice of Delaware is substantially driven by the fact that the debtor knows it will have its case heard by a "good" judge. Since Delaware is a small district with only two bankruptcy judges, attorneys filing petitions know that they have a fifty percent chance of getting one of the two. Most lawyers also suggested that if they had to file a petition tomorrow, they would be satisfied with either Judge Walsh or Judge Walrath, Delaware's two bankruptcy judges.⁶⁸ This response reflected the sentiments expressed by those lawyers who regularly represent creditors as well. The debtors' counsel interviewed all asserted that, while this factor was of primary importance to them in the choice of venue calculus, this factor has decreased in importance with the case backlog that has led to the assignment of cases to visiting and District Court judges.

Lawyers also clearly meant something else in addition to judges when they used the term

⁶⁸

“predictability” to explain their choice of Delaware. Many of the debtors’ counsel pointed to the existence of precedent in complex cases as lending predictability to new filings there.⁶⁹ According to one New York bankruptcy attorney, “when I file a retailer case in Delaware, I know that the judge will understand the special issues surrounding inventory, for example, and I also have an idea how those issues will be resolved.”⁷⁰ One lawyer who has recently moved to Delaware reports that “process and predictability are 90 percent of [the decision of where to file], and we have judges who understand that.”

2. Sophistication of the Judges

The emphasis on predictability in lawyer responses frequently accompanied another factor, namely, the sophistication of Delaware’s judges. All of the attorneys who regularly represent debtors made reference to the competence and sophistication of the Delaware bankruptcy bench. As one Chicago bankruptcy lawyer put it, “if I’m a smart lawyer, with a big, complex case, I want judges who will be able to follow and understand my arguments.”⁷¹ Another Chicago attorney who regularly represents financial institutions added “time is money; if it takes time to educate the judge on a particular point, then the proceeding will cost more in the long run.”⁷²

There is a “path dependent” component to the sophistication factor articulated by so many

69

70

71

72

bankruptcy lawyers. The Delaware bankruptcy court is viewed as a preferred venue for complex cases in part because these judges have handled many complex cases in the past. The “human capital” that they have developed lends to the efficient, effective and speedy resolution of subsequent cases. As a result, few lawyers expressed comfort about the prospect of filing complex cases in other, less experienced districts.

The sophistication of the Delaware bankruptcy bench has won it substantial notoriety in bankruptcy circles. As one Texas bankruptcy attorney noted, “everybody knows the names of the two judges in Delaware; can you name any two bankruptcy judges in Atlanta, Boston, or Dallas?”⁷³ This national reputation is one with remarkable detail. Many of the lawyers, for example, noted that Judge Walsh has an admirable work ethic, and “puts in very long hours.” Others asserted that Judge Walrath was a fitting replacement for Judge Helen Balick, who retired from the Delaware bankruptcy bench in 1995.⁷⁴ According to one California lawyer, “she is as smart as any bankruptcy judge in the country.”⁷⁵ Another California lawyer thought that, while he held much admiration and respect for Judge Walrath, no judge could fill the shoes of Judge Balick. “She was a tough act to follow; Walrath is very smart, don’t get me wrong, but she’s no Helen Balick.”⁷⁶

3. Responsiveness and Availability of the Judges

73

74

75

76

The third most commonly cited factor by lawyers was that of responsiveness. Debtors' counsel universally refer to the ability to get "first day orders" on the first or second day after filing as a critical consideration in the venue selection process. In bankruptcy, "first day orders" are the judicial orders that constitute exceptions to the blanket automatic stay, permitting the payment of payroll, and completion of Debtor-in-Possession financing transactions, as well as any other immediate action that is necessary to operate the business day-to-day.⁷⁷ The Delaware bankruptcy bench has a well established reputation, according to the lawyers interviewed, for getting first day orders heard and issued quickly. Judge Walrath in particular was widely praised for her ability to decide first day orders before the end of business on the day after the petition is filed.⁷⁸

Many lawyers with whom I spoke noted that the responsiveness of the Delaware bankruptcy judges was not independent of their sophistication and experience with complex cases. According to one New York bankruptcy attorney, "If I have to educate the judge on the overwhelming importance of getting a particular order quickly, and if she has to read briefs from all sides on the issue, then I've lost before I've started." A Delaware-based bankruptcy attorney put it another way. "If the judge has seen fifteen cases like yours, then she knows what first day orders you need before you walk in the door."

Judicial responsiveness, in the eyes of lawyers, goes beyond first day orders. Many of the

⁷⁷

⁷⁸Delaware Local Bankruptcy Rule 4001-2(b) contains substantial restrictions on the content of first day orders.

attorneys cited the “availability” of the Delaware bankruptcy bench as exceptional. The Delaware judges were praised for their willingness to “bend over backwards” to accommodate parties when scheduling hearings or meetings. A San Francisco bankruptcy attorney said that the judges are sensitive to attorney travel demands, and have gone so far as schedule hearings in unrelated cases with an eye toward his convenience. “Its not always possible, but its nice when I can get both covered in one trip.” Others noted that the judges have been willing to stay late to address the needs of cases, and frequently work through weekends. According to one judge who has visited the Delaware bankruptcy court, “those two judges work very hard, and they are willing to do what the case requires.” The willingness of the judges to hold emergency hearings was also listed as evidence of their availability.

4. Attorneys’ Fee Applications

The uniform responses of lawyers grew mixed when the sensitive subject of attorneys’ fees was broached. Attorneys’ fees in a bankruptcy proceeding are awarded by the court pursuant to section 330 of the bankruptcy code.⁷⁹ Court approval of the debtor’s attorneys’ fees is required in bankruptcy because all professional fees are considered administrative expenses of the proceedings.⁸⁰ As administrative expenses, they come out of the common pool that is supposed to benefit the general creditors.⁸¹ Court approval ensures, theoretically, that the pie in which the creditors share is actually

⁷⁹11 U.S.C. § 330(a) (2001).

⁸⁰*See* Rule 2014.

⁸¹

enhanced by the services provided by the professionals.

Although section 330 grants courts sitting in bankruptcy the power to award attorneys' fees, it does not dictate the method by which fee applications are evaluated and approved. Many districts around the country have developed local rules to accomplish this task. Much is left to the discretion of the judge. The Skeptics have asserted that the Delaware judges have effectively "rubber stamped" attorney's fee applications, handing over whatever debtors' counsel desire.

While all of the lawyers spoken with adamantly reject the assertion that the Delaware judges fail to scrutinize fee applications, they are divided about the role that attorneys' fees play in the venue selection decision process. Some bankruptcy lawyers rejected the idea that fee applications played a role in the venue calculus at all. "If I have a large client, with millions of dollars on the line, do you think I'd risk a less than optimal outcome for a few bucks in the short run?" Another attorney thought the fee issue was a smokescreen. According to him, the speed and efficiency of a Delaware filing might actually mean fewer hours and less work than a filing elsewhere. "Delaware cases may actually be cheaper."

A slight majority of attorneys thought that fees played some role, but not in the manner suggested by those asserting that the Delaware judges "turn their heads." These lawyers insisted that Delaware judges do not rubber stamp fee applications submitted by debtors' counsel. The level of scrutiny may be less than that found among other judges in the Third circuit (who typically order the submission of voluminous and costly fee application reports produced by independent auditors), but it is inaccurate to assert that any fee item will be approved.

The lawyers acknowledging that fee applications influence the filing decision claimed that it did so in an indirect, rather than direct, manner. The reason why the effect is said to be indirect is that some districts arbitrarily cap fees to the rates prevailing in the local jurisdiction.⁸² “Utah bankruptcy judges, for example, will not allow debtors’ counsel to be paid anything more than the prevailing rate in Provo, even if a particular corporate debtor’s counsel is based in New York or Los Angeles.” According to one debtors’ counsel, “a court’s policy on fees is likely to drive cases away, rather than attract.” Therefore, if cases are driven away from the principal place of business, one “other alternative is the place of incorporation, Delaware.” In response to the flight of cases to Delaware, the Chief Judge of the United States Bankruptcy Court for the Southern District of Texas made the remarkable public announcement that “the war on attorney’s fee applications is over.”⁸³

Delaware has another policy on fees that only one lawyer thought influenced venue selection. The District of Delaware was the first to issue a local rule that permitted as much as 80% of attorney’s fees to be paid on a continuing, monthly basis.⁸⁴ In many other districts, lawyers must wait until the end of the case to be paid, or petition for interim compensation in long cases.⁸⁵ Even the lawyer who thought this rule was important suggested its influence was less than self serving. “It allows clients the ability to track and budget their legal expenses as the proceeding goes along.” He also thought that the

82

83

84

⁸⁵Interim compensation can be requested every 120 days. *See* 11 U.S.C. § 331 (2001).

absence of this rule was more likely to repel cases from the headquarters district rather than draw cases to Delaware.

5. Geographic Convenience

Much has been made about the geographic convenience of Delaware, and lawyers generally agree that this factor plays a modest role in the venue selection decision. Wilmington enjoys proximity to Philadelphia, its international airport and Amtrak train station, now with high speed Accela service to and from New York.⁸⁶ Many lawyers said that too much should not be made of Delaware's geographic convenience. It is, after all, less convenient to New York companies than the Manhattan bankruptcy court. One lawyer quipped that the bankruptcy court in Wilmington is "just a two hour train ride from most company headquarters in New York; then again, the same is true for the bankruptcy court in Manhattan."

Geographic convenience cannot be universally true for all debtors, and the evidence gathered by Eisenberg and LoPucki seems to bear this out. With the exceptions of companies based in Santa Ana and New York, the percentage of companies choosing Delaware venue are much higher for those based in eastern cities than for those based in western ones. Midwestern cities like Chicago and Dallas experience a lower "shop out" rate than those in the east, but higher than Los Angeles or Denver.⁸⁷ Still, one San Francisco bankruptcy attorney remains undaunted by the prospect of Delaware venue.

⁸⁶

⁸⁷Eisenberg & LoPucki, *supra* note ____, at 998-999.

“Distance isn’t really an issue; there’s good air service, I know the flight schedules, and I get a lot of work done on the plane.”

6. Creditor Pressure

One of the factors which the Skeptics believe is driving the convoy to Delaware received a mixed reception from both debtors’ counsel and creditors’ counsel. While a few debtors counsel acknowledged that a powerful creditor’s preference for Delaware venue might influence or even tip the balance in that direction, other lawyers representing debtors claimed that creditor pressure for venue was either non-existent or not important. The ways in which creditor pressure might operate can vary. Some creditors might, for example, withhold workout approval or Debtor-in-Possession (post-petition) financing unless the petition is filed in Delaware.⁸⁸ Some of the debtors’ counsel acknowledged that some lenders will insist upon “Delaware filing” covenants in their post-petition lending agreements, while others say they have never allowed a creditor to dictate the place of filing. One lawyer adamantly declared that “I would never let a creditor tell me where to file.” He added, “if I say ‘no,’ what are they going to do?”

Despite this display of machismo, there is undisputable evidence of some creditor preference for Delaware. It takes the form of covenants incorporated in post-petition lending agreements that are prepared in anticipation of a prepackaged chapter 11, or in workout documents that contemplate a

88

chapter 11 filing.⁸⁹ Whether such covenants are enforceable is an interesting question, but not one within the scope of this article. The relevance of these covenants, for our purposes, is with regard to the sentiments of which they provide evidence: a creditor preference for Delaware. Professors Rasmussen and Thomas argue that such a preference is understandable and even laudable, given a creditor's interest in a speedy, efficient, and resource-conserving reorganization process.⁹⁰ Despite the logic of this assertion, and the irrefutable evidence of creditor preference, most lawyers thought that this factor was a real one, but not a particularly powerful one.

One thing that the Skeptics are correct about is the influence of secured creditors on the place of filing. As one prominent attorney put it, "these days, secured creditors call all of the shots." Secured creditors, through the power afforded them by their collateral, can influence many of the debtor's key decisions, including venue selection. Theoretically, secured creditors should not be concerned with bankruptcy because, as the old adage goes, "liens pass through bankruptcy."⁹¹ The reality is that most secured creditors dread bankruptcy because of the possibility of depreciation of the secured asset over the course of a long proceeding. To protect secured creditors from this threat, the bankruptcy code requires the debtor to give the secured creditor "adequate protection."⁹² Fights between a secured creditor and the debtor have historically centered around the adequacy of the adequate protection.⁹³

89

90

91

92

93

The fight between the secured lender and creditor have gone away in the large Delaware filings, however, with a new form of adequate protection: the debtor can now get the secured creditor on the same page by agreeing to pay, up front, for the secured creditor's professionals.⁹⁴ This form of adequate protection for the secured lender is not provided for in the bankruptcy code, and is not judicially administered.⁹⁵ It is an entirely private development, arranged at arms-length between the debtor and the secured lender.

7. Danger of a Bad Local (Home) Judge

Many lawyers added the risk of drawing a "bad" hometown judge as a very important factor leading to the Delaware venue decision. In a manner similar to the effect attributed to attorneys' fee receptivity, the existence of an undesirable judge in the district of the company's principal place of business had the tendency to drive cases away. Since Delaware is an alternative for so many public companies, Delaware gets the nod. When asked what they meant by bad local judge, lawyers responded with a wide array of characterizations which included "crazy," "dumb," "not very bright," "lazy," "inconsistent," "biased," and "slow." One bankruptcy judge added that he thought many lawyers are terrified of getting judges that have standing policies that make no sense, such as an unwillingness to hold "a cash collateral hearing until more than 15 days after the case has been filed."⁹⁶

94

95

96

In this sense, many lawyers felt that consistently bad judges were as undesirable as inconsistent ones.

8. Intrusiveness of the Local (Home) United States Trustee

One final factor that came up in the responses of several lawyers was the level and quality of the intrusiveness of the United States Trustee in the region in which a company has its principal place of business.⁹⁷ The United States Trustee, an office created by the 1978 enactment of the Bankruptcy Code, is a federal government official that performs various administrative tasks in a bankruptcy proceeding.⁹⁸ In chapter 7 cases, the trustee appoints an interim trustee, and in chapter 11 cases, monitors, evaluates, and files comments on attorneys' fee applications.⁹⁹ Perhaps more importantly, section 1102 directs the United States Trustee to appoint the members of the committee of unsecured creditors, and "additional committees of creditors . . . as the United States trustee deems appropriate."¹⁰⁰ While these powers might appear to be relatively innocuous, many lawyers expressed their belief that some United States Trustees are "activists," exceeding the scope of their administrative powers in order to affect the outcome of cases, or the negotiations which take place within them.

⁹⁷The United States is divided into 21 regions for purposes of the United States Trustee program. Each United States Trustee is appointed to a five year term by the Attorney General of the United States. 28 U.S.C. § 581 (2001).

⁹⁸Originally tested in 17 states and the District of Columbia, Congress expanded the United States Trustee program in 1986 to make it nationwide.

⁹⁹28 U.S.C. § 586(a)(3) (2001).

¹⁰⁰11 U.S.C. § 1102(a)(1) (2001).

Several attorneys pointed to the actions of the United States Trustee in the Pacific Gas and Electric bankruptcy as an example of an overzealous and intrusive exercise of authority. In that case, the United States Trustee for the Northern and Eastern Districts of California and the District of Nevada, Linda Ekstrom Stanley, appointed a “Committee of Ratepayers.”¹⁰¹ She publicly stated that her decision was intended to “give the consumers of California a say in this proceeding.”¹⁰² While many observers applauded the decision, others viewed it as an unauthorized extension of the United States Trustee’s powers under the code.¹⁰³ In the end, Bankruptcy Judge Dennis Montali upheld PG&E’s motion to disallow the ratepayers committee and its participation in the bankruptcy proceeding.¹⁰⁴ Judge Montali asserted that ratepayers have other means to protect their interests. “The Bankruptcy Code, and the Bankruptcy Court, were designed to resolve debtor-creditor problems,” he wrote. “State agencies are where issues such as rates for electricity are handled.”¹⁰⁵ Stanley said she was “disappointed in the judge’s ruling . . . because we were within our discretion to appoint a ratepayers committee.”¹⁰⁶

¹⁰¹5/16/01 Knight-Ridder Trib. Bus. News - KRTBN (Pg. Unavail. Online), 2001 WL 20967166 KRTBN Knight-Ridder Tribune Business News: The Sacramento Bee - California Official Defends Panel in Pacific Gas, Electric Case in San Francisco

¹⁰²

¹⁰³

¹⁰⁴

¹⁰⁵5/19/01 L.A. Times B7, 2001 WL 2488063 Los Angeles Times The State THE ENERGY CRISIS PG&E Judge Bars Panel of Customers Ruling: Pacific Gas & Electric Co.’s 4 million customers are not entitled to a committee to represent interests in bankruptcy case.

¹⁰⁶Id.

Lawyers citing the PG&E bankruptcy said that the “activism” of United States Trustees like Stanley introduce an element of unpredictability and instability into a chapter 11 proceeding. According to one San Francisco attorney, “if there’s any risk of something like [the Stanley decision in PG&E] happening in my case, I’m going to want to file it somewhere else.” That somewhere else, he added, is likely to be Delaware. According to one prominent attorney, the only time a United States Trustee’s office affects the decision on where to file are in those districts that are known for having a particularly intrusive United States Trustee. In those districts, the United States Trustee “does what fee restrictions do; they drive cases away.” Delaware is not known for having a particularly intrusive United States Trustee, although one judge who has sat on the Delaware bankruptcy court as a visitor said that he was “disappointed” with the United States Trustee’s office there. He said that the office was “not particularly helpful” when it came to evaluation of attorneys’ fee applications. He added that perhaps he “was just spoiled” by the helpfulness of his home court’s United States Trustee’s office.

B. “Non-Factors” or Neutral Considerations According to Debtors’ Counsel

When presented with the concerns of the Delaware Skeptics about the motivations that might be driving the venue selection decision, many lawyers rejected some of the factors central to the Skeptics’ position. Among the factors that most lawyers thought were irrelevant were (1) the level of scrutiny with which judges reviewed and confirmed plans of reorganization, (2) the desires of managers to keep their jobs, and (3) the costs of retaining local counsel in a Delaware proceeding.

1. Level of Plan Scrutiny

Most lawyers denied the assertion that the desire for a venue where plans of reorganization will escape scrutiny drives the move to Delaware. According to one Chicago based creditors' counsel, "if there's something wrong with a plan, the people most affected by it will catch it." Another Chicago attorney added that it would be risky to one's reputation as well as the client's case to slip something past the Delaware court. "It wouldn't be worth it in the long run."

Lawyers also adamantly denied the unspoken premise that the Delaware bankruptcy judges are more lax with regard to chapter 11 plans than judges in other districts. A lawyer based in San Diego replied that "the judges in Delaware work faster because they are more experienced and have seen lots of complex cases before, not because they are less careful." All of the debtors' counsel with whom I spoke dispute Professor LoPucki's charge that "the judges in the District of Delaware will rubber stamp a ham sandwich."¹⁰⁷ All contend that the scrutiny that plans of reorganization receive is on par with what they meet in other districts around the country. "The difference is that in Delaware," according to one Chicago attorney, "the judges can look at and understand a plan more quickly, particularly if they've seen a lot of these types of plan provisions before."

2. Managers' Desires to Keep Their Jobs

Many lawyers instantly dismissed the notion that the desire of debtor management to keep their

107

jobs was a determinant of the Delaware venue selection decision.¹⁰⁸ One New York based debtors' counsel said "the way they keep their jobs is to keep the company going, and they do that by doing whatever it takes to have a successful reorganization." He went on to say that if that meant choosing to file in Delaware, it is because Delaware offered the brightest prospects for success. Another New York attorney said much the same. "Whether or not the managers get to keep their jobs is more a function of how well the company comes through the reorganization process." Managers, therefore, "are going to choose the forum that is best for the company, because that's what is best for them, and that's exactly how we ought to want them to think." Contrary to the charge of the Skeptics, the desire of managers to keep their jobs is likely to be value enhancing for a plan of reorganization.

3. Cost of Local Counsel

Delaware Local Bankruptcy Rule 9010-1 requires local counsel for most parties. Most commentators on Delawarization have acknowledged the likelihood that local counsel in Delaware carry a premium over counsel in other districts.¹⁰⁹ Yet, this factor did not appear to be a consideration in the minds of the lawyers charged with the venue decision. Most of the debtors' counsel with whom I spoke say that this is not a consideration at all. "You pay them and then move on." As noted earlier, many large national law firms have opened Wilmington offices, in part to satisfy the local counsel requirement.

108

109

C. An Example: The ENRON Bankruptcy Venue Decision

The above description of the factors that play a role in the venue selection process demonstrates that the decision is a complex one, without a single determinant that can explain all Delaware cases. A glimpse into the complexity and rationality of the venue selection decision can be found in the process that led up to the filing of a case that did not wind up in Delaware: ENRON. The ENRON decision making team chose to file in New York rather than Delaware.¹¹⁰ A spokesperson for the decision team explained the decision as follows. First, they rejected Houston, ENRON’s “principal place of business,” because the old policy of the Southern District of Texas on fees had caused them to drive away complex cases for years.¹¹¹ This meant that the Houston judges lacked expertise in complex cases.¹¹² They also did not want to undergo a bankruptcy proceeding in a town where all of the (now disgruntled) employees lived, and where the outcome of the case would be affected by the evening news and local politics.¹¹³

Second, ENRON, could have filed in the District of Oregon. One of ENRON’s subsidiaries was Portland Power, a corporation chartered in Oregon. Since the bankruptcy venue provision of 28 U.S.C. section 1408 allows for the filing of a bankruptcy case were “there is pending a case under title 11 concerning such [entity’s] affiliate,” ENRON could have filed on behalf of Portland Power, and then

110

111

112

113

filed its own petition to gain Oregon venue.¹¹⁴ The ENRON decision team ultimately decided against an Oregon bankruptcy filing, in large measure because that court also lacked expertise in complex cases.

After Oregon was eliminated, the ENRON decision team considered filing the company's bankruptcy petition in Delaware. They were well aware of the reputation of the Delaware judges for sophistication, responsiveness, and diligence. Yet, the ENRON decision team rejected Delaware, because although that court had many of the qualities that has led to its prominence in the world of corporate bankruptcy, it is currently very busy. The ENRON decision team thought that the Delaware court was too busy to give them the kind of attention and responsiveness that they feared they might require with such a complex case.

The ENRON decision team settled upon a filing in the Southern District of New York through a process of elimination.¹¹⁵ The New York court has sophisticated judges, arguably as sophisticated as the Delaware judges.¹¹⁶ The New York court also had time to hear the case. New York was convenient for the corporate managers, while distant from the local politics of Houston. Finally, the ENRON decision team felt that the New York court had an institutional memory of a ready-made template for the ENRON case: the Drexel-Burnham case that it had handled a decade before.¹¹⁷ The

114

115

¹¹⁶The Southern District of New York has 9 bankruptcy judges under 28 U.S.C. § 152(a)(2) (2001).

117

Drexel precedent also lent an air of predictability that they felt did not exist in other districts.

III What Judges Think

While the explanations offered by lawyers as to why they are choosing Delaware bankruptcy venue over other alternatives are interesting in themselves, they cannot, alone, explain a jurisdictional competition story. Charles Tiebout encourages us to think of states as competitors in markets for citizens, corporations, and the tax revenues and social goods they bring with them.¹¹⁸ States are, according to Tiebout, “suppliers” of law, while citizens and corporations are consumers of that supply.¹¹⁹ In the Delaware venue selection story, then, we must think of the Delaware bench as a court competing for cases, and the debtors’ counsel that have selected Delaware venue as having “bought what they are selling.” According to the lawyers above, the Delaware bankruptcy judges are “selling” predictable, reliable, competent, and speedy service.

So, we know what the Delaware judges are selling, but our next question must be: “why?” Why would federal bankruptcy judges, with no direct interest in the state government, state revenues, or even the state bar, and with the protection afforded by 14 year terms, seek to “compete” with other

¹¹⁸See Charles Tiebout, *A Pure Theory of Local Expenditures*, 64 J. POL. ECON. 416 (1956).

¹¹⁹

bankruptcy courts around the nation for cases? The answer to this question, which I refer to as the “supply side” of the jurisdictional competition equation, requires an inquiry into the judicial mind-set. For this purpose, it was necessary to get the thoughts of judges about why the Delaware judges might engage in activity that attracts cases. The question, “what is it that judges get from providing the kind of service lawyers seek?,” was put to several judges at various levels and court systems across the country. More than a dozen judges, more than half of whom were federal bankruptcy judges, were asked this question in face-to-face conversations, telephone interviews, and an electronic mail questionnaire.

Almost all of the judges, from bankruptcy, state, and federal district and appeals courts, suggested that there is a level of prestige and satisfaction that attaches to hearing and deciding important cases. Some of the judges used the term “psychic income” to refer to this prestige and satisfaction. According to one Illinois bankruptcy judge, “big chapter 11 cases are interesting as well prestigious.” He added that judges get satisfaction from overseeing something that is vital to the nation’s economy as well.

Vice Chancellor Leo Strine of the Delaware Court of Chancery adds another factor. He feels that the legal culture in Delaware is one driven by “pride and service.” “In Delaware, we believe that we are doing something that benefits all of society, and that it is important to do this well.” He notes that Judge Walrath was appointed by the Third Circuit as an outsider (she was a member of the Philadelphia bar), precisely to discourage the expansion of the Delaware docket that they had witnessed prior to her appointment. He also points to her assimilation into the way things were done in

Delaware as evidence of what he refers to as “the psychic income from being a part of this sophisticated and service oriented legal culture.” He feels that lawyers and judges in Delaware feel the pressure to add value to society, and they respond to this pressure.

When asked why the Delaware court might attract seemingly “boring” pre-packaged bankruptcies, almost all of the judges who thought that “psychic income” was important noted that it is a mistake to assume that “pre-packs” are boring. According to one judge, “many pre-packs unravel after they are filed, and many of the ones that don’t involve things that the parties want to do, but shouldn’t be done through a bankruptcy filing.” Another judge suggested that judges can get satisfaction from making sure “good” pre-packs make it through, adding “if there’s nothing broke, it shouldn’t be fixed.”

Many judges thought, however, that the significance of the “psychic income” gained by judges handling important cases was overstated. As one Pennsylvania bankruptcy judge said, “they pay Judge Walrath exactly what they pay me, and it doesn’t make sense to me that I will be a better judge if I take on so many cases that I don’t have time to make thoughtful decisions.” A United States District Court judge questioned the “psychic income” that flows from an overwhelming docket. “I can’t see how anyone can possibly enjoy feeling as though they don’t have time to make thoughtful decisions on important cases.”

A bankruptcy judge who had spent time handling the overflow of cases in Delaware as a visiting judge thought that too much was being made about the motivations behind the judges there. First, he noted that, although motions to transfer venue were infrequent, “both bankruptcy judges

seemed receptive to motions to transfer venue.” He added that “the Delaware judges do not think they are better able to handle chapter 11 cases than other bankruptcy judges.” According to this judge, in a recent 18 month period, the Delaware bankruptcy judges “heard 19 motions to transfer venue, and 17 of them were granted.” He felt that this demonstrated that the Delaware judges see themselves as simply “doing their jobs,” and not making a name for themselves. Another bankruptcy judge agreed. “They get the cases and they hear them, because that is what they are supposed to do.”

IV Delaware Bankruptcy As Jurisdictional Competition

It is clear that a number of factors, according to the lawyers interviewed, have driven cases toward Delaware, and that this may have provided Delaware with an intractable advantage with respect to expertise. The more complex cases that the Delaware court hears, the more sophistication they may gain from the experience. It may be a mistake, however, to view the path-dependent entrenchment of the District of Delaware as a bad thing. If these judges have developed socially valuable human capital that can be tapped to produce shorter, less costly, and more efficient reorganization proceedings, then perhaps we should encourage, and not interfere with the move toward Delaware. In fact, if Vice Chancellor Strine is correct about the motivations of the judges and the impact of Delaware’s legal culture, Congress ought to consider expanding the Delaware bankruptcy bench to accommodate the ever expanding docket. The legal culture, if Strine is correct, will produce additional sophisticated

bankruptcy judges.

What is less clear is whether the shift to Delaware is a form of jurisdictional competition of the type that generates the benefits we see in the race for corporate charters. If it is, then judges in other districts, particularly Nevada and New York, have an incentive to compete with Delaware judges for these same cases, and society ought to benefit from this competition. But before we start to cheer about the winner of the race for bankruptcy venue, perhaps we ought to look at the responses of lawyers and judges and ask whether what they have described is really a form of jurisdictional competition that we recognize.

A. A Review of the Jurisdictional Competition Debate - Why Motives Matter.

The arguments on both sides of the jurisdictional competition debate are well rehearsed and familiar. It is an old debate, but its modern incarnation could be said to have originated in 1956 with the publication of Charles Tiebout's seminal article, *A Pure Theory of Local Expenditures*.¹²⁰ In 1966, Grant McConnell's now classic critique of American federalism, *Private Power & American Democracy*, challenged the logic underlying the application of a competitive market model to the relationships between states, as well as between states and the federal government.¹²¹ In 1974, William Carey moved the debate into the realm of corporate law, by asserting that charter competition between the states results in a "race to the bottom," with states adopting manager-friendly laws to attract

¹²⁰See Tiebout, *A Pure Theory of Local Expenditures*, *supra* note 113, at 416.

¹²¹GRANT MCCONNELL, *PRIVATE POWER & AMERICAN DEMOCRACY*, 101-118 (1966)

corporations.¹²² Ralph Winter joined the issue with the argument that, while managers may be self interested, market forces drive them to be responsive to investors. This leads managers to seek efficient regulation, and states, in competition with each other to supply this efficient regulation, engage in a “race to the top.”¹²³ In this manner, jurisdictions can be said to compete with each other to attract corporate charters, citizens, and the revenues that they bring with them.¹²⁴

In the debate over whether the jurisdictional competition between states leads to a race to the bottom or to the top, motives are what matters. States like Delaware are driven by the pecuniary interests of its bar, as well as the desire to generate revenues, to provide a “public good” in the form of efficient organization law.¹²⁵ Corporate decision-makers are motivated by the desire to capture the “Delaware premium” that share value enjoys under the authority of efficient corporate governance legal regimes, which in turn allows them to reap the private benefits that inure to managers of well-performing companies.¹²⁶ We can think of all participants in the jurisdictional competition story, then, as acting out of enlightened self interest in the market for law. States, as suppliers of organizational law, are

¹²²William L. Carey, *Federalism and Corporate Law: Reflections Upon Delaware*, 83 Yale L. J. 663 (1974).

¹²³Ralph K. Winter, *State Law, Shareholder Protection, and the Theory of the Corporation*, 6 J. Legal Stud. 251 (1977).

¹²⁴See Charles Tiebout, *A Pure Theory of Local Expenditures*, 64 J. POL. ECON. 416 (1956).

¹²⁵ROBERTA ROMANO, *THE GENIUS OF AMERICAN CORPORATE LAW* (1993).

¹²⁶Robert Danes, *The Delaware Premium . . .*

responsive to the desires of the consumers of organizational law, namely, firm managers and investors.¹²⁷

B. Is the Delawarization of Corporate Bankruptcy a Story of Jurisdictional Competition?

The torrent of chapter 11 cases that has flowed in the direction of Delaware over the past twelve years has brought with it the debate over jurisdictional competition. The arguments over the beneficence of the Delawarization of bankruptcy are much the same as those that attached to the debate over Delaware's position in the corporate charter race. Is the move toward Delaware venue in bankruptcy a race to the bottom? Or has the preservation of the domicile option in bankruptcy's venue provision provided a window of opportunity for beneficial competition?

1. The "Race to the Bottom" Arguments of the Skeptics

The critics of the logarithmic expansion of the Delaware bankruptcy docket point to two reasons for the phenomenon. First, they claim that Delaware is chosen because it is corporate debtor-friendly.¹²⁸ This posture has led, in the eyes of the Delaware Skeptics, to an unseemly laxity among the judges in Delaware with regard to pre-packaged bankruptcies as well as traditional chapter 11 plans of reorganization.¹²⁹ In the words of the leading Skeptic, Professor Lynn LoPucki, the Delaware judges

¹²⁷

¹²⁸

¹²⁹

would “rubber stamp a ham sandwich” if a corporate debtor placed it in front of one of them.¹³⁰

In an effort to prove this assertion of laxity on the part of the Delaware bankruptcy bench, LoPucki and Kalin conducted an empirical analysis of chapter 11 plans filed in Delaware by large, publicly held corporate debtors.¹³¹ LoPucki and Kalin point to the high “refiling” rate among Delaware chapter 11 cases as proof that the process fails when it is done in Delaware.¹³² According to their study, a firm that reorganizes in Delaware is four times as likely to file a second bankruptcy petition as is a firm that reorganizes in another jurisdiction.¹³³

Professors Rasmussen and Thomas, point out several difficulties with the LoPucki and Kalin study, including that it failed to distinguish between traditional chapter 11's and pre-packaged ones, and that it draws a negative inference from refiling when none is necessarily justified.¹³⁴ They demonstrate that the optimal refiling rate is probably not zero, given that there are costs that attach to the effort and time required to achieve a zero refiling rate.¹³⁵ Professor Skeel adds that the higher Delaware refiling rate may be due to a self-selection bias: firms selecting Delaware venue may have a more complicated

130

¹³¹Lynn M. LoPucki and Sara D. Kalin, *The Failure of Public Company Bankruptcies in Delaware and New York: Empirical Evidence of a “Race to the Bottom,”* 54 VANDERBILT L. REV. 231 (2001).

¹³²*Id.* at 233.

133

¹³⁴Robert K. Rasmussen and Randall S. Thomas, *Wither the Race? A Comment on the Effects of the Delawarization of Corporate Reorganizations,* 54 VANDERBILT L. REV. 283 (2001).

¹³⁵*Id.* at 296-297.

capital structure and, concomitantly, a more complicated restructuring.¹³⁶ He also notes that firms choosing Delaware may also be the ones with the most serious business problems.¹³⁷

Whether LoPucki and Kalin are right about the significance of refiling rates is not, for present purposes, a critical issue. What is central to the debate is that they identify the venue selection process as one of jurisdictional competition that results in what they feel is a form of pernicious “forum shopping” and a “race to the bottom.”¹³⁸

2. The “Glass is Half Full” Arguments of the Enthusiasts

The Delaware Enthusiasts see the rise of Delaware bankruptcy venue quite differently. Professor Skeel, for example, trumpets the “virtues of Delaware”: speedy and efficient handling of corporate bankruptcy proceedings by expert judges within a professional and responsive judicial culture, producing what he refers to as a “clientele effect.”¹³⁹ Professors Rasmussen and Thomas point to another benefit of the Delaware way: an understanding and encouragement of consensual and contractual solutions to corporate restructuring needs.¹⁴⁰ Although the enthusiasts acknowledge that the

¹³⁶David A. Skeel, Jr., *What’s So Bad About Delaware?*, 54 VANDERBILT L. REV. 309, 319 (2001).

¹³⁷*Id.* at 320.

¹³⁸

¹³⁹David A. Skeel, Jr., *Bankruptcy Judges and Bankruptcy Venue: Some Thoughts on Delaware*, 1 Del. L. Rev. 1, 27 (1998).

¹⁴⁰

competition we are witnessing in the race for bankruptcy venue is not directly parallel to that which characterizes the race for corporate charters, they point to these benefits and embrace “the glass as half full.”¹⁴¹

C. “Delaware is Not a State” – Why the Jurisdictional Competition Debate Doesn’t Fit

Any reviewer of the literature comprising the debate over the Delawarization of corporate bankruptcy is stalked by the shadow of an unspoken premise: the Delawarization of corporate bankruptcy is “like” the Delawarization of corporate law. It is true that Skeptics LoPucki and Kalin dismiss any claim that the phenomenon is “federalist.”¹⁴² But LoPucki and Kalin, by their recognition of the distinctions between the structures involved in the bankruptcy version of the debate, and summary dismissal of “federalist” arguments, fail to consider the possibility that competition other than that of a federalist character might be taking place. Self-proclaimed Delaware Enthusiast Skeel likewise acknowledges the differences between bankruptcy’s Delawarization and that in the corporate charter race.¹⁴³ He acknowledges that the failure of bankruptcy Delawarization to rise to the “genius” found in corporate law attenuates the benefits we may derive from this competition, but he prefers to see the “glass as half full, rather than half empty.”¹⁴⁴ Nevertheless, both the Skeptics and Enthusiasts frame

¹⁴¹*Id.* at 26.

¹⁴²See LoPucki and Kalin, *supra* note ____, at 267-268.

¹⁴³Skeel at

¹⁴⁴Skeel, *Some Thoughts*, *supra* note ____ at 26.

their arguments in the “race to the bottom” and “race to the top” terms inextricably associated with the corporate charter debate.

One San Francisco bankruptcy lawyer, when presented with the arguments on both sides of the Delawarization debate, responded emphatically. “Your talking as though Delaware is a state. Delaware is NOT a state; it’s a district. For purposes of bankruptcy, Delaware is a *district*.”¹⁴⁵

To illustrate his point, he provided an example of a case that could have been filed in Wilmington (the District of Delaware), in Sacramento (the Eastern District of California), or with a little creativity, in Oakland (the Northern District of California). All of the considerations suggested that, although the company was headquartered in Sacramento, an Oakland or Delaware filing would have been preferable. In the end, he chose Oakland over both Delaware and Sacramento. “I made sure I had a good enough argument to steer clear of rule 11, and because most of the big creditors were San Francisco banks, I knew I wasn’t likely to get a motion to switch venue to Sacramento.”

The San Francisco attorney’s observation may suggest why the jurisdictional competition terminology provides such an uncomfortable fit in the context of bankruptcy venue. If what we are calling the Delawarization of corporate bankruptcy is a form of jurisdictional competition, it is one that takes place between districts, and not states. Many of the districts which are in competition with each other are within the same state. This makes it unclear whether a state, even if it could influence the process, would act on behalf of one district or all of them.

¹⁴⁵Emphasis as spoken by interviewee.

Delaware, as a state, is limited in its capacity to influence the competition between bankruptcy courts. Although Delaware can structure its organization law as to make its bankruptcy venue available to as many companies as choose to file charters in its Secretary of State's office, there is no bankruptcy equivalent of the internal affairs doctrine that will guarantee that its own law will apply in cases filed outside its borders.¹⁴⁶ Bankruptcy judges are appointed by the federal circuit overseeing the district, and the appointees need have no prior relationship to the bar or even the state in which she sits.¹⁴⁷ Bankruptcy law is, for the most part, federal, and while state substantive law plays an important role, the relevant state law need not have a connection with the bankruptcy venue.¹⁴⁸ This is not to suggest that the differences between bankruptcy courts is illusory. To the contrary, the evidence is clear: bankruptcy courts differ. The evidence presented here suggests an equally clear reason as to why they differ: they differ because of the judges hearing the cases. Delaware, as a state, has very little influence over the success or failure of Delaware the federal district. The success or failure of Delaware the District is largely in the hands of the judges that sit on its bench. In short, as even Professor Skeel must acknowledge, Delaware venue has more to do with judges than institutions. Any competition between bankruptcy courts for big cases, then, is one between personalities, and not jurisdictions.

1. Personality vs. Institution-Based Competition

146

147

148

In the 1942 motion picture *Casablanca*, the protagonist ran a nightclub by the name of “Rick’s Café Americain” in the refugee haven of unoccupied French Morocco. It was said of the café that “sooner or later, everyone comes to Rick’s.”¹⁴⁹ It was also said that “Rick’s wouldn’t be Rick’s without Rick.”¹⁵⁰ In much the same way, we can think of the District of Delaware as the Café Americain of bankruptcy. It might seem as though sooner or later, virtually all large reorganizations will take place in that venue. But in a very real sense, the “Delawarization” of corporate bankruptcy is more accurately characterized as the “Wal-zation” of corporate bankruptcy. As life often imitates art, the empirical evidence suggests that “Delaware wouldn’t be Delaware without Walsh and Walrath.”

In much the same manner that federal district court Judge Harvey Weinstein wielded a sophistication and work ethic that attracted many of the most complex lawsuits in the country to the Southern District of New York, Judges Walsh and Walrath, and Judge Balick before them, have honed a reputation for speedy but competent decision-making in the most complex bankruptcy cases in the country. In the minds of many, they are very deserving of the notoriety and respect that they have received. But there are limits to how much they can do in a jurisdictional competition between bankruptcy courts. Those limitations can be thought of as personal and structural.

The responses of lawyers and judges to the questions of why lawyers might choose Delaware, and why judges might want these cases, all reflect a common understanding: lawyers appear to be choosing judges, not courts or legal regimes. It is true that the lawyers choices may be characterized as

149

150

a preference for particular procedures or predictable exercises of judicial discretion, but these characterizations are just another way of saying “judges.” Lawyers like the way first Judge Balick, and then Judges Walsh and Walrath, have managed and decided cases, and they want more of the same.

And they will get more of the same, so long as: (1) Judges Walsh and Walrath continue to sit on the Delaware bankruptcy bench; (2) Judges Walsh and Walrath do not get so overburdened by cases that new cases get assigned to visiting judges; (3) Judges Walsh and Walrath are not supplemented by Congressional addition of seats to the Delaware bankruptcy bench, and Third Circuit appointments to those seats; (4) Congress does not alter or eliminate the “domicile” venue option; or (5) Congress does not create a new “Little Rock”-type United States court district for the Eastern, Western, Northern, Southern, or Central District of Delaware, causing Delaware bankruptcy judges to have cause to compete with each other for cases of Delaware corporations.¹⁵¹

The purpose of the forgoing “parade of horrors” is to point out the systemic helplessness of Delaware in the Delawarization of corporate bankruptcy. While Delaware’s status as a district does not, in itself, preclude it from engaging in jurisdictional competition with other districts, the structure of federal court districts severely limits the potential for such competition. Virtually all of the “supply side” decision-making authority rests in the hands of two judges (and, to some extent, their superiors), while virtually all of the supply side gains are enjoyed (or visited upon) those same two judges.

¹⁵¹Arkansas is divided, for purposes of the federal court system, into the Eastern District of Arkansas and the Western District of Arkansas. These districts each have their own judges, but are joined in Little Rock, where they share a United States District Court judge, the judge for the Eastern *and* Western Districts of Arkansas.

What's more: they are only human. Unlike Delaware corporate law, the humanity of the supply side of the jurisdictional competition equation is exhaustible. Delaware corporate law can be said to constitute a "public good," which has traditionally been defined in neoclassical economics as one that is inexhaustible and non-exclusive.¹⁵² Bankruptcy judges, to the contrary, are neither inexhaustible nor non-exclusive. At some point, and it is quite possible that point has already been reached, the supply of the services that lawyers are seeking through Delaware venue can no longer be provided. A judge can be too busy to handle yet another case. Or too tired. Or both.

Bankruptcy judges are also, for purposes of hearing cases, exclusive. A judge cannot be at two hearings at the same time. While the Delaware judges have, by all accounts, performed a masterful juggling act, every new case limits the availability of the judge for any other matter. The humanity of the bankruptcy judge, even the Delaware bankruptcy judge, is a real limitation on further expansion the supply of Walsh and Walrath to the lawyers that crave them. In economic terms, at some point the supply of the "thing" that lawyers want from Delaware venue becomes infinitely inelastic.¹⁵³

The above discussion is not to suggest that Delaware venue, *per se*, is limited. Any number of corporations can charter in Delaware, and any number of those that do can file bankruptcy petitions there. But the purpose of selecting Delaware venue is defeated, however, if the form is not accompanied by the substance provided by Judges Walsh and Walrath.

152

153

2. The Limits of “Intramural” Jurisdictional Competition

The association of the Delawarization of bankruptcy with the corporate charter debate may have a serious and unfortunate consequence. It may serve as a distraction from what is emerging as a more significant debate over jurisdictional competition. The term “jurisdictional competition,” because of the corporate charter debate, frequently calls to mind the horizontal competition that takes place between states and nations. Yet jurisdictional competition need not be confined to the race for corporate charters between Nevada and Delaware, or for welfare budgets between Illinois and Wisconsin.¹⁵⁴ In the federalist system that is American government, jurisdictional competition takes place on a vertical plane as well as a horizontal one.¹⁵⁵

Vertical jurisdictional competition, in the American sense, characterizes the separation of powers between state governments and the federal government. Just as states compete against each other in the race to supply desirable law and legal outcomes, the federal government is engaged in a tension with state governments for a larger share of the divided sovereignty.¹⁵⁶ Bankruptcy law is a part of that tension, in that it operates as a non-exclusive solution to the collective action problem that arises when a debtor’s assets are exceeded by its liabilities.¹⁵⁷ Bankruptcy law, in a very real sense, “competes” with state debt collection law, with state insolvency law, and most importantly for present

154

155

156

¹⁵⁷Cole, *The Federalist Cost* . . .

purposes, with state law of contract. Debtors and creditors can, and often do engage in forum shopping between federal and state regimes in order to gain an advantageous disposition of their relationship.

The foregoing discussion of vertical jurisdictional competition suggests that there may be “more than meets the eye” with respect to the Delawarization debate. The very real benefits that the Delaware enthusiasts admire with regard to venue in that district may provide just enough satisfaction to parties, particularly those involved in pre-packaged chapter 11's, to diffuse any sentiment for reform of federalized, less than contractual, bankruptcy. Public choice theory suggests that too much enthusiasm over Delaware's proclaimed victory in the horizontal competition for reorganization cases may rob inertia from the vertical competition over the current federal monopoly over corporate reorganization. Delawarization, in other words, may coopt the call for real, vertical jurisdictional competition in bankruptcy.

3. Real Jurisdictional Competition in Bankruptcy

Just because the jurisdictional competition between bankruptcy districts has fallen short of being reliable, long-term and systemic, it does not follow that real jurisdictional competition cannot bring its benefits to the world of corporate reorganization. In fact, much of the leading debate over the last decade concerning corporate reorganization can be re-characterized as one of a jurisdictional competition of sorts. The real jurisdictional competition story in corporate bankruptcy may not be one of mere intramural, horizontal competition between federal districts applying federal bankruptcy law,

but rather a vertical tension between federal bankruptcy law and private, contractual corporate restructurings under state law of contract.

a. The New Deal Monopoly vs. Contractarianism

Contractualism in corporate bankruptcy is most closely associated with the work of Professors Robert Rasmussen, Randall Thomas, Douglas Baird and Alan Schwartz.¹⁵⁸ A contractualist approach to bankruptcy can be thought of as one that recognizes that the common pool collective action problem which federal bankruptcy law is designed to solve can often be effectively and efficiently handled through contractual “workouts” between the debtor and its creditors.¹⁵⁹

The contractualists appear to be pleased with the Delawarization of corporate bankruptcy. This pleasure is due, in no small measure, to the fact that much of the reorganization activity in Delaware takes place through pre-packaged chapter 11 plans.¹⁶⁰ These plans put into action the pre-negotiated, consensual, contractual solutions that contractualists argue are more efficient than the cumbersome meanderings of a traditional chapter 11 proceeding.¹⁶¹ The bankruptcy court merely adds the force of a court order to what would otherwise be enforceable under ordinary notions of contract breach and damages, and pulls in potential free riders or hold-outs.¹⁶²

158

159

160

161

162

Recent musings by contractualists have suggested that pre-packs are only a first step in the right direction. A more satisfactory and socially-welfare-enhancing approach might resemble a step back into the nineteenth and early twentieth century world of the equity receivership.¹⁶³ Under the equity receivership, a single lead creditor served as a coordinator of a corporate restructuring effort.¹⁶⁴ The effort was largely consensual, requiring the use of a state court's equitable powers to solve the commons tragedy and its hold out and free-rider problems.¹⁶⁵ While these solutions generally satisfied the parties involved, they increasingly raised alarm among the general public over the lack of government control, influence, and oversight of large companies in industries that were so vital to the economic lifeblood of the nation.¹⁶⁶ When Franklin Delano Roosevelt was swept into office on a wave of populism, New Dealer William O. Douglas, a former Yale law professor, took the helm of the Securities and Exchange Commission and pushed through the Chandler Act, essentially capturing the corporate reorganization business for the federal bankruptcy courts, and from the states.¹⁶⁷ The equity receivership was dead.

Contractualists appear to be pressing for a resurrection.

¹⁶³Baird and Rasmussen, U. Va. L. Rev.

¹⁶⁴

¹⁶⁵

¹⁶⁶Skeel, Debt's Dominion,

¹⁶⁷

b. Half Full, or More than Half Empty, and Dirty at That?

If contractualists are sincere in their desire for a consent-based, contractual approach to corporate reorganizations, reminiscent of the genius of the equity receivership, then they might reconsider their enthusiasm for the Delawarization of corporate bankruptcy. The evidence presented here seems to suggest that the competition we are witnessing is personal, and not structural. It is, therefore, fragile, and not permanent. If Congress were to, say, add a federal district to Delaware, splitting the Secretary of State's office right down the middle of its file cabinet, the predictability and competence that draw cases to Delaware might disappear, making an anti-Delaware venue provision unnecessary. The appointment of more judges, or the retirement of the current ones might have the same effect. In Professor Skeel's terms, the glass may not be half full; it might be more than half empty, and dirty at that.

V Conclusion