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Delaware is Not a State: Are We Witnessing Jurisdictional Competition in Bankruptcy

G. Marcus Cole

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“Delaware is Not a State”: Are We Witnessing Jurisdictional Competition in Bankruptcy?

Marcus Cole*

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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. This relatively recent rise in Delaware bankruptcy venue cannot, on its face, be explained by Delaware's eighty-five-year preeminence in the race for corporate charters, since the advantages most often postulated for Delaware's dominance in corporate law do not carry over to corporate bankruptcy. The state has limited influence over federal bankruptcy law and virtually no control over the selection of federal bankruptcy judges.¹

This rise of Delaware bankruptcy venue, or *Delawarization* of bankruptcy, has drawn widespread criticism of the current bankruptcy venue provision, which, since 1978, has permitted a corporate debtor to file in either its "principal place of business" or its place of incorporation.²

1. Delaware has been the preferred location for chartering large, publicly held companies since it wrested this crown from New Jersey in 1917. See ROBERTA ROMANO, *THE GENIUS OF AMERICAN CORPORATE LAW* 6 (1993). Federal bankruptcy judges are selected by the United States courts of appeals for the circuit in which they sit. 28 U.S.C. § 152 (2000).

2. The actual language of the bankruptcy venue provision in title 28 of the U.S. Code 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 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.

§ 1408. Courts interpreting § 1408 have construed the "domicile" of a corporation to be its "place of incorporation." See, e.g., *In re Ocean Props. 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).

Although the Delawarization of corporate bankruptcy has raised alarm, no one has analyzed the motives underlying the actions of the parties that produced this curious development. To determine whether Congress should pass an "anti-Delaware" amendment to the Bankruptcy Code, we need to know why this development is taking place. This Article attempts to unravel the mystery by exploring the explanations proffered by the key decisionmakers: debtors' counsel, creditors' counsel, and bankruptcy judges. I have talked with over fifty lawyers and judges and have assembled their often-unexpected explanations for the Delaware bankruptcy phenomenon, as well as their forecasts for the future of Delawarization.

This Article proceeds in five parts. In Part I, 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 choice of the District of Delaware. In Part III, I look at the "supply side" of the jurisdictional competition equation, surveying the opinions of bankruptcy and other judges as to why a court might participate in a competition for cases. 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.

The responses of lawyers and judges suggest that there are critical differences between the jurisdictional competition that Roberta Romano refers to as the "genius of American corporate law" and the type of competition that we have witnessed in bankruptcy over the last twelve years.³ Unlike the jurisdictional competition that characterizes the corporate charter race, the evidence presented here suggests that the Delawarization of bankruptcy is the product of an entirely different form of competition. This competition, which I term "professional competition," can be defined as a contest between professionals to provide more and better service to those in need of their expertise, and without regard to tangible compensation for superior service. In Part V, I explore the concept of professional competition and demonstrate that the Delawarization of bankruptcy venue is more accurately understood as a contest between professionals driven by the psychic income they derive in the form of prestige, recognition, and satisfaction for the excellent discharge of their duties.

3. ROMANO, *supra* note 1, at 1.

Part V concludes with an exploration of the untapped potential of professional competition between judges and the various ways in which bankruptcy venue might be reformed to capture its benefits. Of the various approaches explored, two appear to be most promising. First, bankruptcy judges might sit at large, in much the same manner as national arbitrators, with debtors selecting the most competent and efficient judges available at the time of filing. Judges might then travel to hear each particular case in the forum most convenient for the parties. These at-large judges might even operate through "at-large courts," with judges selecting and training their successors in much the same manner as law firms and university faculties. Professional competition might even suggest a move toward private bankruptcy judges. Second, states might reemerge as the locus of reorganization law, a position they once enjoyed in the late nineteenth and early twentieth centuries. This reemergence might foster jurisdictional competition between various reorganization mechanisms, many of which have been presented by critics of the current Chapter 11 process over the past decade.⁴ It is also possible that the reemergence of jurisdictional competition in bankruptcy might be inconsistent with, and perhaps undermine, the relatively untapped form of competition we currently witness between professionals. All reforms are likely to be resisted by the State of Delaware, however, in large part because of their collateral effects on that state's position atop the corporate charter race.

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, several United States Trustees, and more than a dozen judges, although some of the explanations offered by judges were in response to a short 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 October 18, 2001, and at the Annual Meeting of the American Bar Association's Section on Business Law in Boston on April 4, 2002. Surveys were circulated in December 2001 and January 2002. Many of the explanations offered by bankruptcy and other judges interviewed in this study mirrored those offered by lawyers. For purposes of analysis,

4. See, e.g., Barry E. Adler, *Financial and Political Theories of American Corporate Bankruptcy*, 45 STAN. L. REV. 311 (1993); Douglas G. Baird, *Revisiting Auctions in Chapter 11*, 36 J.L. & ECON. 633 (1993); Douglas G. Baird, *The Uneasy Case for Corporate Reorganizations*, 15 J. LEGAL STUD. 127 (1986); Lucian Arye Bebchuk, *A New Approach to Corporate Reorganizations*, 101 HARV. L. REV. 775 (1988); Mark J. Roe, *Bankruptcy and Debt: A New Model for Corporate Reorganization*, 83 COLUM. L. REV. 527 (1983).

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 preeminence as a bankruptcy haven is a recently acquired one. A corporation or entity considering a Chapter 11 filing may be confronted with a number of venue choices. Delaware became an option beginning in 1978, when a business was permitted to file its petition in the district where it is incorporated.⁵ Prior to 1990, most bankruptcy cases were brought in the district where the debtor had its principal place of business.⁶ When a venue other than the principal place of business was sought for a complex bankruptcy case, the Southern District of New York was the preferred venue throughout the 1980s.⁷

In 1990, one case changed everything. Continental Airlines was confronting the possibility of bankruptcy for the second time in two years.⁸ Instead of filing in Houston, where the company was headquartered and where it had previously filed a Chapter 11 petition, Continental's lawyers chose to file in Delaware.⁹ The success of Continental's second reorganization captured the imagination of bankruptcy attorneys around the country. By 1993, 40% of Chapter 11 cases involving large, publicly traded debtors were filed in Delaware.¹⁰ By 1996, the District of Delaware had become the venue for 86% of these cases.¹¹ As of 2001, 94% of the Delaware Chapter 11 debtors listed a non-Delaware address.¹² Only 5.3% of filings in other states

5. *Ocean Props.*, 95 B.R. at 305.

6. See Theodore Eisenberg & Lynn M. LoPucki, *Shopping for Judges: An Empirical Analysis of Venue Choice in Large Chapter 11 Reorganizations*, 84 CORNELL L. REV. 967, 968 (1999).

7. *Id.* at 973.

8. Robert K. Rasmussen & Randall S. Thomas, *Timing Matters: Promoting Forum Shopping by Insolvent Corporations*, 94 NW. U. L. REV. 1357, 1366 (2000).

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

10. Lynn M. LoPucki & Sara D. Kalin, *The Failure of Public Company Bankruptcies in Delaware and New York: Empirical Evidence of a "Race to the Bottom,"* 54 VAND. L. REV. 231, 234 (2001). LoPucki and Kalin define large, public debtors as those with assets exceeding \$100 million in 1980 dollars and those required to file annual reports with the Securities and Exchange Commission. *Id.* at 235 n.15.

11. *Id.* at 235.

12. Edward Flynn & Gordon Bermant, *Bankruptcy by the Numbers: Delaware Chapter 11's*, AM. BANKR. INST. J., Mar. 2002, at 20. The statistics cited by Flynn and Bermant were obtained from the Fee Information and Collection System maintained by the Executive Office for United

involved debtors listing addresses outside the state in which the petition was filed.¹³ An analysis of the fifteen largest cases filed each year from 1995 through 2001, a total of 105 cases in all, shows that fifty-six of these high-profile cases were filed in Delaware.¹⁴ The Southern District of New York was a distant second with eighteen. No other state had more than three.¹⁵ Table 1 illustrates both the recency and consistency of this trend.¹⁶

Table 1
Chapter 11 Filings: Delaware vs. the Nation

Year	Chapter 11 Filings: All Districts Combined*	Delaware Chapter 11 Filings	Delaware Percentage of All Chapter 11 Filings
2001	10,967	1,222	11.1
2000	9,716	2,277	23.4
1999	9,181	2,106	22.9
1998	8,283	385	4.4
1997	10,554	205	1.9
1996	11,726	211	1.8
1995	12,771	235	1.8
1994	14,823	83	0.6
1993	19,180	101	0.5
1992	22,906	176	0.8
1991	24,056	102	0.4
1990	20,690	104	0.5

*This figure excludes Chapter 11 petitions filed in Alabama and North Carolina.¹⁷

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

States Trustees, and exclude information on Alabama and North Carolina cases, which are served by bankruptcy administrators.

13. *Id.* at 21.

14. See BankruptcyData.com (listing the fifteen largest bankruptcy cases, by total assets, for each year since 1995).

15. *Id.*

16. *Id.* The recent and dramatic decline in Delaware bankruptcy cases in 2001 is addressed *infra* Part IV.C.2.

17. Flynn & Bermant, *supra* note 12, at 20. Flynn and Bermant assert that the raw numbers somewhat overstate the rise of Delaware bankruptcy, because many more of the cases filed in Delaware are groupings of one large debtor with its various subsidiaries and affiliated companies. *Id.* Nevertheless, this understanding of the nature of the Delaware filings provides a proxy for complexity that a simple "one debtor, one filing" approach might actually understate.

cases in which the debtor's bankruptcy filing takes place in conjunction with a plan of reorganization that has been negotiated with and agreed to by the debtor's creditors prior to the filing.¹⁸ Between 1986 and 1990, only eight, or 1.2%, of the 633 publicly held corporations that filed for bankruptcy filed a "prepackaged" plan.¹⁹ That number increased to seventy, or 11.3%, of the 622 public companies that filed for bankruptcy between 1991 and 1997.²⁰ Of that number, roughly half of the "prepackaged" plans were filed in Delaware.²¹ 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 and evidences an increasing creditor preference for Delaware venue.²²

Early in 1997, the onslaught of cases hitting the Delaware court's docket caused alarm. 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.²³ 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.²⁴ Under the Judiciary Act, federal district courts are given exclusive and original jurisdiction over bankruptcy cases.²⁵ The Supreme Court has determined that this jurisdiction is required by Article III of the Constitution.²⁶ Title 28 also authorizes a district court to automatically refer bankruptcy cases to bankruptcy judges within its district.²⁷ Prior to 1997, the district court in Delaware, like all other districts, automatically referred bankruptcy cases to the

18. See CHARLES JORDAN TABB, *THE LAW OF BANKRUPTCY* 835 (1997).

19. See Rasmussen & Thomas, *supra* note 8, at 1375.

20. Alan Denton, *Large and Small Companies Exhibit Diverging Bankruptcy Trends* (Jan. 2002), available at <http://www.fdic.gov/bank/analytical/bank/bt0201.html>.

21. Nancy L. Lazar & James I. McClammy, *Recent Developments in the Law of Prepackaged Bankruptcy Plans*, 820 PLI/COMM 309, 312 (2001).

22. Robert K. Rasmussen & Randall S. Thomas, *Whither the Race? A Comment on the Effects of the Delawarization of Corporate Reorganizations*, 54 VAND. L. REV. 283, 287 (2001).

23. Robert J. Rosenberg & Gregg D. Josephson, *Recent Developments in the Law on Venue in Bankruptcy Cases*, 827 PLI/COMM 21 (2001).

24. Order of Chief Judge Joseph Farnan, United States District Court for the District of Delaware, Jan. 31, 1997.

25. See 28 U.S.C. § 1334(a) (2000).

26. See *N. Pipeline Constr. Co. v. Marathon Pipe Line Co.*, 458 U.S. 50, 87-88 (1982) (holding that bankruptcy judges, as judges created pursuant to Article I of the Constitution, could not exercise powers reserved to the federal judiciary under Article III).

27. § 1412.

bankruptcy judges of that district.²⁸ 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 heard by both bankruptcy judges and district court judges.

Even with district court and bankruptcy judges hearing bankruptcy cases, the move to Delaware placed a strain on that court's resources. Approximately 40% of the Delaware bankruptcy docket is comprised of large Chapter 11 cases and large Chapter 7 cases that were converted from Chapter 11 cases.²⁹ In December 2000, the Bankruptcy Committee of the Judicial Conference of the United States commissioned a study to examine the Delaware bankruptcy workload, which concluded that the court needed eight or nine judges to handle the filings.³⁰ The strain has been alleviated somewhat by help from the outside. For several years, all consumer bankruptcy cases in Delaware have been heard by Judge Judith K. Fitzgerald of Pittsburgh, who sits in Wilmington two days per month.³¹ The Chapter 11 load has been shared, from time to time, by seven visiting judges "sitting by designation."³² 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.³³

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.³⁴ 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.³⁵ On April 6, 2001, four days after the W.R. Grace filing, which, incidentally, was one of the cases assigned to Judge Newsome, Chief Judge Robinson withdrew the automatic

28. *Delaware District Court Withdraws Reference of All Chapter 11 Cases to Bankruptcy Court*, BANKR. L. REP. (CCH) (Jan. 30, 1997), at 123.

29. See www.BankruptcyData.com.

30. Report of the Judicial Conference of the United States, Committee on Bankruptcy, Dec. 2000.

31. Judge Fitzgerald is also the President of the National Conference of Bankruptcy Judges.

32. United 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.

33. See 28 U.S.C. § 155(a) (2000) (providing for the temporary transfer of bankruptcy judges).

34. Judge Newsome ordinarily sits in Oakland, California.

35. See Rosenberg & Josephson, *supra* note 23, at 33.

reference once again.³⁶ 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.”³⁷ Five months later, on September 6, 2001, Chief Judge Robinson once again reinstated the automatic reference, which became effective October 6, 2001.³⁸ 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 thus “had an opportunity to clear their calendars.”³⁹

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 (“NBRC”). The NBRC was established under the Bankruptcy Reform Act of 1994 to investigate issues relating to the Bankruptcy Code and to evaluate proposals for change in the future.⁴⁰ 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.⁴¹

The NBRC, consistent with this conclusion, crafted a report to Congress that addressed these concerns.⁴² In its report, the NBRC recommended that the debtor’s state of incorporation be expressly eliminated as a basis for venue in a bankruptcy case.⁴³ Although the commissioners stated 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,”⁴⁴ commentators

36. Order of Susan Robinson, Chief Judge, United States District Court for the District of Delaware, Apr. 6, 2001.

37. *Id.*

38. *Id.*

39. *Delaware District Court Reinstates Chapter 11 Reference*, 37 BANKR. CT. DEC. (LRP) 3 (2001).

40. See DAVID SKEEL, *DEBT’S DOMINION* 231 (2001).

41. Lynn M. LoPucki & William C. Whitford, *Venue Choice and Forum Shopping in the Bankruptcy Reorganization of Large, Publicly Held Companies*, 1991 WIS. L. REV. 11, 34-36 (1991).

42. NAT’L BANKR. REV. COMM’N, *BANKRUPTCY: THE NEXT TWENTY YEARS* 770-87 (1997).

43. *Id.* at 778-79.

44. *Id.* at 779.

and news reports interpreted the change as an attack on Delaware's emergence as the front-runner in the race for Chapter 11 cases.⁴⁵

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.⁴⁶ The proposed Bankruptcy Reform Act of 1999,⁴⁷ as introduced, did not change the corporate bankruptcy venue provision.⁴⁸ During the House Judiciary Committee's markup session on the bill, however, Representative Howard L. Berman from California inserted an anti-Delaware amendment in the bill on a voice vote.⁴⁹ The House passed the bill containing this amendment.⁵⁰ However, 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.⁵¹ The final bill was vetoed by President Clinton in December 2000.⁵² More recently, the House and Senate versions of the Bankruptcy Reform Act of 2002 have no significant changes to the venue provisions of the Bankruptcy Code, and even provide an additional bankruptcy judgeship to the District of Delaware.⁵³ 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.⁵⁴

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

45. *NY Bankruptcy Court's New Chapter: Reforms, Crowded Delaware System Touch off Huge Gains in Filings*, 17 CRAIN'S N.Y. BUS. 3 (2001), available at 2001 WL 7065038.

46. SKEEL, *supra* note 40, at 197-99.

47. H.R. 833, 106th Cong. (1999).

48. Rosenberg & Josephson, *supra* note 23, at 34.

49. The amendment stated that a corporation's domicile would be defined as its principal place of business, effectively eliminating the state of incorporation alternative. See Celia Cohen, *Anti-Delaware Clause Put in Bankruptcy Bill*, N.Y. L.J., May 6, 1999, at 5.

50. Rosenberg & Josephson, *supra* note 23, at 33.

51. S. 220, 107th Cong. § 1 (2001).

52. See *Clinton Lets Bipartisan Bankruptcy Reform Die*, MILWAUKEE J. & SENTINEL, Dec. 20, 2000, at 01D, available at 2000 WL 26102558; see also Greg Miller, *Bill Making Bankruptcy Filings Harder for Individuals Nears*, L.A. TIMES, Mar. 15, 2001, at A1, available at 2001 WL 2470049.

53. In § 1409(b) of title 28 of the United States Code, the bill would require adversary proceedings for a nonconsumer debt against a noninsider of less than \$10,000 to be heard in the district where the defendant resides. S. 220; H.R. 833, 106th Cong. (1999). The thirty-two-member House and Senate Conference Committee includes Senator Joseph Biden of Delaware. See *Pending Legislation*, AM. BANKER, Sept. 13, 2001, available at 2001 WL 26574114.

54. See Cohen, *supra* note 49, at 1; see also SKEEL, *supra* note 40, at 232.

guidelines governing “prepackaged” reorganization cases.⁵⁵ Prior to these guidelines, “prepacks” were structured to comply with the rules governing traditional Chapter 11 petitions. In January 2000, the Southern District of Texas (which encompasses Houston) revamped its bankruptcy procedures with respect to Chapter 11 cases designated as “complex.”⁵⁶ To be deemed “complex,” a case must be “of sufficient scope.”⁵⁷ Once a case is deemed complex, a judge must hold emergency hearings and hear “first-day” motions no later than two days after a request for a hearing has been filed.⁵⁸

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 that had filed for bankruptcy under Chapter 11 in Delaware, back to Houston.⁵⁹ Judge Walrath’s order stated that she was “aware of the new rules in the Houston Court seeking to solve the problem articulated by the debtor about prompt scheduling of hearings [Q]uite frankly, comparing it to my own calendar, I think [Houston] may be able to give the debtor a little better service.”⁶⁰

Despite the occasional transfer of venue back to corporate headquarter districts, if there is a battle for bankruptcy venue, “[t]he war is over and Delaware has won.”⁶¹ In recognition of this victory, many large national law firms have opened offices in Wilmington within the past three years, often staffing them exclusively with bankruptcy practitioners.⁶²

Delaware’s recent rise as a bankruptcy haven cannot be explained as a simple function of its preeminence in the corporate charter race. Bankruptcy law is federal, not state, law. A bankruptcy

55. Southern District of New York, Guidelines for Prepackaged Chapter 11 Petitions.

56. *Houston, We Know We Have a Problem (but We’re Working on It!)*, 35 BANKR. CT. DECISIONS: WKLY. NEWS & COMMENT, Feb. 8, 2000, at A1; see also David E. Rovella, *Texas, Del. Loek Horns: Lone Star State Won’t Leave Bankruptcy Practice Alone*, DEL. L. WKLY., Aug. 14, 2001, at 1.

57. Rovella, *supra* note 56.

58. *Id.* In bankruptcy, “first-day” orders are the judicial orders that constitute exceptions to the blanket automatic stay, permitting the payment of payroll, completion of debtor-in-possession financing transactions, and addressing any immediate actions that are necessary to operate the business day to day. See DEL. BANKR. L.R. 2014-1.

59. *In re Apple Orthodontix Inc.*, unpublished order.

60. *Id.*

61. Rasmussen & Thomas, *supra* note 22, at 283.

62. Reed Smith Shaw, Shearman and Sterling, and Jones Day Reavis and Pogue are among the several firms opening Wilmington offices between 2000 and 2002. See *Nielson Elggren Opens Delaware Office*, 38 BANKR. CT. DEC. (LRP) 1 (Dec. 25, 2001); Jeff Blumenthal, *Buchanan Ingersoll Will Open Delaware Office*, DEL. L. WKLY., Mar. 13, 2001, at 1.

judge is appointed by the United States court of appeals for the circuit in which the judge sits, not by the President of the United States, as is the case for Article III judges.⁶³ Unlike Article III judges, bankruptcy judges are selected without the advice and consent of the U.S. Senators for their respective states. Bankruptcy judges are not chosen from among the highly respected and sophisticated chancellors on the Delaware state court bench. They need not even 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 retiring Judge Helen S. Balick. The court of appeals appointment power highlights 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 have the life tenure enjoyed by Article III judges, they do receive the shelter afforded by fourteen-year terms.⁶⁴

Delaware's ascent as the preferred locale for bankruptcy venue has stimulated heated debate among academics. The "Delaware Skeptics," to use Professor David Skeel's nomenclature, include Professor Lynn LoPucki of UCLA School of Law, and his coauthor, Professor Theodore Eisenberg of Cornell Law School.⁶⁵ The Skeptics believe that the choice of Delaware is evidence of a pernicious race to the bottom.⁶⁶ LoPucki and Eisenberg, for instance, argue that the choice of Delaware is a product of judicial laxity on the part of the Delaware bankruptcy judges with respect to the details of plans of reorganization, as well as their refusal to scrutinize attorneys' fee applications.⁶⁷ Professor LoPucki and his coauthor, Sara Kalin, attribute the increased number of failed plans emanating from Delaware proceedings as supporting evidence for this claim.⁶⁸ The Skeptics advocate 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.⁶⁹ This effort appears doomed, however, as

63. 28 U.S.C. § 152 (2000).

64. See § 152(a).

65. Eisenberg & LoPucki, *supra* note 6, at 969.

66. *Id.* at 1002.

67. *Id.*

68. LoPucki & Kalin, *supra* note 10, at 233.

69. NAT'L BANKR. REV. COMM'N, BANKRUPTCY, *supra* note 42; see also Eisenberg & LoPucki, *supra* note 6, at 973.

Senator Joseph Biden of Delaware has vowed to kill any bankruptcy bill with such a provision.⁷⁰

Other academics view Delaware bankruptcy venue quite differently. The “Delaware Enthusiasts,” among whom Skeel numbers himself, Professors Robert Rasmussen and Randall Thomas of Vanderbilt University Law School, and Douglas Baird of the University of Chicago Law School, attribute Delaware’s prominence to the efficiency and sophistication of the two Delaware bankruptcy judges and the pressures they experience within the Delaware legal culture.⁷¹ 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 “prepackaged” bankruptcies as evidence of this positive development.⁷² 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.⁷³

Despite the controversy concerning perceived forum-shopping by corporations, 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 ascertain whether the alarm expressed by 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 venue-selection equation through the lens of opinions and explanations offered by lawyers and judges. Part II examines the factors that lead lawyers to choose Delaware for the filing of a Chapter 11 petition, while Part III explores why judges might want to attract Chapter 11 cases. These explanations are then followed in Parts IV and V by an examination of how they fit within current understandings of jurisdictional competition.

70. SKEEL, *supra* note 40, at 231.

71. David A. Skeel, Jr., *Bankruptcy Judges and Bankruptcy Venue: Some Thoughts on Delaware*, 1 DEL. L. REV. 1, 20, 26 (1998).

72. See David A. Skeel, Jr., *What's So Bad About Delaware?*, 54 VAND. L. REV. 309, 328 (2001).

73. Douglas G. Baird & Robert K. Rasmussen, *Control Rights, Priority Rights, and the Conceptual Foundations of Corporate Reorganizations*, 87 VA. L. REV. 921, 956-58 (2001); Rasmussen & Thomas, *supra* note 22, at 287.

II. LAWYERS' EXPLANATIONS FOR CHOOSING DELAWARE

The venue-selection decision for any large, publicly held company ultimately depends on the judgment of the debtor's counsel. It is true that these companies 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.⁷⁴ In reality, virtually all proceedings involving a publicly held debtor commence voluntarily, and a disproportionate number of voluntary petitions are now filed in the District of Delaware.⁷⁵ Creditors' counsel are very influential in the venue-selection process, particularly when consensual "prepackaged" Chapter 11 petitions are filed. But even when creditors' counsel make their preferences known, the venue of choice is Delaware.⁷⁶ In order to gain an understanding of why Delaware has become the venue of choice for both managers and creditors of publicly held companies, it is necessary to understand why lawyers see Delaware as a superior selection given the alternatives.

A. *The Factors for Lawyers*

1. Predictability

The prominent debtors' and creditors' counsel with whom I have spoken list several factors as important in their choice of Delaware as a forum. Leading their list is "predictability." While virtually every lawyer and most of the judges interviewed 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 50% 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.⁷⁷ The debtors' and creditors'

74. Section 303 of the Bankruptcy Code sets forth the requirements for the filing of an involuntary petition, and includes sanctions and penalties for improper and bad-faith filings, including compensatory and punitive damages, attorneys fees, and court costs. 11 U.S.C. § 303(h), (i) (2000).

75. LoPucki & Kalin, *supra* note 10, at 234.

76. See Rasmussen & Thomas, *supra* note 8, at 1374.

77. Two lawyers, out of over thirty, expressed reservations about the possibility of having the case heard by Judge Walrath.

counsel interviewed all asserted that, while this factor was of primary importance to them in the choice-of-venue calculus, it has decreased in importance with the case backlog that has led to the assignment of cases to visiting and district court judges.

Lawyers also meant something else, in addition to judges, when they used the term "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.⁷⁸ 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." One lawyer who has recently moved to Delaware reports that "process and predictability are 90% of [the decision of where to file], and we have judges who understand that."

2. Speed

Nearly all of the lawyers interviewed mentioned speed as an important benefit they associated with Delaware bankruptcy venue. The ability of Delaware bankruptcy judges to quickly dispose of cases, and issues within a case, was said to be an important expectation of debtors. The direct costs of a Chapter 11 proceeding are widely acknowledged to be substantial, although no empirical study of such costs has established them with any certainty.⁷⁹ Speed was often mentioned as an aspect of predictability, and lawyers credited streamlined procedures for first-day orders, the judges' familiarity with cases involving a particular industry or credit relationship, and the resolutions obtained in similar cases. Both debtors' counsel and creditors' counsel alike trumpeted speed as a predictable by-product of judicial experience. One attorney posited that a case filed in Delaware

78. Nearly all of the lawyers who were asked to clarify what they meant by "precedent" explained that they were referring to unpublished but widely understood results of prior procedural rulings. One element of particular importance was an open letter written by Judge Walsh to the Delaware bar that explained what types of financing provisions would be acceptable in first-day and other filings and what types of arrangements were unacceptable. All lawyers with whom I spoke were very aware of the contents of the letter, a copy of which is reproduced in Appendix.

79. For evidence about reorganization costs, see Brian L. Betker, *The Administrative Costs of Debt Restructurings: Some Recent Evidence*, FIN. MGMT., Winter 1997, at 56. The only empirical study of direct costs associated with the duration of a bankruptcy proceeding was conducted by Lawless and Ferris, but that study involved only Chapter 7 cases. See Robert M. Lawless & Stephen P. Ferris, *Professional Fees and Other Direct Costs in Chapter 7 Business Liquidations*, 75 WASH. U. L.Q. 1207, 1230-31 (1997) (reporting that time in bankruptcy is a significant determinant of administrative costs).

results in a cost savings to the estate. "If it doesn't take as long to get the judge up to speed, Delaware may be cheaper" than cases filed in other districts.

Empirical studies of case-processing time have produced mixed results. One study commissioned by the Judicial Conference of the United States suggested that cases filed in Delaware were concluded much more quickly than those filed in other districts.⁸⁰ This study examined Chapter 11 cases filed in 1994 and 1995, and demonstrated significant time savings for cases filed in Delaware.⁸¹

Eisenberg and LoPucki take issue with the findings of the Judicial Conference report. They studied the speed with which bankruptcy courts dispose of their docket and concluded that Delaware judges do not process cases more quickly than those in other districts.⁸² While Eisenberg and LoPucki acknowledge the time savings associated with Chapter 11s filed in Delaware as a whole, that district's advantage drops sharply when "prepackaged" cases are removed from the pool.⁸³ When traditional Chapter 11 cases are considered, the Delaware judges boast mean and median case-processing times of 510 and 463 days, respectively.⁸⁴ To be sure, these numbers are significantly faster than the Southern District of New York's mean and median of 765 and 582 days, but Eisenberg and LoPucki show that Delaware processing time shows no statistically significant difference from that of other districts around the nation.⁸⁵

Despite the evidence produced by Eisenberg and LoPucki, the perception that the Delaware judges process cases more quickly than those in other districts is real and widespread among the lawyers interviewed.

3. (The Absence of) "Real Law"

The third most important factor in the venue-selection analysis, according to the lawyers interviewed, was the state of substantive law with regard to the central issues of their cases. The role of this factor, however, was quite different than, and seemingly contradictory to, the predictability of Delaware venue. Counsel for

80. See Gordon Bermant et al., *Chapter 11 Venue Choice by Large Public Companies: Report to the Judicial Conference Committee on the Administration of the Bankruptcy System*, FED. JUD. CTR. 1997, at 37 (discussing filings in 1994 and 1995), available at [http://www.fjc.gov/publid/pdf.nsf/lookup/ch11venue.pdf/\\$file/ch11venue.pdf](http://www.fjc.gov/publid/pdf.nsf/lookup/ch11venue.pdf/$file/ch11venue.pdf) (last visited Oct. 12, 2001).

81. *Id.*

82. Eisenberg & LoPucki, *supra* note 6, at 1001-02.

83. *Id.* at 988-89.

84. *Id.* at 989.

85. *Id.*

debtors stressed the *absence* of what they termed “real law” as a reason to choose a particular district over others. The absence of established substantive precedent, according to debtors’ counsel, actually enhanced the bargaining position of debtors. In other words, the absence of this type of predictability was actually a virtue in the eyes of debtors, affording room for creative and novel solutions to a company’s financial predicament.

Given the emphasis on procedural predictability, a preference for an absence of substantive certainty might seem odd. Nevertheless, several of the attorneys for both debtors and creditors offered examples of how the absence of “real law” enhanced a district’s standing for purposes of venue. The most commonly cited example concerned the assumption of intellectual property licenses. The Ninth Circuit sent shock waves through both bankruptcy and intellectual property circles with its decision in *Perlman v. Catapult Entertainment, Inc.*⁸⁶ Catapult was a California corporation that filed for bankruptcy in 1996 in order to effect a “reverse triangular merger.”⁸⁷ The company was not insolvent; it merely wished to use the Chapter 11 reorganization mechanisms to reduce the costs of its merger. During the bankruptcy proceeding, Catapult filed a motion, as debtor-in-possession wielding the full powers of the trustee, to assume some 140 executory contracts, including its intellectual property licenses.⁸⁸ When one licensor’s objections fell on deaf ears in the bankruptcy and district courts, he appealed to the Ninth Circuit, which reversed the lower court rulings permitting the assumption of the licenses.⁸⁹ The court held that the plain language of the Bankruptcy Code prohibits assumption of executory contracts by a debtor-in-possession where those contracts are unassignable under applicable nonbankruptcy law.⁹⁰

86. 165 F.3d 747, 754-55 (9th Cir. 1999).

87. A reverse triangular merger is one in which the acquiring company sets up a subsidiary to merge with the target company, which then automatically becomes a subsidiary of the acquirer. *Id.* at 749.

88. *Id.* at 753.

89. *Id.* at 757.

90. *Id.* at 753. The Ninth Circuit’s holding was based on the fact that 11 U.S.C. § 365(c)(1) places a limitation on the assumption of executory contracts. In relevant part, § 365(c) provides that:

(c) The trustee may not assume or assign any executory contract or unexpired lease of the debtor, whether or not such contract or lease prohibits or restricts assignment of rights or delegation of duties, if (1)(A) applicable law excuses a party, other than the debtor, to such contract or lease from accepting performance from or rendering performance to an entity other than the debtor or the debtor in possession, whether or not such contract or lease prohibits or restricts assignment of rights or delegation of duties; and (B) such party does not consent to such assumption or assignment

Debtors whose going-concern value is closely associated with intellectual property licenses are well advised to steer clear of bankruptcy venue in the Ninth Circuit, as well as circuits that follow the *Catapult* rule. The Third Circuit, which contains the District of Delaware, is just such a circuit, and according to many lawyers has lost bankruptcy cases for precisely that reason.⁹¹ The First Circuit has a rule exactly opposite to that established by the Ninth Circuit in *Catapult* and has become a more attractive venue for reorganizations involving intellectual property licensees.⁹²

Other examples of venue decisions heavily influenced by real law include the rule with respect to priority of real estate tax assessments. In the Third Circuit, for example, a real estate tax bill payable on a date after the filing of the petition receives an administrative expense priority for the full amount due, even though the lion's share of the tax accrued prior to the petition date.⁹³ The prevailing rule in the Seventh Circuit, on the other hand, prorates real estate taxes, making any portion accruing up to the date of the filing of the bankruptcy petition a prepetition claim, with only that portion which actually represents postpetition holdings worthy of administrative expense priority.⁹⁴ Several lawyers speculated that the Kmart bankruptcy filing in the Northern District of Illinois was calculated to take advantage of this particular rule and the tens of millions of dollars in tax savings it represented to the estate.

4. Sophistication of the Judges

The emphasis on predictability in lawyer responses frequently accompanied another factor, namely the sophistication of Delaware's

91. The *Catapult* rule has been adopted by the Third, Fourth, and Eleventh Circuits. See *In re James Cable Partners*, 27 F.3d 534, 537 (11th Cir. 1994); *In re West Elecs., Inc.*, 852 F.2d 79, 83 (3d Cir. 1988); *In re Catron*, 158 B.R. 629, 633-638 (E.D. Va. 1993), *aff'd per curiam*, 25 F.3d 1038 (4th Cir. 1994).

92. The First Circuit rule, designated the "actual performance test," was established in *Institut Pasteur & Pasteur Sanofi Diagnostics v. Cambridge Biotech Corp.*, 104 F.3d 489, 492 (1st Cir. 1997), *cert. denied*, 521 U.S. 1120 (1997). The actual performance test can be characterized as the opposite of the "hypothetical test" applied in *Catapult*, in that it requires a demonstration that the executory license at issue was actually in danger of being captured by an undesirable competitor of the licensor. *Id.*

93. *In re C.S. Assocs.*, 29 F.3d 903, 907 (3d Cir. 1994) ("Section 503 . . . indicates that tax claims are generally afforded the status of ordinary administrative expenses, thereby receiving first priority after secured claims, unless they are the type of taxes specified in § 507(a)(7), in which case they will receive a seventh ranked priority after secured claims.").

94. *Nat'l Terminals Corp. v. Handy Andy Home Improvement Ctrs., Inc.*, 222 B.R. 149, 152 (N.D. Ill. 1997) (Williams, J.) (holding that debtor was "not obligated to pay the second installment 1994 real estate tax bills or the first installment 1995 real estate tax bills because those taxes accrued prior to the petition date").

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." Another Chicago attorney who regularly represents financial institutions added that "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."

There is a "path-dependent" component to the sophistication factor articulated by so many 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, "[E]verybody knows the names of the two judges in Delaware; can you name any two bankruptcy judges in Atlanta, Boston, or Dallas?" This national reputation is remarkably detailed. 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 1995.⁹⁵ According to one California lawyer, "[S]he is as smart as any bankruptcy judge in the country." 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."

5. Responsiveness and Availability of the Judges

A 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, completion of debtor-in-

95. Jef Feeley, *Key Bankruptcy Post to Be Filled: Phila. Lawyer Named to Long Vacant Del. Court Spot*, NAT'L L.J., May 18, 1998, at B5.

possession financing transactions, and any other immediate action that is necessary to operate the business day to day.⁹⁶ 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.⁹⁷

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 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 to schedule hearings in unrelated cases with an eye toward his convenience: "It's not always possible, but it's 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, "[T]hose 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.

6. Attorneys' Fee Applications

The uniform responses of lawyers were more mixed when the sensitive subject of attorneys' fees was broached. Attorneys' fees in a bankruptcy proceeding are awarded by the court pursuant to § 330 of

96. See Russell A. Eisenberg & Frances F. Gecker, *The Doctrine of Necessity and Its Parameters*, 73 MARQ. L. REV. 1, 37-39 (1989).

97. See DEL. BANKR. L.R. 4001-2(b) (containing substantial restrictions on the content of first-day orders).

the Bankruptcy Code.⁹⁸ Court approval of the debtor's attorneys' fees is required in bankruptcy because all professional fees are considered administrative expenses of the proceedings.⁹⁹ As administrative expenses, they come out of the common pool that is supposed to benefit the general creditors.¹⁰⁰ Court approval ensures, theoretically, that the pie in which the creditors share is actually enhanced by the services provided by the professionals.

Although § 330 grants courts hearing bankruptcy cases 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 Delaware Skeptics have asserted that the Delaware judges have effectively "rubber-stamped" attorneys' fee applications, handing over whatever debtors' counsel desire.¹⁰¹

While all of the lawyers queried 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 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. They believe that although Delaware judges' level of scrutiny may be less than that of other judges in the Third Circuit (who typically order the submission of voluminous and costly fee application reports produced by independent auditors), it is inaccurate to assert that Delaware judges will approve any fee item.

Lawyers who acknowledged that fee applications influence the filing decision claimed that it did so indirectly, because some districts arbitrarily cap fees at the rates prevailing in the local jurisdiction.

98. 11 U.S.C. § 330(a) (2000).

99. See DEL. BANKR. L.R. 2014-1.

100. 11 U.S.C. § 503(b)(2) (2000).

101. See LoPucki & Kalin, *supra* note 10, at 238.

"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 attorneys' fee applications is over."¹⁰²

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 attorneys' fees to be paid on a continuing, monthly basis.¹⁰³ In many other districts, lawyers must wait until the end of the case to be paid or petition the court for interim compensation in long cases.¹⁰⁴ Even the lawyer who thought this rule was important suggested its influence was not purely self-serving. "It allows clients the ability to track and budget their legal expenses as the proceeding goes along." He also thought that the absence of this rule was more likely to repel cases from the headquarters district rather than draw cases to Delaware.

7. 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 with its international airport and Amtrak train station. Many lawyers said that not too much should 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.¹⁰⁵ With the exceptions of companies based in Santa Ana (California) and New York, the percentage of companies choosing

102. See Rovella, *supra* note 56.

103. See DEL. BANKR. L.R. 9010-1.

104. Interim compensation can be requested every 120 days. See 11 U.S.C. § 331 (2000).

105. Eisenberg & LoPucki, *supra* note 6, at 979.

Delaware venue is much higher for those based in eastern cities than for those based in western ones.¹⁰⁶ Midwestern cities like Chicago and Dallas experience a lower “shop out” rate than those in the East but a higher rate than Los Angeles or Denver.¹⁰⁷ Still, one San Francisco bankruptcy attorney remains undaunted by the prospect of Delaware venue. “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.”

8. Creditor Pressure

Creditor pressure, one of the factors the Delaware Skeptics believe is driving the convoy to Delaware, received a mixed reception from both debtors’ 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 nonexistent 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 (postpetition) financing unless the petition is filed in Delaware. Some of the debtors’ counsel acknowledged that lenders may insist upon “Delaware filing” covenants in their postpetition lending agreements, while others say they have never allowed a creditor to dictate the place of filing. One lawyer adamantly declared that “[he] would never let a creditor tell [him] 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 postpetition lending agreements that are prepared in anticipation of a “prepackaged” Chapter 11 or in workout documents that contemplate a Chapter 11 filing. 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 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.¹⁰⁸ Most lawyers thought that creditor preference was a real, but not particularly powerful, factor.

106. *Id.*

107. *Id.* at 998-99.

108. Rasmussen & Thomas, *supra* note 8, at 1359-66.

One thing about which the Delaware Skeptics are correct 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."¹⁰⁹ The reality is that secured creditors do care because of the possibility of depreciation of the secured asset during a long proceeding. To protect secured creditors from depreciation, the Bankruptcy Code requires the debtor to give the secured creditor "adequate protection."¹¹⁰ Fights between a secured creditor and the debtor have historically involved the adequacy of the protection. The fight between the secured lender and creditor has dissipated in the large Delaware filings, however: the debtor can now assure the secured creditor adequate protection by agreeing to pay, up front, for the secured creditor's professionals.¹¹¹ It is unclear whether such consensual arrangements constitute the "indubitable equivalent" of adequate protection for the secured lender, as described by § 361 of the Bankruptcy Code.¹¹²

9. 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 a "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 who have standing policies that make no sense, such as an unwillingness to hold "a cash collateral hearing until more than fifteen days after the case has been

109. This maxim has a long and distinguished history. See *Long v. Bullard*, 117 U.S. 617, 620-21 (1886); *Dewsnup v. Timm*, 502 U.S. 410, 418 (1992); see also *Johnson v. Home State Bank*, 501 U.S. 78, 84 (1991) (describing how bankruptcy extinguishes in personam claims against the debtor but generally has no effect on in rem claims against the debtor's property).

110. 11 U.S.C. § 361 (2000).

111. This mechanism appears to be a new use of the third alternative, permitting adequate protection to be afforded by "other appropriate means."

112. § 361(3).

filed.” Many lawyers felt that consistently bad judges were as undesirable as inconsistent ones.

10. 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 involvement of the United States Trustee in the region in which a company has its principal place of business.¹¹³ The United States Trustee, an office created by the 1978 enactment of the Bankruptcy Code, is a federal government official who performs various administrative tasks in a bankruptcy proceeding.¹¹⁴ In Chapter 7 cases, the trustee appoints an interim trustee, and in Chapter 11 cases, the trustee monitors, evaluates, and files comments on attorneys’ fee applications.¹¹⁵ Perhaps more importantly, § 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.”¹¹⁶ While these powers might appear 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 that take place within them.

Several attorneys pointed to the actions of the United States Trustee in the Pacific Gas and Electric (“PG&E”) 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.”¹¹⁷ She publicly stated that her decision was intended to “give the consumers of California a say in this proceeding.”¹¹⁸ While many observers applauded the decision, others viewed it as an unauthorized extension of the United States Trustee’s powers under the Code.¹¹⁹ In the end, Bankruptcy Judge Dennis Montali upheld PG&E’s motion to disallow

113. The United States is divided into twenty-one 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 (2000).

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

115. § 586(a)(3).

116. 11 U.S.C. § 1102(a)(1) (2000).

117. Claire Cooper, *California Official Defends Panel in Pacific Gas, Electric Case in San Francisco*, SACRAMENTO BEE, May 16, 2001, at A3, available at 2001 WL 20967166.

118. *Id.*

119. *Id.*

the ratepayers' committee and its participation in the bankruptcy proceeding.¹²⁰ Judge Montali asserted that ratepayers have other means to protect their interests.¹²¹ "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."¹²² Stanley said she was "disappointed in the judge's ruling . . . because we were within our discretion to appoint a ratepayers committee."¹²³

Lawyers citing the PG&E bankruptcy said that the "activism" of United States Trustees like Stanley introduces an element of unpredictability and instability to 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, a United States Trustee's office only affects the decision on where to file in those districts known for having a particularly intrusive United States Trustee. In those districts, the United States Trustee "does what fee restrictions do . . . drives 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 evaluating 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 the level of scrutiny with which judges reviewed and confirmed plans of reorganization, the desires of managers to keep

120. *Id.*

121. *Id.*

122. Tim Reiterman, *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*, L.A. TIMES, May 19, 2001, at B7, available at 2001 WL 2488063.

123. *Id.*

their jobs, and 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 try to slip something past the Delaware court. "It wouldn't be worth it in the long run."

Lawyers also adamantly denied the 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 disputed Professor LoPucki's insinuation that the judges in the District of Delaware will rubber-stamp any pro-management plan. All contended that the scrutiny that plans of reorganization receive in Delaware 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 jobs was a troublesome determinant of the Delaware venue-selection decision.¹²⁴ 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." Thus, in the view of

124. This argument was advanced by LoPucki and Kalin, *see supra* note 10, at 233.

debtors' counsel, managers' desire 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.¹²⁵ Many commentators on Delawarization have acknowledged the likelihood that local counsel in Delaware carry a premium over counsel in other districts.¹²⁶ 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 said that this cost was 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.¹²⁷

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 to the filing of a case that did not wind up in Delaware: Enron. The Enron decision team chose to file in New York rather than Delaware.¹²⁸ 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.¹²⁹ This meant that the Houston judges lacked expertise in complex cases. 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.¹³⁰

125. DEL. BANKR. L.R. 9010-1 (2002).

126. *Id.*

127. *See supra* note 62.

128. Richard B. Schmitt & Michael Orey, *Courts Compete for High-Profile Bankruptcies*, WALL ST. J., Dec. 5, 2001, at B1.

129. *See Rovella, supra* note 56, at 1.

130. At the time of our conversation in early December 2001, those involved in the Enron filing decision did not appear to believe that the company's bankruptcy would draw front-page headlines.

Second, Enron could have filed in the District of Oregon. As an Oregon corporation, Enron was entitled to file in its place of domicile.¹³¹ 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 a "piggy-back" bankruptcy petition in Delaware, where the company had incorporated many of its "affiliates" and subsidiaries.¹³² They knew of the reputation of the Delaware judges for sophistication, responsiveness, and diligence. They rejected the Delaware court because they thought that the Delaware court was currently too busy to give them the kind of attention and responsiveness they needed 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. The New York court has sophisticated judges, arguably as sophisticated as the Delaware judges.¹³³ 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 and press 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.¹³⁴ The Drexel precedent also lent an air of predictability that they felt did not exist in other districts. With several of Enron's three thousand affiliates and subsidiaries chartered as New York corporations, venue in that state merely required a pro forma filing on behalf of a subsidiary.¹³⁵

III. WHAT JUDGES THINK

While the explanations offered by lawyers as to why they are choosing Delaware bankruptcy venue over other alternatives are interesting on their own, 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

131. 28 U.S.C. § 1408 (2000).

132. Subsection 2 of the bankruptcy venue statute permits a filing in the place where a debtor's "affiliate" has an ongoing bankruptcy proceeding. By filing a petition on behalf of an affiliate, a debtor can "piggy-back" into virtually any jurisdiction to file its own bankruptcy petition. *Id.*

133. The Southern District of New York has nine bankruptcy judges under § 152(a)(2).

134. See *In re Drexel Burnham Lambert Group, Inc.*, 960 F.2d 285 (2d Cir. 1992).

135. § 1408(2).

and social goods they bring with them.¹³⁶ States are, according to Tiebout, "suppliers" of law, while citizens and corporations are consumers of that supply.¹³⁷ In the Delaware venue-selection story, then, we can 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 interviewed, 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 fourteen-year terms, seek to "compete" with other 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 obtain the thoughts of judges as to 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 nearly two dozen judges. More than half of these individuals were federal bankruptcy judges.

Almost all of the judges 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 as prestigious." He added that judges get satisfaction from overseeing something that is vital to the nation's economy.

A chancellor 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 are 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

136. See Charles M. Tiebout, *A Pure Theory of Local Expenditures*, 64 J. POL. ECON. 416, 421 (1956).

137. *Id.*

and judges in Delaware feel and respond to the pressure to add value to society. When asked why the Delaware court might attract seemingly "boring" prepackaged bankruptcies, almost all of the judges who thought that "psychic income" was important noted that it is a mistake to assume that "prepacks" are boring. According to one judge, "Many prepacks 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" prepacks 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 of Delaware judges. 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 eighteen-month period, the Delaware bankruptcy judges "heard nineteen motions to transfer venue, and seventeen 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. IS DELAWARE BANKRUPTCY 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 a sustainable advantage in expertise. The more complex cases 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 the move toward Delaware. If the above-mentioned Delaware chancery judge 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.¹³⁸ The legal culture will then produce additional sophisticated bankruptcy judges.

What is less clear is whether the shift to Delaware is actually a form of jurisdictional competition of the type that generates the social benefits argued to result from federalism.¹³⁹ 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 competition for bankruptcy venue, we ought to look at the responses of lawyers and judges and ask whether what they have described is a form of jurisdictional competition that we recognize and value.

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 can be said to have originated in 1956 with the publication of Charles Tiebout's seminal article, *A Pure Theory of Local Expenditures*.¹⁴⁰ Tiebout suggested that states be thought of as producers of law in a competitive market for citizens and the revenue they bring. In 1966, Grant McConnell's now classic critique of American federalism, *Private Power and 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.¹⁴¹ In 1974, William Cary 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

138. See *supra* Part III.

139. For an explication of the social benefits arising from federalism, see G. Marcus Cole, *The Federalist Cost of Bankruptcy Exemption Reform*, 74 AM. BANKR. L.J. 227, 242-43 (2000) (explaining how federalism facilitated the Great Migration of African Americans away from the Jim Crow legal regimes in the southern United States).

140. See Tiebout, *supra* note 136, at 416.

141. GRANT MCCONNELL, *PRIVATE POWER AND AMERICAN DEMOCRACY* 101-18 (1966).

states adopting manager-friendly laws to attract corporations.¹⁴² Ralph Winter joined the debate with the argument that, while managers may be self-interested, market forces drive them to be responsive to investors.¹⁴³ 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."¹⁴⁴ 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.¹⁴⁵

According to both Tiebout and Winter, in the debate over whether the jurisdictional competition between states leads to a race to the bottom or to the top, motives matter. Delaware is driven by the pecuniary interests of its bar, as well as the desire to generate revenues, to provide the "public good" of efficient organization law.¹⁴⁶ Corporate decisionmakers 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 high-performing companies.¹⁴⁷ 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 responsive to the desires of the consumers of organizational law, namely firm managers and investors.

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

The flow of Chapter 11 cases to Delaware 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 does the domicile option in bankruptcy's venue provision facilitate beneficial competition?

142. William L. Cary, *Federalism and Corporate Law: Reflections upon Delaware*, 83 YALE L.J. 663, 705 (1974).

143. Ralph K. Winter, Jr., *State Law, Shareholder Protection, and the Theory of the Corporation*, 6 J. LEGAL STUD. 251, 256 (1977).

144. *Id.*

145. See Tiebout, *supra* note 136, at 1120-24.

146. ROMANO, *supra* note 1, at 6.

147. See Robert Daines, *Does Delaware Law Improve Firm Value?*, 62 J. FIN. ECON. 525, 533, 555 (2001) (finding that Delaware firms were worth 5% more in 1996, on average, and received more takeover bids than firms incorporated elsewhere).

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.¹⁴⁸ This posture has led, in the eyes of the Delaware Skeptics, to an unseemly laxity among the judges in Delaware with regard to prepackaged bankruptcies as well as traditional Chapter 11 plans of reorganization.¹⁴⁹ In the minds of the Skeptics, the Delaware judges would rubber-stamp any plan of reorganization that a corporate debtor placed in front of them.

In an effort to prove this assertion of laxity on the part of the Delaware bankruptcy bench, Professors LoPucki and Kalin conducted an empirical analysis of Chapter 11 plans filed in Delaware by large, publicly held corporate debtors.¹⁵⁰ LoPucki and Kalin point to the high "refiling" rate among Delaware Chapter 11 cases as evidence that the process fails when it is done in Delaware.¹⁵¹ 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.¹⁵²

Professors Rasmussen and Thomas point out several difficulties with the LoPucki and Kalin study, including its failure to distinguish between traditional Chapter 11 petitions and prepackaged plans, and that it draws a negative inference from refiling when none is necessarily justified.¹⁵³ 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.¹⁵⁴ 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 capital structure and, concomitantly, a more complicated restructuring.¹⁵⁵ He also notes that firms choosing Delaware may also be the ones with the most serious business problems.¹⁵⁶

148. LoPucki & Kalin, *supra* note 10, at 233-34.

149. *Id.*

150. *Id.*

151. *Id.* at 235.

152. *Id.*

153. Rasmussen & Thomas, *supra* note 22, at 283.

154. *Id.* at 296-97.

155. Skeel, *supra* note 72, at 319.

156. *Id.* at 320.

Whether or not LoPucki and Kalin are right about the significance of refiling rates, they view the venue-selection process as a “race to the bottom.”¹⁵⁷

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, cites the “virtues of Delaware”: speedy and efficient handling of corporate bankruptcy proceedings by expert judges within a professional and responsive judicial culture.¹⁵⁸ These virtues, according to Skeel, produce what he refers to as a “clientele effect.”¹⁵⁹ Professors Rasmussen and Thomas point to another Delaware benefit: an encouragement of consensual solutions to corporate restructuring needs.¹⁶⁰ The Enthusiasts point to the central economic purpose of bankruptcy law, to reduce the cost of credit *ex ante*, and creditor preference for Delaware, both *ex ante* and *ex post*, as evidence of Delaware’s efficiency.¹⁶¹ After all, they argue, creditors would not prefer a court that raised the cost of credit, particularly after all of the credit-pricing decisions had been made.¹⁶² Although the Enthusiasts acknowledge that the competition for bankruptcy venue is not directly parallel to that for corporate charters, they point to these benefits and embrace “the glass as half full.”¹⁶³

C. Why the Jurisdictional Competition Debate Doesn’t Fit

1. “Delaware is Not a State; It’s a District.”

The debate over the Delawarization of corporate bankruptcy is taking place in the shadow of the continuing debate over the Delawarization of corporate law. Delaware Skeptics LoPucki and Kalin dismiss any claim that the phenomenon is “federalist.”¹⁶⁴ But LoPucki and Kalin, by their recognition of the distinctions between the structures involved in the bankruptcy version of the debate and dismissal of “federalist” arguments, fail to consider the possibility that

157. LoPucki & Kalin, *supra* note 10, at 272.

158. Skeel, *supra* note 71, at 27.

159. *Id.*

160. Rasmussen & Thomas, *supra* note 22, at 287.

161. Skeel, *supra* note 71, at 27.

162. *Id.*; *see also* Rasmussen & Thomas, *supra* note 8, at 1397.

163. Skeel, *supra* note 71, at 26.

164. *See* LoPucki & Kalin, *supra* note 10, at 267-68.

a nonfederalist type of competition might be taking place in Delaware. Delaware Enthusiast Skeel likewise acknowledges the differences between bankruptcy's Delawarization and the corporate charter race.¹⁶⁵ He also acknowledges that these differences attenuate the benefits we may derive from this competition, but he prefers to see the "glass as half full, rather than half empty."¹⁶⁶ Nevertheless, both the Skeptics and Enthusiasts frame their arguments in the "race to the bottom" and "race to the top" terms associated with jurisdictional competition and the corporate charter debate.

One San Francisco bankruptcy lawyer, when presented with the arguments on both sides of the Delawarization debate, responded emphatically: "You're talking as though Delaware is a state. Delaware is NOT a state; it's a district. For purposes of bankruptcy, *Delaware is a district.*"¹⁶⁷

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. The choice of venue takes place between districts of the federal court system, not between states. Many of the potentially competing districts that might be in competition with each other are within the same state. This fact makes it unclear whether a state, if it could influence the process, would act on behalf of one district or all of them. Would California attempt to attract cases to the Northern District, even at the expense of its Eastern District? Or might California take actions that make all of its districts more attractive?

These questions presume that states can take steps to make their federal bankruptcy courts more attractive. This is quite a presumption. Delaware, as a state, is limited in its capacity to

165. Skeel, *supra* note 71, at 26.

166. *Id.*

167. Emphasis is noted as spoken by interviewee.

influence the competition between bankruptcy courts. Although Delaware can structure its organization law 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 guarantees that its own law will apply in cases filed outside its borders.¹⁶⁸ Bankruptcy judges are appointed by the federal circuit overseeing the district, and an appointee need have no prior relationship to the bar or even to the state in which she sits.¹⁶⁹ Although the appointment process is typically administered by a committee, the lawyers comprising such committees are commonly drawn from districts throughout the circuit.¹⁷⁰ States have little influence on the selection of their bankruptcy judges.

The limitation on state influence in bankruptcy is not restricted to judicial appointments. States are handcuffed at the level of substantive law as well. 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.¹⁷¹ States can influence bankruptcy legislation at the national level through their federal congressional delegations, but unless these representatives are well placed, any one state is unlikely to turn federal law to its own peculiar advantage. In short, if a state is to succeed in the battle for bankruptcy venue, it cannot depend upon judicial selection and legislation.

Even if Delaware were to win a competition for bankruptcy venue, what would it win? If we think of jurisdictional competition in the terms encouraged by Tiebout and Winter, the debate surrounding the Delawarization of corporate bankruptcy seems odd. For Tiebout, competition is between jurisdictions within the market for law.¹⁷² Like other markets, the market for law has a supply side and a demand side. Within the Tiebout model, jurisdictions are "suppliers" of law, while individuals, corporations, and the lawyers that represent them are "consumers" of law.¹⁷³ On the demand side of the jurisdictional competition equation, individuals, corporations, and their lawyers

168. The internal-affairs doctrine is the traditional choice-of-law rule that directs courts to look to the law of the state of incorporation to determine the basic rights and duties applicable to a particular corporation. See Norwood P. Beveridge, Jr., *The Internal Affairs Doctrine: The Proper Law of a Corporation*, 44 BUS. LAW. 693, 702-09 (1989).

169. 28 U.S.C § 152 (2000).

170. Each circuit has its own procedures for appointing bankruptcy judges.

171. See Skeel, *supra* note 71, at 26. For an argument that bankruptcy law, as enacted under the Bankruptcy Code of 1978, is in reality state substantive law within a federal procedural framework, see Cole, *supra* note 139, at 236-44.

172. Tiebout, *supra* note 136, at 421.

173. *Id.*

seek the most advantageous regime, the one with the most "desirable" law. When coupled with the constitutional right of interstate travel, individuals and corporations can be thought to consume law by "voting with their feet."¹⁷⁴

It is the supply side of the jurisdictional competition equation that gives Tiebout competition its name, however. Tiebout competition involves a tussle between jurisdictions for revenue. Jurisdictions generate revenue through the development of "desirable" law.¹⁷⁵ A jurisdiction fosters the development of desirable organization law through its careful selection of state legislators and judges.¹⁷⁶ In the corporate charter race, for example, Delaware is widely regarded as having nurtured responsive and sophisticated legislators and judges interested in preserving the state's status as the leader in corporate charters.¹⁷⁷

It is this supply side of the jurisdictional competition equation that makes it a poor description of the Delawarization of bankruptcy. Although the State of Delaware enjoys borders that are contiguous with those of its federal court district, the state cannot generate revenue directly from the production of desirable bankruptcy law for two reasons. First, the state does not receive direct compensation from the debtor's choice to file a petition in the bankruptcy court that sits there. Lawyers from out of town must stay and eat somewhere, and the Delawarization of bankruptcy must be good for the hospitality trade in Wilmington. But the tax revenues generated by hotel and restaurant guests pale in comparison to those realized in the corporate charter race.¹⁷⁸ Much, if not most, of the pecuniary benefits associated with bankruptcy venue accrue to local counsel. Even these indirect benefits to the Delaware bar are diluted by the influx of bankruptcy lawyers from national law firms that have opened offices in Wilmington to satisfy the local counsel requirement. Second, even if Delaware could realize revenue by supplying desirable bankruptcy law, its ability to increase revenue through bankruptcy venue is severely limited. As noted earlier, bankruptcy law is, for the most part, federal law. Delaware cannot produce better bankruptcy law, in part because it cannot supply responsive legislators and judges. In

174. See Cole, *supra* note 139, at 251.

175. See ROMANO, *supra* note 1, at 4-6; see also Marcel Kahan & Ehud Kamar, *Price Discrimination in the Market for Corporate Law*, 86 CORNELL L. REV. 1205, 1211-14 (2001).

176. See Kahan & Kamar, *supra* note 175, at 1212-14.

177. ROMANO, *supra* note 1, at 9.

178. One source estimates that Delaware receives, on average, nearly 15.5% of its operating budget from corporate charter filing fees. See *id.* at 8.

terms of jurisdictional competition, Delaware's supply of desirable law is relatively inelastic.

2. Inelasticity of Supply of the District of Delaware Judges

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.¹⁷⁹ It was said of the café that "sooner or later, everyone comes to Rick's."¹⁸⁰ It was also said that "Rick's wouldn't be Rick's without Sam."¹⁸¹ 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 the empirical evidence suggests that Delaware would not be Delaware without Walsh and Walrath. The responses of lawyers and judges to the questions of why lawyers might choose Delaware, and why judges might want these cases, reflect a common understanding: Lawyers primarily choose judges, not courts or legal regimes. It is true that the lawyer's choices may be characterized as a preference for particular procedures or predictable exercises of judicial discretion, but these preferences often manifest themselves as a preference for particular judges. Lawyers prefer the way in which the Delaware bench—first Judge Balick, and then Judges Walsh and Walrath—has managed and decided cases. And they will get to exercise this choice, so long as: (1) Judges Walsh and Walrath continue to sit on the Delaware bankruptcy bench; (2) Judges Walsh and Walrath are not 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; and (4) Congress does not alter or eliminate the "domicile" venue option.

The purpose of the foregoing "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, by 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 decisionmaking 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.

179. CASABLANCA (Warner Brothers 1942).

180. *Id.*

181. *Id.*

What is more, these judges are only human. Unlike Delaware corporate law, the human capital of the supply side of the jurisdictional competition equation is exhaustible. Delaware corporate law can be said to be similar to a "public good," because it can be supplied to additional consumers at negligible marginal cost.¹⁸² Bankruptcy judges, to the contrary, are neither inexhaustible nor nonexclusive. 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 or too tired to handle yet another case.

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 of the supply of Walsh and Walrath to the lawyers that crave them. In economic terms, at some point the supply of what lawyers want from Delaware venue becomes increasingly inelastic.

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 if the form is not accompanied by the substance provided by Judges Walsh and Walrath. It is this limitation on the desired supply that demonstrates that the Delawarization of bankruptcy venue is not a story of jurisdictional competition in the sense meant by Tiebout. But if we are not witnessing jurisdictional competition in bankruptcy, then why is the Delawarization of corporate bankruptcy taking place? The answer may be that we are witnessing a heretofore unrecognized form of competition, one we might think of as "professional competition."

182. The idea that Delaware corporate law is a public good has gained wide acceptance. See, e.g., Edward B. Rock, *Saints and Sinners: How Does Delaware Corporate Law Work?*, 44 *UCLA L. REV.* 1009, 1097 (1997). Delaware corporate law is not a true public good as that term has come to be defined by neoclassical economists, since each additional corporation imposes some small marginal cost on the state. See Kahan & Kamar, *supra* note 175, at 1214.

V. PROFESSIONAL COMPETITION IN BANKRUPTCY

A. Professionals and the Professionalization of the Bankruptcy Bench

The preceding discussion demonstrates that the Delawarization of bankruptcy law is not typical jurisdictional competition, as described by Charles Tiebout, to which we have become accustomed in the more familiar setting of the corporate charter race.¹⁸³ It would be a mistake, however, to conclude that the absence of Tiebout competition implies the absence of competition for bankruptcy petitions. Some type of competition is taking place with regard to bankruptcy venue. What kind of competition is it?

The explanations offered by the lawyers in Part II may provide some insight into the nature of the competition we are witnessing in the Delawarization of bankruptcy venue. Recall the various factors listed by lawyers, in order of declining importance. The most important factor, predictability, is a characterization of both the probability associated with drawing a particular judge, as well as how she is likely to exercise her discretion once drawn.¹⁸⁴ This factor, then, is more a matter of which judge is drawn rather than in which district she happens to sit. Likewise, the third factor, namely the sophistication of the judges, can be thought of as a personal, rather than a territorial, quality.¹⁸⁵ It is true that attorneys' fee applications are circumscribed by local rules and the scrutiny exercised by the United States Trustee, but even here, the final word on their award rests with the judge.¹⁸⁶ Although the responsiveness of a particular judge is clearly a personal trait, even factors as seemingly impersonal as creditor pressure or the intrusiveness of the home trustee can be linked to the deference or leeway a judge or potential judge might permit those non-debtors within the context of Chapter 11 proceedings. In short, virtually all of the factors listed by the lawyers making the venue-selection decision are considerations revolving around the personal characteristics of bankruptcy judges. Lawyers are primarily selecting judges, not districts.

If the lawyers involved in the venue-selection decision are selecting judges, two questions must follow. First, why might a federal bankruptcy judge, with no material gain associated with docket size, want to attract cases and increase her workload? Even if we arrive at an answer to this first question, we are still confronted with a second:

183. Tiebout, *supra* note 136, at 421.

184. *See supra* Part II.A.1.

185. *See supra* Part II.A.4.

186. *See supra* Part II.A.6.

Why have the judges in the District of Delaware succeeded in attracting cases from their colleagues in other districts?

The first question, which might be restated as "Why might federal judges work harder when they don't have to?," is not a difficult one for many close observers of the federal judiciary. One such observer, Richard Posner, himself a federal judge, might attribute the behavior we observe in the bankruptcy venue race to the "professionalization" of federal bankruptcy judges.¹⁸⁷ In his book, *The Problematics of Moral and Legal Theory*, Judge Posner documents what he heralds as the "growing professionalism of law."¹⁸⁸ By "professionalism," Posner has in mind a very specific meaning: the performance of "an occupation of considerable public importance the practice of which requires highly specialized, even esoteric, knowledge that can be acquired only by specialized formal education or a carefully supervised apprenticeship."¹⁸⁹ What is important, from Posner's perspective, is a generally held belief that the practitioners of the occupation possess unique skill or knowledge, regardless of whether this belief is accurate.¹⁹⁰

Posner distinguishes between "bad" professionalism and "good" professionalism.¹⁹¹ The "bad" form of professionalism, according to Judge Posner, exists when there is an unjustified belief that the specified group possesses unique ability.¹⁹² This bad form of professionalism characterized the practice of law for centuries, and was typified by an obscurantist style of discourse, screening of prospective entrants through general and specialized educational requirements, cultivation of charismatic personality, underspecialization, lack of hierarchy, altruistic pretense, anticompetitiveness, and a resistance to algorithmic duplication.¹⁹³ Posner asserts that law was once a prototype of this cartel-like form of professionalism but has evolved away from it.¹⁹⁴

The practice of law, according to Posner, has become more professional in a good sense.¹⁹⁵ Law has become increasingly specialized, hierarchical, and intensely competitive.¹⁹⁶ To their credit,

187. RICHARD A. POSNER, *THE PROBLEMATICS OF MORAL AND LEGAL THEORY* 190 (1999).

188. *Id.*

189. *Id.* at 186.

190. *Id.* at 187.

191. *Id.*

192. *Id.*

193. *Id.* at 187-89.

194. RICHARD A. POSNER, *OVERCOMING LAW* 23 (1995).

195. *Id.*

196. *Id.*

lawyers and judges have employed the findings of empirical research in the social sciences to further the enterprise of law.¹⁹⁷ Lawyers, according to Posner, are keeping their economic status in society by trading "professional mystique" for genuine hard work and useful service.¹⁹⁸ He points to judges in particular as exemplars of the new professionalism that has swept through law.¹⁹⁹ There are specialized courts and even courts of general jurisdiction with members noted for particular expertise.²⁰⁰ There is hierarchy within courts that did not exist before the advent of law clerks, staff attorneys, interns, and externs.²⁰¹ Judges themselves have responded to the increased professionalism of the lawyers that practice before them by becoming increasingly sophisticated, learned, and hardworking.²⁰²

But why have the judges responded to legal practitioners by building human capital, relinquishing leisure time, and assuming burdensome dockets? Jonathan Macey explains this behavior as motivated by a simple economic calculus: judges prefer hard work to being reversed upon appeal and the concomitant stigma of reversal.²⁰³ Posner suggests that the costs of hard work are willingly borne by judges in exchange for other enhancements to their welfare that they prefer.²⁰⁴ According to him, judges are self-interested actors who seek to maximize their influence, prestige, reputation, and personal enjoyment and satisfaction.²⁰⁵ These welfare enhancements are achievable in the modern, sophisticated legal environment through hard work, increased specialization, and all of the other earmarks that Posner associates with the "good" professionalism trend.²⁰⁶

Other close observers of the federal judiciary have taken notice of these trends but have expressed dissatisfaction with the simple economic explanations for the increased professionalism of federal judges. Some Law and Economics scholars, such as David Skeel and Robert Cooter, have pointed to the failure of neoclassical assumptions regarding self-interested motivation to explain the behavior of the

197. POSNER, *supra* note 187, at 204-05.

198. *Id.*

199. *Id.*

200. *Id.*

201. *Id.* at 192.

202. *Id.*

203. Jonathan R. Macey, *The Internal and External Costs and Benefits of Stare Decisis*, 65 CHI.-KENT L. REV. 93, 110-11 (1989).

204. Richard A. Posner, *What Do Judges and Justices Maximize? (The Same Thing Everybody Else Does)*, 3 SUP. CT. ECON. REV. 1, 13-15, 31 (1994).

205. *Id.* at 13-15.

206. *Id.*

federal judiciary.²⁰⁷ According to Skeel, "Public choice theorists have had far more difficulty modeling . . . judges' behavior, as compared to legislators and private economic actors, due to the absence of a compelling theory as to what . . . judges maximize."²⁰⁸ Cooter acknowledges that "economists have not had much success in creating a theory to explain the objectives of public judges."²⁰⁹

Professor Lynn Stout has attributed the seemingly inexplicable diligence of federal judges to altruism.²¹⁰ Unlike the altruistic pretense that Posner associates with "bad" professionalism, Stout finds genuine altruism to be both helpful as an explanatory description of the selfless behavior exhibited by federal judges and consistent with sociological and psychological evidence of altruism in other human settings.²¹¹ De-emphasizing motivations, Stout asserts that judges display "other-regarding revealed preferences."²¹² According to Stout, whatever their motivations, judges act as though they care, not just about their own costs and benefits, but about the costs and benefits of their actions as borne by others.²¹³ Included in Stout's concept of "others" are litigants, the economy, the rule of law, and even ideals of proper judicial conduct.²¹⁴

The concept of professionalism appears to capture the ways in which bankruptcy judges are viewed by lawyers and by other judges. Lawyers interviewed used the terms "hardworking," "competent," "sophisticated," and "savvy" numerous times to characterize the work of District of Delaware Judges Walsh and Walrath. Lawyers also referred frequently to the specialization that these two judges have achieved with respect to large, complex Chapter 11 cases. Whether these qualities are motivated by altruism or highly particularized preferences, the evidence provided by the bankruptcy bar suggests that Judges Walsh and Walrath have achieved professional excellence.

207. *Id.*; see also Robert D. Cooter, *The Objectives of Private and Public Judges*, 41 PUB. CHOICE 107, 129 (1983).

208. David A. Skeel, Jr., *Public Choice and the Future of Public-Choice-Influenced Legal Scholarship*, 50 VAND. L. REV. 647, 653 n.19 (1997) (book review).

209. Cooter, *supra* note 207, at 128-29.

210. Lynn A. Stout, *Judges as Altruistic Hierarchs*, 43 WM. & MARY L. REV. 1605, 1609 (2002).

211. *Id.* at 1607.

212. *Id.* at 1610.

213. *Id.*

214. *Id.*

*B. The Delaware Influence on Professional Bankruptcy
Judges: "Professional Competition"*

The competition for bankruptcy cases can be thought of as "professional competition"—a race between professionals to perform their services effectively and efficiently, without regard to tangible rewards or compensation for their superior service. The observation that judges are competing with each other to deliver their professional services leads to yet another simple question: Why? Why is it not enough for judges to perform to the best of their abilities? Why must they engage in a race for complex, demanding cases, and why have the two that sit in the District of Delaware won this race?

While the discussion of Tiebout competition in Part IV emphasizes the formal, systemic helplessness of the State of Delaware in the competition between federal bankruptcy judges and districts, it is a mistake to conclude that institutional helplessness is equivalent to actual helplessness. As several Delaware attorneys and state court judges emphasized, Delaware's legal environment is characterized by "a culture of service." According to one Delaware chancellor, "lawyers and judges in this state see themselves as part of something critical to the well-being of the country, and even the world." Wilmington's legal culture, according to him, leads "lawyers and judges in Delaware to provide service that is hard to find anywhere else."

To influence the federal professionals who are beyond the reach of Delaware electoral politics, Delaware puts its culture to work, aligning the interests of the professional judges with those of the community. As one Delaware corporate lawyer put it, "When Enron filed its bankruptcy in New York, the front page of the Wilmington newspaper read 'Enron chooses New York Over Delaware.' Where else could you read a headline like that?" According to this lawyer, the Delaware legal community is painfully aware of bankruptcy venue decisions.

To emphasize the strength of Delaware's service culture, one nationally prominent Ohio bankruptcy attorney recounted his experience locating a multibillion-dollar settlement trust:

I was busy attempting to get opinion letters from various state attorneys general to assure me that location of the trust in their state would not subject our trust to state taxes. When a Delaware corporate lawyer got wind of our efforts, he called up a friend in the Delaware legislature, and within three months, Delaware actually put a law on its books exempting us from taxation. The difference was that in Delaware we were fully protected by statute, when it took even longer to get the partial protection of an attorney general's letter in other states.

Another lawyer, based in Delaware, reported his experience with the Delaware culture at the highest levels of state government. "I

had a client who had, for a number of reasons, decided to recharter in Nevada. When the Governor (of Delaware) heard of the company's decision, he actually got on the phone and invited the general counsel to lunch. By the time lunch was over, the company was a Delaware corporation again."

Delaware's service culture goes beyond the legislative and executive branches of government. It infects the judges as well, including those on the federal bench. One Delaware corporate lawyer explained, "Wilmington is a really small community. Everybody knows everybody else. If these bankruptcy judges wanted to buck the system, they would find life in Delaware very unpleasant and lonely. It's just not reasonable to expect them to act differently than all of the other lawyers and judges here."

It follows, then, that the State of Delaware is not an irrelevant variable in the bankruptcy venue equation. It is true that Delaware does not have direct influence over bankruptcy law or the appointment of bankruptcy judges. But Delaware's influence cannot be explained away so easily. The move toward Delaware venue is likely the product of the indirect but extended influence that Delaware law and culture have on anything that comes near it. That culture, according to one Delaware corporate lawyer, is one of "service and responsiveness." He added that "as a legal community, we will 'out serve' any other legal environment in the world in order to keep companies here, and keep them happy."

The use of the phrase "out serve" points to another element of Delaware's legal culture, namely "competition." Delaware lawyers see themselves in competition with other communities for the services they provide. According to another Delaware corporate lawyer, "Wilmington is a one-industry town, and we know how our bread is buttered." It is this understanding, according to this attorney, that permeates "everything we do." He also insisted that this understanding is so prevalent that it rises to the level of an unspoken understanding between all members of the legal community.

Delaware lawyers who were asked about how Delaware's legal culture could reach seemingly immune federal bankruptcy judges all responded emphatically that no judge could be immune. According to one lawyer, "This is where they live, this is where they shop on the weekends, and where their kids go to school. They can't just opt out of this community." Another lawyer said, "We all know each other and see each other all the time," adding "We go to the same parties, dinners, restaurants. If a judge was bucking the Delaware way of doing things, the disapproval would be a real part of their lives." One Delaware state court judge cited the fact that Judge Walrath was

appointed with the widely recognized intention to limit the influence of Delaware on corporate bankruptcy. "As soon as she was sworn in, she became one of us."

Bankruptcy lawyers praise the effect of the Delaware service culture upon Delaware bankruptcy judges. According to one bankruptcy lawyer who recently moved his practice from New York to Wilmington, "Delaware legal professionals take great pride in what they do. They see it as something that is important, not just for Delaware, but for the economy, the country, and the world." According to a Delaware Chancery Court judge, the satisfaction received from performing such an important service provides immeasurable "psychic income" to Delaware's judicial professionals.

Delaware's influence on the bankruptcy bench can be viewed as a social science experiment. Bankruptcy law, with its national reach and uniformity, establishes a control. Federal bankruptcy judges around the country are paid exactly the same and hold the same position within the federal judicial hierarchy, as any other bankruptcy judge in any other district.²¹⁵ The Federal Rules of Bankruptcy Procedure are the same in all districts, as is the Bankruptcy Code of 1978. What differs from district to district are the judges themselves and the ways in which they exercise their discretion.

The cultural influence of Delaware appears to explain the part of the story that is missing from an analysis of the formal institutions alone. Judges in Delaware are influenced by Delaware's culture to act responsively and predictably. The cultural explanation makes sense of the assimilation of Judge Walrath, purportedly appointed to buck that very culture. It also suggests more permanence to Delaware's perch atop the bankruptcy venue totem than a view of the formal institutions might lead one to forecast.

The reach of Delaware culture is more than superficial. It motivates professional judges to develop substantive innovations that provide them with a competitive edge. Such innovation may explain the growth of "prepackaged" plans within the Delaware docket. "Prepackaged" plans necessarily provide for the management of the reorganized companies as well as for the distribution of ownership stakes. The management of a reorganized firm can be thought of as a deployment decision, in that it represents how assets are deployed. Ownership interests, however, are independent of deployment, and can be thought of as allocation determinations. There is no necessary relationship between who owns assets and how they are used. The increase in the number of "prepackaged" plans in the Delaware docket

215. See 28 U.S.C. § 153(a) (2000).

may reflect a market determination about the use of judicial oversight and discretion. Creditors and debtors may be filing "prepackaged" plans in Delaware because they may believe that Delaware judges are less likely to interfere with deployment determinations, reserving judgment for questions of allocation. Market participants may view Delaware judges as deferential to the business judgment of managers and creditors. These market participants also see the Delaware judges as limiting the exercise of judicial intervention to questions of equity. If this is an accurate characterization of what the Delaware judges are doing, then their actions are consistent with the calls for such bifurcation that have come from the law and economics literature over the past decade.²¹⁶

That Delaware's legal culture influences bankruptcy judges and, ultimately, bankruptcy venue decisions is probably not surprising. The real question with respect to Delaware, its culture, and professional competition is why, in a state as legally purposive as Delaware, would its bar and its officials care to influence cases that bring little more than restaurant receipts and an influx of bankruptcy lawyers? The answer may lie in an understanding of what bankruptcy venue preserves rather than in what it attracts.

The influence of Delaware's legal culture on professional bankruptcy judges can be seen as a collateral effect of its victory in the corporate charter race. Companies win the right to file for bankruptcy in Delaware as part of the bundle of advantages associated with being chartered there. As long as Delaware is viewed as the "best" place to file a Chapter 11 petition, then few companies will look twice at the premium enjoyed through the decision to charter there. Once bankruptcy venue in another district becomes viewed as superior to that in Delaware, then the Delaware premium becomes offset, to some extent, by the potential "cost" of Delaware bankruptcy. Delaware corporate lawyers, then, have an interest in ensuring that Delaware bankruptcy is a "benefit," and not a "cost," of chartering a corporation in that state, and Delaware's powerful United States Senators have an interest in resisting reform of the current venue regime.

C. Professional Competition vs. Jurisdictional Competition

It is not immediately obvious that Delaware ought to win a competition between professional federal judges sitting within its borders and those situated elsewhere. The professional competition for

216. The most recent calls for such a bifurcation of function have been made by Douglas Baird and Robert Rasmussen. See *The End of Bankruptcy*, 55 STAN. L. REV. (forthcoming 2002) (manuscript on file with author).

bankruptcy venue enjoys characteristics that differ from those we find in customary jurisdictional competition. These differences are rooted in the motivations driving the competitors, the role of geography, the durability of victory, and the economic character of the supply provided by competitors.

1. Personal Interests vs. Joint Interests

The first and most obvious difference between the type of competition in the race for corporate charters and that in the race for bankruptcy venue resides in the interests driving the competition. In jurisdictional competition, states like Delaware compete against Nevada and New York because success directly promotes the interests of state decisionmakers. Delaware legislators share the bounty generated by charter filing fees through enhanced state budgets, and Delaware state court judges enjoy a level of prestige and notoriety not shared by their counterparts in other states. The Delaware bar shares in the lucre, gaining exclusive rights to represent more and wealthier corporate clients. As one Delaware attorney put it, "When we keep a company in Delaware, or when we get a new one, everybody wins."

In contrast, professional competition is apparently driven by the personal interests of the competitors. Whether judges are maximizing prestige and influence or satisfaction at "just doing their jobs," the direct benefits of success in a race between professionals inure to the professional. This is not to say that jurisdictional interests are not implicated in professional competition; they clearly are. As the above discussion of Delaware's influence should make clear, the joint interests of Delaware residents drive them to influence indirectly the professional competition in bankruptcy.

2. Geographic Flexibility vs. Territorial Fixation

A second difference between professional competition and jurisdictional competition involves the reliance upon geography. Professionals need not be tied to any particular territorial restriction. Even professional federal bankruptcy judges are less territorially tied than most observers might realize. As noted earlier, Judge Judith K. Fitzgerald of the Western District of Pennsylvania hears the consumer bankruptcy cases in Wilmington.²¹⁷ This placement occurs because bankruptcy judges within any particular federal appeals court circuit serve at the pleasure of the United States court of appeals for that

217. See *supra* Part IV.

circuit.²¹⁸ The normal duties of the bankruptcy judge in the Southern District of Alabama, for example, entail regular sittings in Pensacola, Florida.²¹⁹ And while it is generally true that bankruptcy judges are bound at the very least by the water's edge of their respective circuits, the parade of visiting judges to sit in Wilmington provides evidence that even this general rule has its exceptions. In the absence of even loose territorial limitations, one might imagine professionals competing without regard to geographic territory.

Jurisdictional competition, on the other hand, enjoys less geographic flexibility. For some consumers, Florida law will always have the assistance of Florida weather. Yet jurisdictional competition in the context of corporate law is not as territorially limited as tort or property regimes. The internal-affairs doctrine and other choice-of-law rules can give Delaware law reach far beyond its borders. Much of Delaware's success in the race for corporate charter and franchise tax revenues is a product of the extraterritorial availability of Delaware incorporation and its benefits.

3. Competitiveness

The geographic flexibility inherent in professional competition points to a third important distinguishing trait. Because of this flexibility, markets for professional services are likely to prove more competitive than those for jurisdictional legal regimes. The corporate charter race provides a tangible illustration of this point. Delaware has been the leader in this race since it snatched the title from New Jersey in 1919.²²⁰ Once it achieved preeminence, the state moved to reinforce its position by developing a body of law and an infrastructure focused on becoming the most attractive locale for filing a charter.²²¹ In and out of eight decades, many things have changed in Delaware: it has had eighteen governors,²²² twenty-four members of the Court of

218. § 152(a)(1) (providing that each circuit of the United States court of appeals shall appoint all bankruptcy judges within its circuit).

219. Many other district courts engage in sharing arrangements that involve the movement of bankruptcy judges across district and even state lines for administrative convenience.

220. ROMANO, *supra* note 1, at 5.

221. *Id.*

222. These governors were John G. Townsend, Jr. (1917-1921), William D. Denney (1921-1925), Robert P. Robinson (1925-1929), C. Douglass Buck (1929-1937), Richard Cann McMullen (1937-1941), Walter W. Bacon (1941-1949), Elbert N. Carvel (1949-1953), J. Caleb Boggs (1953-1960), David Penrose Buckson (1960-1961), Elbert N. Carvel (1961-1965), Charles Laymen Terry, Jr. (1965-1969), Russell Wilber Peterson (1969-1973), Sherman W. Tribbitt (1973-1977), Pierre S. du Pont IV (1977-1985), Michael N. Castle (1985-1992), Dale E. Wolf (1993), Thomas R. Carper (1993-2001), and current Governor Ruth Ann Minner (2001-present). For current

Chancery,²²³ and countless legislators, administrators, and legal professionals. Yet one thing has stayed the same: Delaware has preserved its preeminence in the corporate charter race. This dominance has been shown to account for a large percentage of the state's revenues and the ability to demand monopoly-priced franchise taxes from large, publicly traded companies in return for its corporate law and chancery courts.²²⁴ Delaware's market power is further enhanced by the failure of other states to compete vigorously for Delaware's market share of corporate charters.²²⁵

Professional competition is likely to be less stable than jurisdictional competition. For example, as was seen in Table 1, Delaware's preeminence in the bankruptcy venue race has already begun to falter.²²⁶ This decline results because professional competition depends upon the personalities driving the race. In professional competition, virtually all of the supply-side decisions are made by individuals who enjoy some but not all of the benefits that come from the supply of their professional services. From the standpoint of a state like Delaware, the supply of services offered in the context of the professional competition that characterizes bankruptcy venue is relatively inelastic, particularly when compared to that state's responsiveness in the corporate charter setting.

Even more important than this inelasticity of supply from the standpoint of the state is the inelasticity of supply from the standpoint of the professional-competitor. Professionals cannot replicate themselves and can only work so hard. In short, the service of particular judges, which is what bankruptcy lawyers say they want from Delaware venue, is highly inelastic.

information, see *The Political Graveyard, Delaware Governors*, at <http://politicalgraveyard.com/geo/DE/ofc/gov.html> (last visited Oct. 12, 2002).

223. These chancellors and vice chancellors include the following: Charles Minot Curtis (1909-1921), Josiah Oliver Wolcott (1921-1938), William Watson Harrington (1938-1950), George Burton Pearson, Jr. (1939-1946), Daniel F. Wolcott (1950-1951), Collins J. Seitz (1946-1966), Howard W. Bramhall (1951-1954), William Marvel (1954-1982), Issac D. Short, II (1961-1973), William Duffy (1966-1973), Grover C. Brown (1973-1985), William T. Quillen (1973-1976), Maurice A. Hartnett, III (1976-1994), Joseph J. Longobardi (1982-1984), Carolyn Berger (1984-1994), Joseph T. Walsh (1984-1985), William T. Allen (1985-1997), Bernard Balick (1994-1998), Myron T. Steele (1994-2000), and current members, Chancellor William B. Chandelier III, (1989-present), and Vice Chancellors Jack B. Jacobs (1985-present), Stephen P. Lamb (1997-present), Leo E. Strine, Jr. (1998-present), and John W. Noble (2000-present). For current information, see Delaware Court of Chancery, *Judges*, at <http://courts.state.de.us/chancery/judges.htm> (last visited Oct. 12, 2002).

224. Kahan & Kamar, *supra* note 175, at 1211-14.

225. *Id.*

226. *See supra* Part I.

4. Private Goods vs. Public Goods

The relative inelasticity of supply of professional services highlights the fourth key difference between jurisdictional competition and professional competition. Unlike jurisdictional competition, which is frequently thought to produce public goods, professional competition produces what are largely private goods. A pure "public good" is defined by welfare economists as having an inexhaustible and nonexclusive supply. This definition is often stretched to include goods that have very small marginal costs. The corporate charter race, for example, is thought to result in the generation of a widely enjoyed public good, namely Delaware corporation law.²²⁷ Delaware law fits the less formal definition of a public good because it is inexhaustible, in that the use of Delaware law by one corporation or investor does not exhaust the supply available for others, and because the process of making Delaware law available for some makes it available to others.²²⁸

Professional competition is not characterized by the same generation of public goods. Only so many corporations can obtain the benefit of Delaware bankruptcy venue. The prized judgment of Judges Walsh and Walrath is limited to the number of cases they can hear. This service is exhaustible, in the sense that the enjoyment of these riches by one case deprives the supply available to others. The supply of Delaware bankruptcy venue is also exclusive, in that the benefits of venue are limited, in large part, to the litigants.

In summary, although Delaware has won the battle for bankruptcy venue, its victory is less stable and defensible than the one it won in the corporate charter race over eighty years ago. Professional competition can be thought of as distinct from jurisdictional competition in that it is driven by the personal interests of professionals, rather than the joint interests of diverse actors bound together by geographic political boundaries. The freedom from territorial fixation creates the potential for more effective competition between professionals than that between jurisdictions. With professional competition, victories are more likely to be fleeting and innovations more successfully duplicated than in jurisdictional competition. The potential dynamism of professional competition also reflects the inelastic nature of the supply of professional services. These characteristics of professional competition—personal motivation, geographic flexibility, competitiveness, and public goods

227. See, e.g., Rock, *supra* note 182, at 1097 (citation omitted).

228. *Id.*

generation—all have implications for the structure and future of our bankruptcy system.

D. Implications of Professional Competition in Bankruptcy

The idea that federal bankruptcy judges might compete with each other for cases despite fixed uniform compensation and an absence of formal hierarchy suggests several possibilities for the enhancement of bankruptcy institutions. First, the fact that professionals compete to provide service, and that the marketplace differentiates between them, suggests that national welfare may be enhanced by the establishment of an “at-large” bankruptcy judiciary. At-large bankruptcy judges might operate in a manner familiar to private arbitrators, freed from the geographical constraints that currently characterize bankruptcy jurisdiction. A second, and perhaps less likely, possibility is a move toward actual jurisdictional competition in bankruptcy, with state-based, rather than federal, bankruptcy law and courts. Each of these possibilities will be examined in turn.

1. At-Large “Arbitrator-like” Bankruptcy Judges

The benefits of professional competition might be enhanced by freeing bankruptcy judges from their geographic limitations. As has been demonstrated above, bankruptcy venue has become quite malleable since Judge Balick’s ruling on domicile over a decade ago.²²⁹ Credit markets, particularly for those of the largest Chapter 11 debtors, are virtually global. If the purpose of federal bankruptcy law is to lower the cost of credit *ex ante*, then why should bankruptcy venue be geographically fixed?

The most common defense of geographic fixation of bankruptcy venue is creditor convenience. Small regional, local, or individual creditors may be left powerless by large debtors able to finance far-flung bankruptcy litigation. Geographically bound bankruptcy venue permits small creditors the ability to assert their claims without significant inconvenience. Creditor convenience also limits a debtor’s ability to stack the deck by traveling to a remote jurisdiction beyond the distant cries of objecting creditors in order to gain support for an otherwise insupportable reorganization plan.

229. See *In re Ocean Props. 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).

These defenses of geographically based bankruptcy venue, however, beg an important question, namely, why are professional bankruptcy judges tied to a particular venue? All of the creditor convenience concerns could be accommodated by a system that brought highly prized professional judges to the most important cases. Bankruptcy judges in such a system might operate as "at-large" judges, "riding circuit" to hear cases on their respective dockets. In this manner, bankruptcy judges might evolve into a hierarchy similar to that which characterizes arbitrators and "private" judges, with the "most professional" or "best" judges being tapped to hear the cases of most importance for the national economy, with less important cases placed into the competent hands of the rest of the bankruptcy bench. Bankruptcy judges might then continue to compete with each other for the prestige and recognition associated with the most important cases, freed from accidents of location.

Creditor convenience concerns also ignore the current realities of bankruptcy venue. As Enron demonstrates, bankruptcy venue can be had just about anywhere.²³⁰ Many of these strategic venue decisions are made with the consent, and sometimes at the insistence, of creditors. An at-large, arbitration-type system of allocating judicial resources removes the pretense from the current system and taps the competitive forces of professionals and professionalism.

One other aspect of an at-large, arbitrator-type bankruptcy judge involves the tangible rewards for professional competition. As the above discussion of the current system demonstrates, professionals are driven to compete even in the absence of tangible rewards.²³¹ It is possible, however, that internalization of some of the benefits of professionalism on the bench might foster greater, more widespread, and more dynamic competition between professionals. Benefits might be internalized by indexing a judge's monetary compensation to the size of the companies or cases brought before her. As long as litigants remain free to settle upon the services of particular judges, then at-large bankruptcy judges might operate like private suppliers in any other market.

The market-like possibilities of at-large bankruptcy judges raise yet another possibility: private bankruptcy judges. A system of private bankruptcy judges, compensated as administrative expenses in the cases before them, might sit in public courtrooms. Like private prosecutors in the English criminal courts, these private actors might be entrusted to discharge the public office of judging.

230. See *supra* Part II.C.

231. See *supra* Parts I-III.

Private judges have operated alongside the governmental civil justice system for a range of cases, including family and commercial disputes.²³² Private judiciaries that would completely displace the governmental monopoly over the judicial function have been proposed, but have had no operational opportunities in modern, industrialized societies.²³³ Such judiciaries, frequently referred to as “polycentric legal systems,” have been proposed in various forms but have several common features and principles.²³⁴ They begin with the premise that the judicial function is a service, and one for which there is a demand and a supply.²³⁵ They also recognize that many of the transactional barriers to the operation of such a system might be overcome through advance planning and contracting.²³⁶ If all adults were required to select and contract with a private judicial service provider in advance, then a tort claim, for example, could be litigated before the victim’s preselected judge, so long as a “comity” arrangement between the tortfeasor’s provider had been established in advance.²³⁷ Polycentrists point to private police and home security contractors as models of how a polycentric judiciary might operate.²³⁸

The most formidable impediments to the implementation of a polycentric legal order stem from the fact that the vast majority of disputes involve litigants whose interests are at odds with each other. A private bankruptcy judiciary avoids this impediment, however, because of the nature of a bankruptcy case. Unlike most property, tort, or contract disputes, bankruptcy cases involve parties whose interests are not necessarily at odds. Although the individual issues within a case can be hotly contested, the overarching principle of bankruptcy, and the principal justification for its existence, is that the claimants to a common pool of assets have a joint interest in maximizing the value of that pool.²³⁹ Individual claimants might injure this joint enterprise through short-sighted asset grabs, so bankruptcy law minimizes

232. See Steven J. Ware, *Default Rules from Mandatory Rules: Privatizing Law Through Arbitration*, 83 MINN. L. REV. 703, 707-27 (1999).

233. See RANDY E. BARNETT, *THE STRUCTURE OF LIBERTY: JUSTICE AND THE RULE OF LAW* 238-97 (1998); see also Tom W. Bell, *Polycentric Law*, HUMANE STUD. REV., Winter 1991-92, at 1; Randy E. Barnett, *Pursuing Justice in a Free Society: Part Two—Crime Prevention and the Legal Order*, CRIM. JUST. ETHICS, Winter/Spring 1986, at 37-47; Randy E. Barnett & Douglas Rasmussen, *The Right to Liberty in a Good Society*, 69 FORDHAM L. REV. 1603, 1611 (2001).

234. See Bell, *supra* note 233, at 1.

235. See Barnett, *supra* note 233, at 37.

236. See Andrew P. Morriss, *Miners, Vigilantes, and Cattlemen: Overcoming Free Rider Problems in the Private Provision of Law*, 33 LAND & WATER L. REV. 581, 581-83 (1998).

237. Barnett, *supra* note 233, at 40.

238. *Id.*

239. THOMAS JACKSON, *THE LOGIC AND LIMITS OF BANKRUPTCY LAW* 26 (1986).

opportunities for opt-out and hold-out behavior.²⁴⁰ As a result, bankruptcy cases differ from other types of civil cases because party interests are aligned in such a way as to render them "one party" cases.

If the object of bankruptcy is to maximize the debtor's estate, then a private judiciary focused upon bankruptcy cases does not suffer the transaction cost difficulties confronted by most polycentric legal system proposals. Private judges might report to hear cases upon a majority or supermajority vote of claimants. Market forces would limit their fees to a percentage of the value their oversight adds to the common pool. Judges who gained an unsavory reputation, say, for unfairness to small creditors or for rubber-stamping management decisions, might undermine their prospects of hearing future cases. Competition between private judges would ensure that each judge would keep up with innovations in the exercise of judicial discretion. Review of questions of law by government courts of appeal could address concerns about departures from settled or legislated mandatory rules.

In sum, if professionals compete in the absence of tangible incentives and in the presence of territorial restrictions, and if this competition produces better and more innovative judges, then perhaps the benefits of professional competition could be maximized by lifting the territorial limitations on bankruptcy judges. A private bankruptcy judiciary might maximize the social benefits of professional competition, in part, by allowing professionals to be selected and compensated in proportion to the value that they add to the cases they oversee.

2. Possibilities for State Law Bankruptcy

The recognition that competition for bankruptcy venue is not jurisdictional competition raises two questions. The first question is, "What would actual jurisdictional competition in bankruptcy look like?" The second question is, "Would actual jurisdictional competition in bankruptcy be better than the professional competition we currently have?" Although political realities render such questions academic, they are worth exploring.

240. *Id.*

*a. Actual Jurisdictional Competition in Bankruptcy**i. State Reorganization Law*

There are at least two possibilities for jurisdictional competition in bankruptcy. One form of state-based bankruptcy law might operate in much the same fashion as state-based corporate law or insolvency law. A state-based discharge regime has not been attempted since the ratification of the Constitution, with its Bankruptcy Clause establishing bankruptcy within the purview of Congress.²⁴¹ Nevertheless, many of the colonies had their own bankruptcy regimes throughout the colonial period, and those that did not incorporated English bankruptcy law.²⁴² Furthermore, reorganization law, as distinguished from the use of bankruptcy as an insolvency regime, *originated* in the state courts in the latter part of the nineteenth century, through the equity receivership.²⁴³

Under the original equity receivership, the lead creditor, typically a Wall Street investment banker, would orchestrate a plan of reorganization for a large, industrial debtor.²⁴⁴ The reorganization typically left small junior creditors out in the cold, but these creditors likely would have received little or nothing in a liquidation anyway.²⁴⁵ The era of the equity receivership was characterized by competition between state courts and innovation by legal professionals, including lawyers and judges.

Resurrection of state-based reorganization or equity receiverships, while politically formidable, is not necessarily impracticable. Two concerns must first be addressed. The most important of these concerns involve questions of *in rem* and *in personam* jurisdiction. Federal bankruptcy courts enjoy jurisdiction over all property of a debtor, wherever situated, as long as it is within the United States.²⁴⁶ Likewise, federal bankruptcy law confers *in personam* jurisdiction upon a court sitting in bankruptcy over any

241. See PETER J. COLEMAN, *BANKRUPTCY AND INSOLVENCY IN COLONIAL AMERICA* 17 (1974); CHARLES WARREN, *BANKRUPTCY IN UNITED STATES HISTORY* 5-8 (1935).

242. See PETER J. COLEMAN, *DEBTORS AND CREDITORS IN AMERICA: INSOLVENCY, IMPRISONMENT FOR DEBT, AND BANKRUPTCY 1607-1900* 14 (1974).

243. See SKEEL, *supra* note 40, at 56-69.

244. See Baird & Rasmussen, *supra* note 73, at 921-24.

245. *Id.* at 931-32.

246. *Celotex Corp. v. Edwards*, 514 U.S. 300, 308 (1995) (holding that "Congress intended to grant comprehensive jurisdiction to the bankruptcy courts so that they might deal efficiently and expeditiously with all matters connected with the bankruptcy estate") (internal citations omitted).

party having an interest in or claim upon a debtor in bankruptcy.²⁴⁷ This far-reaching jurisdiction permits federal courts sitting in bankruptcy to make final dispositions of property and enjoin all future claims against the debtor by operation of bankruptcy's discharge. Can state-based bankruptcy enjoy the reach held by federal bankruptcy law?

The answer to this question is a resounding "maybe." The most promising avenue for addressing jurisdictional concerns runs through the Full Faith and Credit Clause of the Constitution.²⁴⁸ This clause requires state courts to enforce the judgments handed down by courts in sister states as though they were issued by domestic state courts.²⁴⁹ Restructurings effected under the equity receivership enjoyed success for decades, in part because the state courts imposing the reorganizations were presumed to issue judgments with national reach.²⁵⁰

A second concern is the uncertainty parties would face in determining which state's bankruptcy regime would apply. Here, one approach is to impose upon a debtor company and its creditors the regime enacted by the debtor's state of incorporation. Such an approach would extend the internal-affairs doctrine that governs corporate affairs and dissolution generally.²⁵¹ Another approach, a variant of one advocated by Professors Rasmussen and Thomas, would permit debtors to choose, *ex ante*, the state regime that would apply in event of bankruptcy.²⁵² A debtor would, under this approach, stipulate in its corporate charter or by-laws the jurisdiction that would govern the proceedings in the event of a bankruptcy filing.²⁵³ Potential investors and creditors alike would then be on constructive notice of any given debtor's bankruptcy venue, and markets could evaluate and price these determinations accordingly.

One major criticism of such an approach is that the choice of venue occurs at a time so much earlier than the time of filing that it

247. The Bankruptcy Code of 1978, unlike its predecessor, the Bankruptcy Act of 1898, gives district courts in personam as well as in rem jurisdiction. See 28 U.S.C. § 1334(b) (2000).

248. The United States Constitution provides as follows:

Section 1. Full Faith and Credit shall be given in each State to the public Acts, Records, and judicial Proceedings of every other State. And the Congress may by general Laws prescribe the Manner in which such Acts, Records and Proceedings shall be proved, and the Effect thereof.

U.S. CONST. art. IV, § 1.

249. *Id.*

250. See SKEEL, *supra* note 40, at 47-49.

251. See Beveridge, *supra* note 168, at 702-03.

252. See Rasmussen & Thomas, *supra* note 8, at 1397.

253. *Id.*

deprives the relevant decisionmakers—the debtor, investors, and creditors—of the benefits of competitive innovations that might change the locus of efficient reorganization in the interim.²⁵⁴ Alternative approaches might permit frequent changes to the venue determination, even up to the date of the filing of the petition. Ostensibly, this system is the same that exists under the current domicile-based venue regime in federal bankruptcy.

The competitive innovation afforded by jurisdictional competition is perhaps the most promising aspect of state-based bankruptcy. One state, for example, might adopt a “chameleon equity” approach to insolvency, as imagined by Professor Barry Adler.²⁵⁵ Under a chameleon equity regime, a period of corporate insolvency would wipe out the interests of shareholders, which would be replaced by junior debtholders. Debt would become equity, without the involvement of courts, lawyers, accountants, and delays.²⁵⁶ Another state might adopt an auction approach, as advocated by Professor Douglas Baird.²⁵⁷ Companies filing for bankruptcy would find their businesses up for sale to the highest bidder, which might be a consortium of current creditors who buy the firm in its entirety, or scavengers who grab assets piecemeal.²⁵⁸ Still other states might enact the “options method” of reorganization favored by Professor Lucian Bebchuk, where junior interests are given options to buy out more senior interests if they view the value of the firm as exceeding their claims.²⁵⁹ In short, academic debates over the most efficient reorganization schemes would no longer be academic. The laboratory of the states could put them to the test.

ii. State Contract Law: Private Reorganization

A second form of state-based bankruptcy might operate in a more diffuse manner than current federal bankruptcy law. A state-based regime of corporate reorganization that operated entirely through the state contract law might prove as effective as a federal or state reorganization scheme. In fact, much of the debate over the last decade concerning corporate reorganization can be recharacterized as one of tension between federal bankruptcy law and private, contractual corporate restructurings under state contract law.

254. See Skeel, *supra* note 71, at 26.

255. See Adler, *supra* note 4, at 312, 323-33.

256. *Id.*

257. See Baird, *supra* note 4, at 633.

258. *Id.*

259. Bebchuk, *supra* note 4, at 789.

Contractualism in corporate bankruptcy is most closely associated with the work of Professors Robert Rasmussen, Randall Thomas, Douglas Baird, and Alan Schwartz.²⁶⁰ Contractualists believe the most effective way to handle the common-pool, collective-action problem is through contractual "workouts" between the debtor and its creditors.²⁶¹

The contractualists appear to be pleased with the Delawarization of corporate bankruptcy.²⁶² This pleasure is due, in no small measure, to the fact that much of the reorganization activity in Delaware takes place through prepackaged Chapter 11 plans.²⁶³ These plans reflect the prenegotiated, consensual, contractual solutions that contractualists argue are more efficient than the cumbersome meanderings of a traditional Chapter 11 proceeding.²⁶⁴ If debtors and creditors choose Delaware as the locus of reorganization and choose consensual prepackaged plans, then the choice of Delaware presumptively reflects a lowered cost of credit *ex ante* and is therefore desirable. The bankruptcy court merely adds the force of a court order to agreements that would otherwise be enforceable under ordinary notions of contract breach and reigns in potential free riders or holdouts. Delaware bankruptcy is efficient in this view because Delaware judges do not make asset deployment decisions; they leave those decisions to the experience and business acumen of debtors and creditors.

Recent musings by contractualists have suggested that prepacks are only a first step in the right direction.²⁶⁵ To further enhance social welfare, another step might be to align bankruptcy proceedings with the equity receiverships of the nineteenth century.²⁶⁶ Under the equity receivership, a single lead creditor coordinated a corporate restructuring.²⁶⁷ The effort was largely consensual, utilizing a state court's equitable powers to solve the commons tragedy²⁶⁸ and

260. Baird & Rasmussen, *supra* note 73, at 956-58; Robert K. Rasmussen, *Debtor's Choice: A Menu Approach to Corporate Bankruptcy*, 71 TEX. L. REV. 51, 53 (1992); Alan Schwartz, *A Contract Theory Approach to Business Bankruptcy*, 107 YALE L.J. 1807, 1812 (1998); David A. Skeel, Jr., *Rethinking the Line Between Corporate Law and Corporate Bankruptcy*, 72 TEX. L. REV. 471, 473 n.1 (1994).

261. See Schwartz, *supra* note 260, at 1809.

262. See Rasmussen & Thomas, *supra* note 22, at 283.

263. Rasmussen & Thomas, *supra* note 8, at 1397.

264. See *id.* at 1359 n.7.

265. Baird & Rasmussen, *supra* note 216.

266. Baird & Rasmussen, *supra* note 73, at 921-24.

267. *Id.* at 922.

268. Harold Demsetz, *Toward a Theory of Property Rights*, 57 AM. ECON. REV. 347, 354 (1967) (explaining that common ownership of a resource leads owners to tragically waste the resource even when doing so undermines the collective interests of the common owners).

holdout and free-rider problems.²⁶⁹ While these solutions generally satisfied the parties involved, they raised alarm among the general public over lack of government oversight of large companies in industries vital to the economic lifeblood of the nation.²⁷⁰ 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.²⁷¹ The equity receivership was dead. Contractualists appear to be pressing for a resurrection.

b. Is Actual Jurisdictional Competition in Bankruptcy Desirable?

Whether actual jurisdictional competition in bankruptcy takes the form of equity receiverships or contractual workouts, the question remains whether actual jurisdictional competition in bankruptcy would be desirable. The answer to that question depends, in turn, upon the objectives of a bankruptcy system. If the purpose of a bankruptcy system is to reduce the cost of credit *ex ante*, and if this reduction can be accomplished most efficiently through competition and choice, then perhaps a state-based bankruptcy system that capitalizes on jurisdictional as well as professional competition might advance social welfare beyond the capabilities of the current structure of federal bankruptcy institutions. Some commentators are reluctant to agree that reduction of credit costs is the central function of a bankruptcy system. These commentators, most notably Professors Karen Gross at New York Law School, Elizabeth Warren at Harvard Law School, and Jay Lawrence Westbrook and Theresa Sullivan, both of the University of Texas Law School, believe that one central purpose of a bankruptcy system is to provide a social safety net, helping to ease transitions for workers and communities affected by failed companies, as well as individuals and families caught up in financial misfortune.²⁷² The central concern of the progressive safety-net position is that venue choice is the prerogative of managers,

269. Baird & Rasmussen, *supra* note 73, at 931.

270. See SKEEL, *supra* note 40, at 42-51.

271. *Id.* at 119-27.

272. See KAREN GROSS, FAILURE AND FORGIVENESS 21 (1997); see also THERESA SULLIVAN ET AL., AS WE FORGIVE OUR DEBTORS 4 (1989) [hereinafter AS WE FORGIVE OUR DEBTORS]; THERESA SULLIVAN ET AL., THE FRAGILE MIDDLE CLASS 22 (2000).

creditors, and investors.²⁷³ In the search for bankruptcy efficiencies, workers and communities are voiceless.²⁷⁴

Social safety-net concerns need not undermine state law-based reorganization initiatives, however. States have historically operated as primary providers of social safety nets and currently fulfill that responsibility with welfare systems, consumer-protection laws, and other mechanisms designed to protect and promote the quality of life enjoyed by their residents. In fact, jurisdictional competition in many of these arenas is credited with the spread of socially beneficial legal innovations, including workers' compensation law.²⁷⁵ Jurisdictional competition in the realm of corporate reorganization law and the efficiencies and innovation that it might promote could protect worker and community interests more effectively and efficiently than indirect efforts through federal bankruptcy law.

Professional competition may be stifled, however, in any move toward jurisdictional competition in bankruptcy. This result may be inevitable given the structure of the federal bankruptcy system, with its national uniformity that permits us to witness professional competition. A move toward state-based reorganization might make the actions of judges and other decisionmakers more opaque to observers seeking to make the comparisons that fuel competition between judicial professionals. Selection of the relevant judiciary is also likely to differ from state to state, displacing the current slate of professionals from their insular fourteen-year terms and possibly replacing them with judges elected every two or four years.²⁷⁶ State-based reorganization law raises a type of Heisenberg uncertainty²⁷⁷: Will state-based law introduce jurisdictional competition at the expense of professional competition, competition which may only exist because of the current laboratory in which we observe it? If such a tradeoff does occur, then it may not be worth the effort. We need to

273. AS WE FORGIVE OUR DEBTORS, *supra* note 272, at 21.

274. GROSS, *supra* note 272, at 6.

275. See, e.g., JACK B. HOOD & BENJAMIN A. HARDY, JR., WORKERS' COMPENSATION AND EMPLOYEE PROTECTION LAWS IN A NUTSHELL 823-27 (1984) (stating that Maryland was the first state to pass a workers' compensation act in 1902). *But see* WILLIAM R. SCHNEIDER, THE LAW OF WORKMEN'S COMPENSATION 32 (1932) (explaining that the federal government, which enacted a workers' compensation system in 1908, was the first governmental entity in the United States to do so).

276. States like Illinois, for example, hold retention elections every two years for interim judges appointed by the chief judges of the various state court districts and contested elections for state court judgeships every four years. See ILL. CONST., art. 6, § 12 (1970).

277. The Heisenberg uncertainty principle states that first, any observation necessarily requires intervention into the system being studied, and second, that we can never be certain that the intervention did not change the system in some unknown way. WERNER HEISENBERG, PHYSICS AND PHILOSOPHY: THE REVOLUTION IN MODERN SCIENCE 47-48 (1958).

learn much more about professional competition before we can know whether we would want jurisdictional competition to displace it.

VI. CONCLUSION

Over the last twelve years, large, public corporations have increasingly chosen to file petitions for reorganization in the United States Bankruptcy Court for the District of Delaware. This recent development has fueled a debate regarding forum-shopping in bankruptcy, with the familiar "race to the bottom" and "race to the top" arguments that characterized the corporate charter competition won by Delaware more than eighty years ago. "Delaware Skeptics," on the "race to the bottom" side, ascribe Delaware's leadership in the race for bankruptcy venue to pernicious activities by fee-hungry debtors' counsel and rubber-stamping Delaware bankruptcy judges. "Delaware Enthusiasts," on the other hand, attribute the rise of Delaware as a product of the value-enhancing efficiency of the judges on the Delaware bankruptcy bench.

This Article presents explanations for the Delawarization of corporate bankruptcy, as articulated by over thirty lawyers and more than twenty judges from around the country with various levels of involvement in this development. Lawyers suggested several factors that lead to the choice of Delaware in the bankruptcy venue determination, including predictability, legal precedent, judicial sophistication, geographic convenience, and the realization of attorneys' fees. Judges attributed much of the growth to a perception that judges around the country were less predictable than the Delaware judges. They also attributed choice of Delaware to the willingness of the Delaware judges to entertain an ever-expanding docket, "psychic income" from overseeing important cases, and Delaware judges' widely recognized professionalism and work ethic.

The evidence assembled here suggests that the Delawarization of bankruptcy is a competition between judges and not jurisdictions. This competition is the product of a confluence of several factors, including the professionalization of the federal bankruptcy bench, Delaware's preeminence in the jurisdictional competition for corporate charters, and pressure emanating from Delaware's legal culture. This pressure results in what this Article calls "professional competition," a competition that fails to conform to Tiebout competition in the classic sense, but has consequences for traditional forms of jurisdictional competition.

Professional competition differs from its jurisdictional counterpart in several respects. First, professional competition

depends on personalities rather than institutions. As a result, it is suited for the advancement of personal interests but is a blunt instrument in the pursuit of joint interests. Second, professional competition enjoys a relative freedom from the geographic limitations associated with jurisdictional competition. Third, professional competition, because it is so dependent upon individual professionals, is likely to be more dynamic and less stable than jurisdictional competition. Delaware's eleven-year reign as the king of corporate bankruptcy venue has already begun to wane, unlike its eighty-year dominance of the corporate charter race. Fourth, professional competition results in the provision of private goods, unlike the public goods thought to be generated by jurisdictional competition.

These differences between professional competition and jurisdictional competition are not mere curiosities. Rather, they suggest reforms significantly different than those proposed by Delaware's harshest critics. Instead of the elimination of Delaware bankruptcy venue, the existence of professional competition between bankruptcy judges suggests that bankruptcy judges should be freed from current geographic constraints. It also suggests that professional competition may be a more desirable mechanism for producing the legal innovation once thought to be the exclusive product of jurisdictional competition. Finally, the existence of professional competition raises questions about the compatibility of the two forms of competition. Jurisdictional competition may actually stifle or limit the fruits of professional competition, rather than supplement them. Only further study of professional competition can tell us whether we ought to prefer it to its more familiar jurisdictional rival.

Appendix

Open Letter from Judge Peter J. Walsh to the
Delaware Bankruptcy Bar
UNITED STATES BANKRUPTCY COURT
DISTRICT OF DELAWARE

Judge Peter J. Walsh
824 Market Street
Wilmington, DE 19801
(302) 573-6272

April 2, 1998

RE: First-Day DIP Financing Orders

Dear Delaware Bankruptcy Counsel:

This is a follow-up to our session of March 11, 1998, where, at the prompting of Judge McKelvie, we discussed the need for improving the DIP financing orders being submitted at first-day hearings. At that meeting, I gave a number of examples of provisions in several orders that I thought were either unnecessary, overreaching, or just plain wrong. In an effort to improve the content of first-day DIP financing orders, I volunteered to comment in writing on the forms and to identify a number of terms or provisions in those orders that I believe should be avoided. The following items, in no particular order of priority (except as to the first item), are not intended as immutable rules that I have on the matter, and certainly I have no authority to speak for the other judges on these matters, but I thought if we could shorten and eliminate some of the more objectionable features of proposed first-day DIP financing orders, we could improve the first-day proceeding. Needless to say, however, I think it is not practicable to have a blanket set of prohibitions, given the numerous variations in the lending arrangements and the prepetition relationships between the debtor and the lender(s).

1. Many of the proposed orders are just too verbose and cover unnecessary matters. It is not necessary for the order to recite, even in summary fashion, the major provisions of the loan documents. For

example, the following is a portion of a paragraph included in a recent DIP financing order, which obviously paraphrases what the loan document says on this particular matter: All advances and other extensions of credit and financial accom[m]odations shall be made solely on the terms and conditions of, and pursuant to, the Postpetition Loan Agreement and the other Postpetition Loan Documents, shall be evidenced by the Lenders' books and records, and shall be due and payable as provided in those agreements. The Lenders shall have no commitment to make any advances or other extensions of credit or financial accom[m]odations, and may, at any time, refuse to make advances, extensions of credit, or other financial accom[m]odations and may exercise their rights and remedies pursuant to the Prepetition Loan Agreement, the Postpetition Loan Agreement, and this Order upon an Event of Default as provided in the Postpetition Loan Agreement, including, without limitation, the incurrence by the Debtors of any liabilities above those approved in the "Budget" (as defined herein) appended hereto as Exhibit B. If the DIP financing order authorizes the debtor to enter into the financing pursuant to the loan documents, it is simply not necessary for the order to restate a lot of the major terms of the financing. (Indeed, most of the above-quoted statement states the obvious for the type of loan transaction that we see on the first day.) The motion itself should spell out the terms that are essential to an understanding of the deal: maximum borrowing, interim borrowing limit, borrowing conditions (e.g., percentage of inventory value), interest rate, maturity, events of default, use of funds limitations, collateral, and/or priority, etc.; but I do not see that it is necessary to get into a lot of details on these in the order. Of course, the order should identify those sections of the Bankruptcy Code designed to protect the estate and/or creditors generally that are being limited or abridged in any manner by the terms of the loan documents.

2. Do not incorporate into the order specific sections of the loan documents without a statement of the section's import. In a recent case the proposed order contained a decretal paragraph regarding events of default that specifically referenced about a dozen particular sections of the loan agreement and tied them into the issue covered by the decretal paragraph. It is simply unrealistic to expect that I can fully read and digest all the provisions of the loan documents in the few hours those documents are in my possession leading up to the first-day hearing. Reciting specific ties between the terms of the order and particular terms or provisions of the loan agreement is something that

under most circumstances on the first day I cannot comfortably append my signature to.

3. Given the limited amount of time we have to review the first-day motions prior to the hearing and given the substantial amount of paperwork presented, particularly the DIP financing motion with the loan documents and the related order, it is not realistic to have a provision in the order that recites that the Court has "examined" all the loan documents, or that the Court "approves" all the terms and provisions of the loan documents, or language of similar import. An egregious example in this regard reads: "The provisions of the Postpetition Loan Agreement and other Postpetition Loan Documents are hereby approved and by this reference incorporated herein as a part of this Order." Remember, the Court is authorizing the debtor to borrow money on basic terms that appear reasonable under the expedited circumstances; it is not placing its imprimatur on the multiple terms and conditions of the loan documents.

4. Many of the proposed orders contain lengthy recitations of findings that are preambles to the decretal portion of the order. Given the fact that at most first-day hearings only the debtor is heard, it is somewhat presumptuous, and in many cases unduly aggressive, for counsel to hand up an order that sets forth detailed, and in many cases nonessential, findings by the Court regarding prepetition deals, relationships, and understandings of the parties. Most of these findings are based on lengthy recitations in the motion papers. It seems to me, given the limited nature of the first-day hearing, that most of these "findings" would better be recited under a heading of "stipulations" between the debtor and the lender. Please note, if the stipulation approach is used, do not put further back in the order a decretal statement that says something to the effect that all the terms and provisions of the subject order constitute an order of the Court. By its nature the order will be acknowledging the stipulations, and of course, appropriate court findings will be a part of the order. .

5. The order should not state that parties in interest have been given "sufficient and adequate notice" of the motion. Nine times out of ten this is simply not true. Rule 4001(c)(2) contemplates an expedited hearing with little or no notice (at least not the type of notice that would be sufficient to prepare for an effective participation by third parties). Consequently, the order should simply recite that the hearing is being held pursuant to the authorization of Rule 4001(c)(2) and recite to whom and when the notice was given.

6. Given the limited nature of the hearing on the first day, the findings that are necessary for the § 364(e) protection afforded the lender can appropriately be expressed in language such as: "Based on the record presented to the Court by the Debtor, it appears that . . ."

7. Absent exigent circumstances, neither the loan documents nor the order should give the lender a lien position on avoidance actions.

8. While, in order to give the prepetition/postpetition creditor protection typically demanded, it is appropriate for the debtor to acknowledge the validity, perfection, enforceability, and nonavoidability of the prepetition indebtedness and perhaps waive any lender liability claims, this provision should preferably be in the form of a stipulation and should be limited to the debtor so that it is not binding on the estate, the committee, or a trustee. As discussed below, a time limit with respect to nondebtor challenges to the prepetition secured position may be appropriate.

9. Where a DIP financing facility includes the use of the prepetition creditors' cash collateral, adequate protection in the form of a substitute lien on postpetition collateral is appropriate to the extent there is a diminution in the value of the prepetition collateral, but such a provision should not include language such as the following: "[T]he Debtors' use of cash collateral pursuant to this Order or otherwise is hereby deemed to result in a dollar-for-dollar decrease in the value of the Prepetition Collateral . . ."

10. The debtor's obligation to reimburse the lender for costs and expenses, including attorneys' fees, etc., should be expressed in terms of "reasonable" costs and expenses and such reimbursement obligation should not apply to the lender's defense to challenges by a committee to the lender's prepetition security position.

11. Carveouts for professional fees should not be limited to the debtor's professionals, but should include the professionals employed by any official committee. While the carveout for professionals of any official committee may appropriately exclude work related to the prosecution of an objection to the prepetition secured position of the lender, that exclusion should not encompass any prechallenge investigative work by the professionals.

12. The carveout for committee professionals and the limited period to challenge the lender's prepetition secured position is important. In my view it is the price of admission to the bankruptcy court to obtain the benefits of preserving the assets of the estate, which preservation typically first benefits secured parties.

13. The period of time during which the creditors' committee should have the right to challenge the lenders' prepetition position should generally be at least sixty days from the appointment of the committee. Unless the case is on a fast track, this period should be ninety days.

14. The following provision is patently objectionable: Nothing contained in this Order shall be deemed a finding with respect to adequate protection (as that term is described in Section 361 of the Code) of the interest of the Lenders in the Prepetition Collateral, but shall [sic] the Lenders' and security interests in the Prepetition Collateral require adequate protection, Lenders shall be deemed to have requested and shall be deemed to have been granted such adequate protection as of the Petition Date or such later date when such liens or security interests first were not adequately protected.

15. The following provision is also patently objectionable: Notwithstanding anything to the contrary contained in this Order or in any of the Postpetition Agreements, the commitment of the Lenders to make loans, extend credit, and grant other financial accommodations to the Debtors shall terminate immediately and automatically, without notice of any kind, upon the institution by any person or entity of any action seeking to challenge the validity or priority of (or to subordinate) any of the Lenders' liens or security interests on any of the Prepetition Collateral.

16. I know of no basis for including in a financing order a finding (recently proposed) such as the following: "The Debtor's other secured creditor(s) is/are adequately protected from any adverse consequences which might result from the consummation of the proposed post-petition secured financing between the Debtor and Lender."

17. In reciting the protection afforded the lender by § 364(e), verbose and redundant provisions such as the following are to be avoided. Furthermore, in the following quoted material the underscored language suggests to me that prepetition debt was intended to be afforded the § 364(e) protection. No such effect would be proper. If any or all of the provisions of this Order or the DIP Financing Agreement are hereafter modified, vacated or stayed by subsequent order of this Court or by any other court, such stay, modification, or vacation shall not affect the validity of any debt to Lender that is or was incurred pursuant to this Order or that is or was incurred prior to the effective date of such stay, modification, or vacation, or the validity and enforceability of any lien, security interest or priority authorized or created by this Order or the DIP Financing Agreement and notwithstanding such stay, modification, or

vacation, any obligations of the Debtor pursuant to this Order or the DIP Financing Agreement arising prior to the effective date of such stay, modification or vacation shall be governed in all respects by the original provisions of this Order and the DIP Financing Agreement, and the validity of any such credit extended or lien granted pursuant to this Order and the DIP Financing Agreement is subject to the protections afforded under 11 U.S.C. § 364(e).

18. Provisions that operate expressly or as a practical matter to divest the debtor, or any other party in interest, of any discretion in the formulation of a plan are not viewed with favor. I believe the lender can appropriately protect itself without attempting to dictate what may happen with respect to a plan. For example, the lender can certainly include a loan provision calling for repayment in full on the plan's effective date.

19. I often find that the record established at the hearing, either by affidavit or live testimony, is rather thin relative to the detailed findings that the Court is called upon to make. It is important that the affidavit or the live witness (either by testimony or, if appropriate, by proffer) offered in support of the motion be specific and complete regarding the findings required with respect to § 364(c) and (e) and Rule 4001(c)(2).

20. The lifting of the § 362 automatic stay upon the event of a default should be conditioned upon providing three to five business days' notice to the debtor, the U.S. Trustee and any official committee.

21. The order should be worded in a manner that makes it clear that, whatever the terms of the interim order, the Court is not precluded from entering a final order containing provisions inconsistent with or contrary to any of the terms of the interim order, subject, of course, to the lender's § 364(e) protection with respect to monies advanced during the interim period. Just by way of example, should the Court deem it appropriate, given a strong showing at the first-day hearing, to allow a waiver of § 506(c), if the subsequently appointed committee presents a persuasive argument, the Court should revisit the matter and be guided by what it hears at the final hearing. The items discussed above are not intended to be a complete list of the matters that need to be addressed on the issue of first-day DIP financing orders. For the most part, they are derived from the latest four or five first-day DIP financing orders that I have had before me. If I were to go back over the last few years and review other such orders, I am sure that I could pick out additional provisions that could be considered objectionable. In any event, I hope that this communication will serve to give counsel sufficient incentive to make the proposed DIP financing orders more palatable while at the same

time preserving those elements of the orders that the lending institutions reasonably believe are essential. Perhaps further dialogue on the matter would be appropriate at a gathering similar to that of the March 11 session.

Very truly yours,

Peter J. Walsh

PJW: vw

cc: Chief Judge Joseph J. Farnan, Jr.
Judge Sue L. Robinson
Judge Roderick R. McKelvie
Patricia A. Staiano, United States Trustee