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The Bankruptcy Abuse Prevention and Consumer Protection Act: An Empirical Examination of the Act's Business Bankruptcy Effects

by

Foteini Teloni*

This paper uses a multivariate logistic regression model to examine empirically and quantify for the first time the effect of the Bankruptcy Abuse Prevention and Consumer Protection Act (BAPCPA) on the Chapter 11 landscape. Two samples are tested: a general sample consisting of firms from various corporate sectors, and a sample consisting only of retailers. Both studies show that the 2005 amendments had a statistically significant effect on traditional Chapter 11 practice. In particular, post-BAPCPA we observe a rise in rapid dispositions through the form of a sale of all or substantially all debtor assets. Indeed, in the post-amendments era, debtors are increasingly using § 363 of the Bankruptcy Code to exit Chapter 11 within a few months after filing for bankruptcy. Now debtors do not spend time negotiating with their creditors to write down debt, but instead seek a strategic buyer at the outset of the case, or liquidate in the early stages of the Chapter 11 proceedings. This trend can be attributed to certain 2005 provisions that have the effect of depleting the debtor of the two elements most necessary for a lengthy case: money and time.

INTRODUCTION

The Bankruptcy Abuse Prevention and Consumer Protection Act (BAPCPA),¹ enacted on October 17, 2005, represents one of the most comprehensive reforms of the Bankruptcy Code. Even though it primarily ad-

*S.J.D. Candidate (2014), Fordham University School of Law. This paper was prepared as part of a broader S.J.D. dissertation thesis that examines the changing business bankruptcy landscape. I am grateful to my supervisor, Professor Richard Squire, for invaluable suggestions on earlier drafts of this project. I would also like to thank Professor Sean Griffith, Professor Thomas Lee, and Professor Michael Simkovic for helpful comments and suggestions.

¹Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, Pub. L. No. 109-8, 119 Stat. 23 (2005).

dresses consumer bankruptcy, BAPCPA also enacted or modified several business-bankruptcy provisions that stirred a heated debate regarding their effect on the Chapter 11 landscape and their policy implications. There are two schools of thought: those who maintain that BAPCPA has made bankruptcy more difficult and burdensome for debtors (especially retailers), encouraging fast-track liquidations; and those who argue that the statute simply rationalized an already lengthy and burdensome process.

Scholars and practitioners siding with the first view attribute the enactment of BAPCPA to lobbying by creditors and other special-interest groups. Indeed, the Bankruptcy Code has always been viewed as debtor-friendly, triggering attempts on part of non-debtor constituencies to strengthen their position within the bankruptcy process.² BAPCPA is considered to be a continuation of this lobbying trend, aiming to reduce bankruptcy courts' discretion to meet the needs of rehabilitation and reorganization of a debtor.³ As one commentator notes, BAPCPA might be special interests' biggest victory.⁴ Indeed, at first glance, the 2005 amendments seem to create a "creditor-in-possession" Chapter 11 model, while depleting the debtor even more of cash. This change in dynamics, coinciding with the unfavorable macroeconomic conditions since 2008, has in theory left the debtor with less time and money to reorganize successfully. Within this context, BAPCPA opponents argue that the new and modified provisions of the Bankruptcy Code hurt the debtor's reorganization chances and thus should be repealed. An attempt to this direction was made in 2009 by Representative Jerald Nadler (D-NY), who proposed, unsuccessfully, the "Business Reorganization and Job Preservation Act."⁵

On the other side of the debate, there are scholars and practitioners who maintain that BAPCPA merely rationalized the Chapter 11 process without effectuating any material change in the business bankruptcy landscape. BAPCPA, they argue, was designed to allow only the strongest of companies

²Harvey R. Miller, *Chapter 11—From Boom to Bust and into the Future*, 81 AM. BANKR. L. J. 375, 388 (2007) ("Despite valiant efforts by the reformers, § 1110 of the Bankruptcy Code, carried forward from the former Bankruptcy Act special protections for sellers, financiers and lessors of certain types of equipment relating to aircraft, railroads and vessels. Using that piece of special interest legislation as a foundation, other creditor groups pressed Congress for legislative containment of the bankruptcy court and the debtor-in-possession's powers. Congress has been generous in responding to the 'needs' of these special interest groups.").

³*Id.* at 387. See, e.g., Richard Levin & Alessia Raney-Marinelli, *The Creeping Repeal of Chapter 11: The Significant Business Provisions of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005*, 79 AM. BANKR. L. J. 603 (2005) (additionally attributing the enactment of BAPCPA to Congressional overreaction to the Enron, WorldCom, Adelphia and other scandals); Biana Borukhovich, *BAPCPA: The Nail in the Coffin for Retailers*, Pratt's Journal of Bankruptcy Law, Vol. 6 No. 5 (2010) (discussing the adverse effect that the 2005 amendments had on retailer-debtors' liquidity).

⁴Miller, *supra* note 2, at 388.

⁵H.R. 1942, 111th Cong. (2009).

to survive, producing, therefore, more economically efficient results.⁶ According to this view, the 2005 amendments did not result in more liquidations; instead they merely sped up the dissolution of economically failed companies that would have liquidated regardless.⁷ Furthermore, these creditor-friendly provisions might not have had the intense effect attributed to them since, in practice, it seems that courts have attempted to strike a better balance between creditors' and debtors' interests.

The extent of BAPCPA's actual effect on business bankruptcies remains to be tested. This study is, to my knowledge, the first to attempt to examine empirically and quantify BAPCPA's effects on the business-bankruptcy landscape. Two samples are examined: a general sample consisting of firms from various corporate sectors, with the only exception of finance, insurance, and real estate companies, and a sample consisting only of retailers. Both studies show that the 2005 amendments have had a statistically significant effect on traditional Chapter 11 practice. In particular, post-BAPCPA we observe a rise in rapid dispositions through the form of a pre-plan sale of all or substantially all debtor assets. Debtors are increasingly using § 363 of the Bankruptcy Code to exit Chapter 11 within a few months after filing for bankruptcy. However, contrary to what is widely maintained, BAPCPA did not have a statistically significant effect on the rate of debtor emergences. Therefore, from a normative point of view, repealing the amendments, as BAPCPA's opponents advocate, would not increase the proportion of firms emerging from their Chapter 11 filing.

The article proceeds as follows: Part I discusses the scholarly literature that comments specifically on the 2005 amendments and their potential effect on Chapter 11 bankruptcies. Part II summarizes previous empirical scholarly work that examines and quantifies the relationship between various

⁶See *Circuit City Unplugged: Why did Chapter 11 Fail to Save 34,000 Jobs?*, Hearing Before the Subcommittee on Commercial and Administrative Law of the Committee on the Judiciary House of Representatives, 111 Cong., 1st Session (March 11, 2009) (hereinafter, *Circuit City Unplugged*) (prepared statement of Professor Zywicki). Professor Zywicki argues that "by bringing about a swift and decisive resolution of a failing company's prospects, thereby clearing the field for more vibrant competitors to grow, BAPCPA's impact in many cases is unquestionably productive," while, he continues, "the overarching purpose of chapter 11 reorganization is to distinguish between firms that are economically failed and those that are in financial distress. An economically-failed firm is one that is essentially better-off dead than alive—shut down operations and reallocate the financial, human, and physical capital of the enterprise elsewhere in the economy. A firm in financial distress is one that simply needs to reallocate its capital structure in order to be a prosperous enterprise. Chapter 11 exists to reorganize firms in financial distress but not those that are economically-failed. There is reason to believe that some of the retailers that have liquidated in recent months are economically-failed firms, rather than merely financially-distressed. Hence, efforts to reorganize and save those companies would likely be economically inefficient." *Id.*

⁷See Bruce S. Nathan et al., *BAPCPA Rollback As A Cure For Unsuccessful Reorganizations? Not So Fast!*, Bus. Reorg. Comm. Newsl. (American Bankruptcy Institute, Alexandria, Va.) (March 2010), available at http://www.abiworld.org/committees/newsletters/busreorg/vol9num4/not_so_fast.pdf.

microeconomic and macroeconomic factors and Chapter 11 outcomes. Part III lays out the methodology and results of the study. Part IV contains the conclusions.

I. BAPCPA AND ITS IMPACT ON THE CHAPTER 11 LANDSCAPE

A. PLAN EXCLUSIVITY

One of the main advantages that Chapter 11 offers to distressed firms is that it allows them to remain in control of the case. It is true that the “debtor-in-possession” (DIP) concept has attracted distressed companies to file for reorganization at early sight of their financial troubles by assuring them that they will be largely able to control the process. One of the most important provisions that gives such control to the debtor refers to the debtor’s “exclusivity” right—namely, the fact that it is the only party in interest permitted to file a plan of reorganization within a given period after commencement of the case.⁸

Under Chapter X of the Bankruptcy Act of 1898,⁹ debtors had an unlimited exclusivity right that gave them strong bargaining leverage over their creditors. Naturally, creditors, whose money was in the firm and yet had no say in the formulation of a plan, pushed for changes. The 1978 Bankruptcy Code eased the tension between these two constituencies by enacting § 1121 and, for the first time, placing a time limit on the debtor’s exclusive right to file a plan of reorganization. Legislative history notes that Congress in drafting the Bankruptcy Code took into consideration the importance of the debtor’s remaining in control of the process.¹⁰ At the same time, however, the legislative history acknowledges that:

⁸See, e.g., Yongqing Ren, *Examining the Efficiency of the Exclusivity Period of the Reorganization Law: Is It Better than a Plan- Competition System?*, 20 J. BANKR. L. & PRAC. 3 ART. 7 (2011); Ross L. Weston, *The Exclusivity Period in Section 1121: How Exclusive is it?*, 11 CARDOZO L. REV. 639 (1990); Eric W. Lam, *Of Exclusivity and for Cause: 11 U.S.C. Section 1121(d) Re-examined*, 36 DRAKE L. REV. 533 (1986/1987).

⁹Bankruptcy Act of 1898, Pub. L. No. 696, 30 Stat. 541 (repealed 1978).

¹⁰H.R. Rep. No. 595, 95th Cong., 1st Sess., at 231-232 (“Proposed Chapter 11 recognizes the need for the debtor to remain in control to some degree, or else debtors will avoid the reorganization provisions in the bill until it would be too late for them to be an effective remedy. At the same time, the bill recognizes the legitimate interests of creditors, whose money is in the enterprise as much as the debtor’s, to have a say in the future of the company.”). See also Weston, *supra* note 8, at 651 (“When section 1121 was first proposed in its current form, Congress was aware of the need to lessen the debtor’s bargaining leverage without removing it completely. A balance was necessary to encourage debtors to timely file under Chapter 11 and to grant creditors some control over the proceeding.”); Mark G. Douglas, *Assessing the Impact of New Chapter 11 Exclusivity Deadline* (Jones Day) (January/February 2007) (“Armed with exclusivity throughout the case, a debtor could hold creditors hostage to its own reorganization agenda and threaten to convert to a liquidating case if creditors were reluctant to do so. Lawmakers attempted to remove what was considered undue bargaining leverage when they enacted the Bankruptcy Code.”), available at http://www.jonesday.com/pubs/pubs_detail.aspx?pubID=S3936.

The exclusive right gives the debtor undue bargaining leverage, because by delay he can force a settlement out of otherwise unwilling creditors, and they have little recourse except to move for conversion of the case to chapter X. That is [as] contrary to their interests as it is to the debtor's, and thus is rarely done. The debtor is in full control, often to the unfair disadvantage of creditors.¹¹

BAPCPA left § 1121 largely unchanged, modifying, however, subsection (d)(2). In particular, § 1121(b) provides that the debtor has the exclusive right to file a reorganization plan for 120 days after the filing of the case. If the debtor does not succeed in filing a plan, then any other party in interest can.¹² If, however, the debtor does file a plan, then it is afforded an extra 60 days to solicit acceptances.¹³ Both periods can be reduced or increased by the bankruptcy court for cause.¹⁴ Nevertheless, and contrary to the pre-BAPCPA Code, court-ordered increases may not extend beyond 18 and 20 months, respectively, after commencement of the case.¹⁵ This cap on extensions, added by BAPCPA, is the one that has stirred a heated debate over its potential effects on traditional reorganizations.

Prior to the enactment of the 2005 amendments, courts would routinely grant extensions of the exclusivity period. As a result, the debtor often enjoyed an exclusive right that lasted several years. Undoubtedly, limiting the time that the debtor spends in bankruptcy is in the best interest of all parties involved. However, commentators emphasize the adverse effect the exclusivity cap might have on the plan negotiation process, especially when it comes to large and complex cases.¹⁶ Indeed, firms such as airlines, which often confront multiple unions and other complex issues, may find the new exclusivity period inadequate for the formulation of a viable plan, even if the maximum extension is granted.¹⁷ Additionally, creditors may now have less incentive to cooperate with the debtor. Non-debtor parties could just wait for the exclusivity period to expire in order to present and pursue their own plans, which usually provide for the liquidation of the debtor.¹⁸ Alternatively,

¹¹H.R. Rep. No. 95-595, at 231 (1978).

¹²11 U.S.C. § 1121(c).

¹³11 U.S.C. § 1121(c)(3).

¹⁴11 U.S.C. § 1121(d)(1).

¹⁵11 U.S.C. § 1121(d)(2)(A), (B).

¹⁶See, e.g., Kara J. Bruce, *Rehabilitating Bankruptcy Reform*, 13 NEV. L. J. 174, 202 (2012) (noting that when it comes to exceptionally large debtors that face unique legal issues, the deadline set forth by modified section 1121 might not be enough).

¹⁷Jeffrey M. Schlerf, *BAPCPA's Impact on Exclusivity Is Hard to Gauge* (July, 2007), available at <http://www.turnaround.org/Publications/Articles.aspx?objectID=7797>.

¹⁸*Id.*; see also Ted Janger, *Crystal and Mud in Bankruptcy Law: Judicial Competence and Statutory Design*, 43 ARIZ. L. REV. 559, 621 (2001) ("Where the judge cannot extend the exclusive period beyond a

creditors could use the exclusivity cap as leverage in their negotiations with the distressed company, conditioning exclusivity extensions on certain cooperative steps that should be taken by the debtor.¹⁹

It follows that debtors have lost pursuant to BAPCPA much of the control they previously enjoyed over the Chapter 11 process. This might have created a disincentive for them to pursue a traditional Chapter 11 reorganization. Consequently, a § 363 disposition of all the assets at an early stage of the case could be an appealing alternative.

B. SELLERS OF GOODS

i. § 503(b)(9) Claims: Elevating Pre-Petition Trade Claims

Section 1129(a)(9)(A) of the Bankruptcy Code sets forth an “administrative solvency” test. Pursuant to this test, a reorganization plan can be confirmed only if the debtor can pay, by the plan’s effective date, all administrative expenses in *full* and in *cash*. Prior to the enactment of BAPCPA, the term “administrative expenses” was limited to operational expenses incurred post-petition²⁰ plus expenses associated with the reorganization procedure itself (e.g. professional fees).²¹ However, the 2005 amendments added several new categories of administrative expenses.²² One of these new provisions deals with the treatment of vendors’ pre-petition claims. In particular, § 503(b)(9) of the Bankruptcy Code creates an administrative claim for goods received by the debtor within twenty days prior to the petition date, provided that such goods were sold to the debtor in the ordinary course of business. Before BAPCPA, these pre-petition trade creditors’ claims were treated as general unsecured claims, meaning that they were subject to plan voting and hence could be compromised without the creditor’s consent.²³

Undoubtedly, this new provision confers significant benefits to suppliers of goods.²⁴ Due to their new administrative status, not only will these claims have to be paid in full, but also creditors may demand prompt payment even

certain point, regardless of the reason for the debtor’s failure to confirm a plan (which might just as well be a product of creditor recalcitrance as debtor delay), creditors who oppose the plan are given a strong incentive to hold out until the twenty month period has expired”).

¹⁹Schlerf, *supra* note 17.

²⁰11 U.S.C. § 503 (b)(1).

²¹11 U.S.C. § 503 (b) (2)-(6).

²²11 U.S.C. § 503 (b)(7)-(9).

²³See 11 U.S.C. §§ 1123(a)(1), 1126(c).

²⁴According to Article 2 of the UCC, “goods” are defined as all things moveable at the time of identification to the contract for sale. Courts adopted this definition of “goods”; see, e.g., *In re Goody’s Family Clothing, Inc.*, 401 B.R. 131, 134; *In re Plastech Engineered Prods.*, 397 B.R. 828, 836; *In re Deer*, No. 06-02460, 2008 WL 723982, **1-2 (Bankr. S.D. Miss. June 14, 2007). Therefore, vendors of services or value do not fall under § 503(b)(9).

before the confirmation of the plan.²⁵ The question that begs then is whether and to what extent the debtor is affected. Many scholars and practitioners have maintained that by elevating these previously general unsecured claims to administrative expenses, BAPCPA reduces the debtor's liquidity, thereby reducing its chances for a successful stand-alone reorganization.²⁶ Especially when the debtor is a retailer relying on receiving a high volume of inventory on a consistent basis, this effect can be exacerbated. The main argument is that by adding to the set of administrative expenses, this provision reduces the debtor's flexibility to reorganize. Furthermore, the satisfaction of these pre-petition claims, which in the case of retailers can reach hundreds of millions of dollars, requires the consumption of post-petition resources that could be used instead to pay operating and other expenses that are necessary to preserve the estate and guide the debtor into reorganization. This diversion of post-petition resources in satisfaction of pre-petition claims, in turn, can discourage DIP lenders from lending to finance a traditional reorganization effort.²⁷

As a practical matter, bankruptcy courts might have mitigated the potentially adverse impact of § 503(b)(9) on a debtor's liquidity. Based on their established discretionary authority as to the timing of the payment of all other administrative expenses, they have generally denied allowing immediate payment of § 503(b)(9) claims as well.²⁸ Indeed, the Bankruptcy Code does not explicitly provide for immediate payment of § 503(b)(9) claims. It follows then, courts have held, that such claims will be treated as all other administrative expenses claims,²⁹ and when deciding the timing of such payments, courts will take into consideration: a) prejudice to the debtor, b) hardship to the claimant, and c) potential detriment to other creditors.³⁰

²⁵11 U.S.C. § 503(a).

²⁶See, e.g., Levin & Raney-Marinelli, *supra* note 3, at 605; Michael G. Wilson & Henry P. Long, *Section 503(b)(9)'s Impact: A Proposal to Make Chapter 11 Viable Again for Retail Debtors*, 30 AM. BANKR. INST. J. 20 (Feb. 2011).

²⁷Testimony of Lawrence C. Gottlieb, *The Disappearance of Retail Reorganization in the Post-BAPCPA Era*, House of Representatives Committee on the Judiciary, Subcommittee on Commercial and Administrative Law (Sept. 25, 2008).

²⁸Brendan Gage, *Should Congress Repeal Bankruptcy Code Section 503(b)(9)?*, ABI L. REV., 215, 244 (2011) ("Most courts now apply the Garden Ridge factors to twenty-day claims, with nearly all of them deferring payment.").

²⁹See *In re Bookbinder's Restaurant Inc.*, No. 06-12302ELF, 2006 WL 3858020 (Bankr. E.D. Pa. Dec. 28, 2006) ("The text of § 503(b)(9) neither states nor even implies that allowance of the expense encompasses an unqualified right to immediate payment. Nor does the text of the provision suggest that an administrative expense allowed under § 503(b)(9) is to be treated in a more favorable manner than any other allowed § 503(b) administrative expense."); see also *In re Global Home Products LLC*, No. 06-10340, 2006 WL 3791955 (Bankr. D. Del. Dec. 21, 2006), *3 ("[t]he parties agree that when a claimant timely files a request for payment of an administrative expense under § 503(a), the timing of the payment of that administrative expense claim is left to the discretion of the court").

³⁰See *In re Garden Ridge Corporation*, 323 B.R. 136, 143 (Bankr. D. Del. 2005).

Nevertheless, the question remains whether the new § 503(b)(9) can increase administrative expenses to a degree that could indeed jeopardize the chances for a stand-alone reorganization. According to the following arguments, the answer is no. Instead, what § 503(b)(9) does is create a more predictable system for vendors who, until then, were relying for repayment of their pre-petition claims on securing a spot in the debtor's "critical vendor" list. To be sure, even prior to the enactment of BAPCPA debtors would move, usually in first-day orders, to pay the pre-petition claims of their key trade creditors, namely those that were essential to their continued operations, in exchange for post-petition terms more favorable to the debtor. These payments would naturally come from post-petition resources, leaving fewer assets for post-petition creditors and other operating expenses. Courts would more often than not allow these payments.³¹ Furthermore, over the course of several years, debtors started characterizing an increasing number of vendors as "critical," thereby significantly disturbing the priority scheme laid down by the Bankruptcy Code and adversely affecting the debtor's liquidity.³² For example, in 2004, Kmart sought and obtained approval from the Bankruptcy Court to pay 2,330 out of its 4,000 vendors as "critical." This translated into payment of \$300 million of pre-petition claims, which came from the \$2 billion of DIP financing that Kmart had secured. The remaining, less-lucky vendors received, along with the rest of the unsecured creditors, about 10¢ on the dollar, mostly in stock of the reorganized Kmart. The District Court reversed and the debtor appealed. The Court of Appeals affirmed the District Court's decision that set forth more stringent standards for the granting of "critical vendor" orders.³³ Nevertheless, the Kmart case is indicative of a pathology that had eroded the priority scheme laid down by the Bankruptcy Code in favor of certain general unsecured creditors who had the clout to achieve "critical" status.³⁴ Therefore, proponents of § 503(b)(9) assert that the provision puts a halt to this system that seemingly favored

³¹See Travis N. Turner, *Kmart and Beyond: A "Critical" Look at Critical Vendor Orders*, 63 WASH. & LEE L. REV. 431, 434 (2006). Bankruptcy courts have been granting "critical vendors" orders relying on §105(a) of the Bankruptcy Code stating that "[t]he court may issue any order, process or judgment that is necessary or appropriate to carry out the provisions of this title," and the "doctrine of necessity." *Id.*

³²Robert A. Morris, *The Case Against "Critical Vendor" Motions*, 22 AM. BANKR. INST. J. 30, 30 (Sept. 2003) ("It has become commonplace to seek bankruptcy court approval to pay certain pre-petition unsecured liabilities because of the alleged "critical nature" of certain suppliers, goods and services in order to preserve the going-concern value of the debtor's business. . . . Critical vendor motions are unnecessary in most cases. They also increase the funding requirements of chapter 11 cases and circumvent the absolute priority rule, one of the fundamental tenets of bankruptcy law. "); see also Joseph Gilday, *"Critical" Error: Why Essential Vendor Payments Violate the Bankruptcy Code*, 11 AM. BANKR. INST. L. REV. 411, 414 (2003) ("Without any provision of the Bankruptcy Code expressly authorizing its action, a court may routinely violate one of the Code's basic-canons: thou shall treat all similarly situated creditors equally.").

³³*In re Kmart Corp.*, 359 F.3d 866 (7th Circuit, 2004).

³⁴*Circuit City Unplugged*, *supra* note 6 (testimony of Professor Zywicki).

powerful vendors by clearly setting the rules of the game.³⁵ In any case, § 503(b)(9) does not affect a debtor's liquidity more than the "critical vendors" orders did.

What the proponents of § 503(b)(9) fail to recognize, however, is that the provision does not dispose of the "critical vendors" system. Creditors qualifying for administrative status under § 503(b)(9) can still move for "critical" status as well.³⁶ Not only that, but as one commentator notes, § 503(b)(9) "is now increasingly used as an added justification for granting critical trade vendor motions."³⁷ Indeed, it seems logical that since BAPCPA treats these creditors as administrative claimants who must be paid in full ahead of unsecured creditors, there is no reason the debtor should not be allowed to pay these claimants at the beginning of the case.³⁸ Additionally, pursuant to § 503(b)(9), administrative priority is not limited to critical vendors. Instead, all sellers of goods, whether critical or not, can achieve administrative status provided that they meet the few and straightforward § 503(b)(9) requirements.³⁹

ii. § 546(c): *Expanded Reclamation Claim*

Another important BAPCPA amendment was the expansion of reclamation rights. Reclamation is broadly defined as the right of a seller to "reclaim"—that is, recover possession of goods that were delivered to an insolvent buyer. This right is provided by U.C.C. § 2-702⁴⁰ and, within the bankruptcy context, is protected and limited by 11 U.S.C. § 546(c) as modified by the 2005 amendments.⁴¹

Until the enactment of BAPCPA and § 503(b)(9), reclamation was the

³⁵*Id.*

³⁶*Circuit City Unplugged*, *supra* note 6 (testimony of Richard Pachulski).

³⁷Shirley Cho, *Chapter 11 Bankruptcy After BAPCPA—A Closer Look At: Critical Trade; Exclusivity; and Dismissal/Conversion*, 63 CONSUMER FIN. L. Q. REP. 79, 79 (2009).

³⁸*Id.* at 80 (citing several cases as examples, e.g. *In re Dana Corporation, et al.*, 358 B.R. 567 (Bankr. S.D.N.Y. 2006); *In re Oneida Ltd., et al.*, 400 B.R. 384 (Bankr. S.D.N.Y. 2009)).

³⁹Alan N. Resnick, *The Future of the Doctrine of Necessity and Critical-Vendor Payments in Chapter 11 Cases*, 47 B.C. L. REV. 183, 205 (2005).

⁴⁰U.C.C. § 2-702 provides in pertinent part: "Where the seller discovers that the buyer has received goods on credit while insolvent he may reclaim the goods upon demand made within ten days after the receipt, but if misrepresentation of solvency has been made to the particular seller in writing within three months before delivery the ten-day limitation does not apply. Except as provided in this subsection the seller may not base a right to reclaim goods on the buyer's fraudulent or innocent misrepresentation of solvency or of intent to pay," while successful reclamation of goods excludes all other remedies with respect to them.

⁴¹11 U.S.C. § 546(c), both pre-BAPCPA and post-BAPCPA, does not create a reclamation right. It merely protects and limits the reclamation right provided by U.C.C. § 2-702. It should be noted, however, that the elimination of "statutory or common-law right" from the language of modified § 546(c) has given rise to certain voices maintaining that new § 546(c) creates a federal reclamation right.

sole remedy available to pre-petition sellers of goods.⁴² Under former § 546(c), a seller that had a statutory or common law right to reclaim possession could exercise such right for goods delivered to an insolvent buyer in the ordinary course of business within ten days before the bankruptcy filing, provided that certain other procedural requirements were met.⁴³ Bankruptcy courts had discretion to deny reclamation by granting the sellers, in lieu of such right, either an administrative expense claim or a secured lien.⁴⁴ Reclamation rights were subject, however, to previous secured interests in the inventory. Indeed, courts would recognize the superiority of a previous lien on the reclaimed goods by relying on the “good faith purchaser” clause of U.C.C. § 2-702(3) and would deny sellers actual repossession.⁴⁵ In that case, the value of the reclamation claim would be determined by the value of the collateral that was under the floating lien. It follows that if an undersecured creditor foreclosed on the reclaimed goods and used the entire proceeds to satisfy its secured debt, the reclaiming seller’s claim would be rendered worthless.⁴⁶

BAPCPA amended this provision in several ways. Under new § 546(c), courts can no longer grant substitute remedies, while it is now explicitly codified that reclamation rights are subject to “the prior rights of a holder of a security interest in such goods or the proceeds thereof.”⁴⁷ Most importantly, BAPCPA expanded the reclamation reach-back period. Namely, under the amended § 546(c), a seller may establish a reclamation claim for goods deliv-

⁴²Hon. Cecilia G. Morris, *Reclamation Rights After BAPCPA: 11 U.S.C. §§ 546(a) and 503(b)(9)*, Unsecured Trade Creditors’ Committee Newsl., ABI (July 25-28, 2007).

⁴³Prior to BAPCPA, § 546(c) had merely incorporated the U.C.C. 10-day period and provided as follows: “The rights and powers of a trustee under sections 544(a), 545, 547, and 549 of this title are subject to any statutory or common-law right of a seller of goods that has sold goods to the debtor, in the ordinary course of such seller’s business, to reclaim such goods if the debtor has received such goods while insolvent, but (1) such a seller may not reclaim any such goods unless such seller demands in writing reclamation of such goods, (A) before 10 days after receipt of such goods by the debtor; or (B) if such 10-day period expires after the commencement of the case, before 20 days after receipt of such goods by the debtor; and (2) the court may deny reclamation to a seller with such a right of reclamation that has made such a demand only if the court, (A) grants the claim of such a seller priority as a claim of a kind specified in section 503(b) of this title; or (B) secures such claim by a lien.”

⁴⁴11 U.S.C. § 546(c) (prior to BAPCPA).

⁴⁵See, e.g., *Lavonia Manufacturing Co. v. Emery Corp.*, 52 B.R. 944, 946 (E.D. Pa. 1985); *In re Diversified Food Services Distributors, Inc.*, 130 B.R. 427, 429-30 (Bankr. S.D.N.Y. 1991); *In re MacMillan Petroleum (Arkansas), Inc.*, 115 B.R. 175, 179 (Bankr. W.D. Ark. 1990).

⁴⁶Lisa S. Gretchko, *The Bankruptcy Reform Act One Year Later: A Disappointment for Trade Creditors*, 26 AM. BANKR. INST. J. 18, 18 (Feb. 2007). See, e.g., *In re Leeds Building Products, Inc.*, 141 B.R. 265, 269; *Pester Refining Co. v. Ethyl Corp. (In re Pester Refining Company)*, 964 F.2d 842, 847.

⁴⁷11 U.S.C. § 546(c)(1); of course, the subordination of the reclamation right to previous perfected secured interests in the inventory decreases the importance of this remedy to prepetition sellers. See, e.g., Brett Berlin et al., *Business Bankruptcy Panel, Hot Topics in Retail Bankruptcy*, 25 EMORY BANKR. DEV. J. 343, 368 (“... reclamation rights are subject to the rights of a lender that’s got a lien on inventory, and if that lender is not oversecured in inventory, then your reclamation claim may be valueless.”).

ered to an insolvent buyer within forty-five days before the date of the bankruptcy filing as opposed to ten under the old regime.⁴⁸

The expansion of the reach-back reclamation period naturally means that more goods will be subject to that right compared to the pre-BAPCPA period. Even though the significance of this modification is watered down by the enactment of § 503(b)(9)—since now § 546(c) will mainly benefit the sellers of goods delivered between twenty-one and forty-five days before commencement of the case—these two provisions combined could cause a debtor to reach an administrative insolvency state at an early stage of the case.⁴⁹ Additionally, by eliminating substitute remedies, the debtor might be increasingly deprived of goods that would most likely be essential to its continuing operations.

iii. *Utility Services: § 366 Amended*

Within the same context of elevating the rights of specific creditors, BAPCPA amended § 366 of the Bankruptcy Code, which deals with the post-petition relationship between the debtor and utilities. In general, § 366, former and modified, balances the interests of the debtor against those of the utility companies.⁵⁰ On the one hand, it ensures that a debtor is not deprived of vital utility services during its post-bankruptcy proceedings. At the same time, however, it protects utility companies from involuntarily financing the distressed debtor.

Former § 366(a) of the Bankruptcy Code imposed an automatic injunction on utilities. In particular, utilities were not allowed to “alter, refuse, or discontinue service to, or discriminate against . . . the debtor solely on the basis of the commencement of [a bankruptcy proceeding] . . . or that a debt owed by the debtor to such utility for service rendered before the order for relief was not paid when due.” Subsection (b) limited that automatic injunction by setting a twenty-day threshold. Namely, a utility would have the right to alter, refuse, or discontinue service if neither the trustee nor the

⁴⁸Under new § 546(c), “. . . a seller of goods that has sold goods to the debtor, in the ordinary course of such seller’s business, [has the right] to reclaim such goods if the debtor has received such goods while insolvent, within 45 days before the date of the commencement of a case under this title, . . .”

⁴⁹*In re Dana Corporation*, 367 B.R. 409, 415 n.5 (further citing to Charles J. Shaw & Brent Weisenberg, *Effect of a Preexisting Security Interest in the Debtor’s Inventory on the Rights of Reclamation Creditors*, 2005 Norton Ann. Surv. of Bankr. Law Part I § 15 (Sept. 2006)).

⁵⁰The Bankruptcy Code does not define the term “utility.” However, according to the legislative history, “. . . utilities have some special position with respect to the debtor, such as an electric company, a gas supplier, or telephone company that is a monopoly in the area so that the debtor cannot easily obtain comparable service from another utility.” H.R.Rep. No. 95-595, 95th Cong. 1st Sess. 350 (1977). Bankruptcy courts have been attempting ever since to define the term “utilities” relying on that legislative history. See, e.g., *In re Moorefield*, 218 B.R. 795 (the court found that a cable television did not have monopoly as a service provider); *In re Good Time Charlie’s Ltd.*, 25 B.R. 226, 227 (“In the first place, we note that Congress chose to use the term “utility” rather than “public utility” in § 366, thereby indicating to us that an entity other than a public utility could be considered a utility for purposes of § 366.”).

debtor furnished within twenty days *adequate assurance* of payment, in the form of a deposit or other security, for service after such date.⁵¹

In practice, the debtor would file a first-day motion asking the bankruptcy court to determine what would constitute adequate assurance payment in order for utilities to continue providing their services to the distressed debtor during the Chapter 11 case. The assurances offered would usually be non-monetary, such as administrative priority and existence of prepetition deposits.⁵² The debtor could also “use” to its benefit its consistent and timely prepetition payment history.⁵³ The logic behind that was that if the debtor was making all payments in a timely manner pre-petition, there was no reason why it would not continue doing so post-petition.⁵⁴ Further, if the utility companies were not satisfied with the assurance payment, they could seek to modify it.

BAPCPA seems largely to tip the balance in favor of utilities by completely altering the pre-BAPCPA status quo. Subsections (a) and (b) were kept intact, but a new subsection (c) was added. This new subsection, applying only to Chapter 11 cases, seems to increase the bargaining power of utilities at the expense of the debtor’s reorganization efforts.⁵⁵ In particular, it is expressly defined for the first time in the Bankruptcy Code what constitutes an “assurance payment.” Contrary to the established pre-BAPCPA practice, this definition is limited only to “cash-type” assurances,⁵⁶ unless the parties agree otherwise, and unequivocally excludes administrative expense priority.⁵⁷ At the same time, subsection (c)(3)(A) provides that in determining whether an assurance of payment is adequate, the court may not take into consideration arguments that were traditionally part of a debtor’s relevant motion in the pre-BAPCPA period. In particular, the court may no longer consider—

- (i) the absence of security before the date of the filing of the petition;

⁵¹11 U.S.C. § 366(b) (prior to BAPCPA).

⁵²Jeremy W. Ryan, *Post-BAPCPA Approaches to § 366 Adequate Assurance Motions*, ABI Telecommunications and Technology Committee Newsletter, Volume 4 Number 4/December 2007.

⁵³*Id.*

⁵⁴Kenneth M. Miskin & Sarah B. Boehm, *Utilities after BAPCPA: What’s Changed?*, 26 AM. BANKR. INST. J. 36, 36 (Mar. 2007).

⁵⁵See *id.* (stating that: “It could be safely assumed that utility providers were jumping for joy with the enactment of § 366(c) of the Bankruptcy Code, which easily could be read to put utility providers in the driver’s seat when negotiating and determining adequate assurance of future payment.”).

⁵⁶Indeed, under new § 366(c)(1)(A), “assurance of payment” can only be: a cash deposit, a letter of credit, a certificate of deposit, a surety bond, a prepayment of utility consumption, or another form of security that is mutually agreed on between the utility and the debtor or the trustee. 11 U.S.C. § 366. See Peter S. Fishman, *Not So Fast: Asset Sales under the New § 363*, 24 AM. BANKR. INST. J. 12, 81 (Sept. 2005) (“essentially all ‘cashless’ forms of adequate assurance of post-petition utility payments have been eliminated.”).

⁵⁷§ 366 (c)(1)(B).

(ii) the payment by the debtor of charges for utility service in a timely manner before the date of the filing of the petition; or

(iii) the availability of an administrative expense priority.⁵⁸

Subsection (c) goes further to provide that utilities may now “alter, refuse or discontinue service, if during the 30-day period beginning on the date of the filing of the petition, the utility does not receive from the debtor . . . adequate assurance payment for utility service that is *satisfactory to the utility*.”⁵⁹ At first glance, it seems that utilities’ bargaining power is enhanced. In the negotiations with the debtor, it is the utility that will determine the amount of assurance payment that is deemed satisfactory.⁶⁰ But does that, also, mean that the debtor can now seek modification only after it has complied with the utility’s demands? This would imply that the debtor would have to provide utilities with whatever amount they would request at the outset of the case, thus diverting valuable reorganization resources in order to ensure the uninterrupted continuation of their services. This provision’s interpretation has been the central issue of many post-BAPCPA holdings, with the bankruptcy court in *In re Lucre*⁶¹ answering affirmatively. There the bankruptcy court stated that in light of this new subsection the debtor in possession “has no recourse to modify the adequate assurance payment the utility is demanding until the . . . debtor in possession actually accepts what the utility proposes,”⁶² thereby declaring the end of traditional assurance-payment first-day motions.⁶³ This holding was highly criticized by the vast majority of bankruptcy courts for thwarting the debtor’s reorganization efforts. As a result, courts deviated from the *Lucre* decision in an attempt to preserve the pre-BAPCPA balance. For example, the bankruptcy court in *In re Circuit*, one of the biggest Chapter 11 liquidations of the last years, held that such an interpretation of § 366 could have dire consequences for the debtor and that “Congress could not have intended to place in peril the entire reorganization process.”⁶⁴ The same court underlined the danger of utility

⁵⁸§ 366(c)(3)(A).

⁵⁹11 U.S.C. § 366(c)(2) (emphasis added).

⁶⁰See, e.g., Bertrand Pan & Jennifer Taylor, *Sustaining Power: Applying 11 U.S.C. § 366 in Chapter 11 Post-BAPCPA*, 22 EMORY BANKR. DEV. J. 371, 372 (commenting on this provision and stating that: “[t]his provision appears to vest the utility provider with total discretion, effectively permitting the utility to terminate the debtor’s service—and rehabilitation effort—at its will. Such a result is entirely at odds with the original purpose of §366”). See also William P. Weintraub, *The Conundrum of New Bankruptcy Code Section 366: To “b” or Not to “b,” That Is the Question, or By the “c,” by the “c,” by the Beautiful “c”*, 16 J. BANKR. L. & PRAC. 1 Art. 1 (2007).

⁶¹333 B.R. 151 (Bankr. W.D. Mich. 2005).

⁶²*Id.* at 154.

⁶³Misken & Boehm, *supra* note 54, at 36.

⁶⁴*In re Circuit City Stores, Inc.*, No. 08-35653, 2009 WL 484553, *2 (Bankr. E.D. Va. Jan. 14, 2009) (characterizing also “[s]uch an interpretation of §366 [as] simply unworkable” that “could lead to absurd results”).

companies' relying on the *Lucre* interpretation of § 366 in order to exert undue pressure on the debtor by making a demand only at the end of the 30-day period and, thus, compelling it to either pay immediately what is demanded, or face the prospect of trying to reorganize without utility services.⁶⁵ Indeed, interpreting modified § 366 according to *Lucre*, debtors would be at the disadvantageous bargaining position to negotiate with maybe hundreds of utilities at the outset of the case, when there is neither time nor cash.⁶⁶

Even though the bankruptcy courts' holdings have probably curtailed the potential adverse impact of § 366 by at least allowing the debtors to seek modification of the assurance payment before having to comply with the utilities' demands, the fact remains that debtors are now obliged to offer assurances in the form of cash or cash equivalents.⁶⁷ When the debtor has to deal with many utility companies, which is usually the case with retailers, the effects can be particularly adverse. What we see then is the oxymoronic phenomenon of a company depleted of cash that has yet to post cash deposits all around the country using the scarce resources that would otherwise be valuable to its reorganization efforts. Combined with the credit crunch companies were faced with during the 2008 recession, and could face again in the future, it is obvious that constraints like this in the debtor's liquidity could prove fatal to its reorganization efforts.

iv. *Landlords: Treatment of Commercial Leases (§ 365)*

Another important change effectuated by BAPCPA relates to the treatment of unexpired non-residential leases in which the debtor is the lessee and, in particular, the conditions under which the debtor may assume, reject, or assign them. Commentators link the treatment of commercial leases post-petition to the debtor's ability to reorganize. They argue that, especially in the case of national chain retailers that operate throughout the country a large number of stores, the debtor's strategic decisions in this matter could

⁶⁵*Id.* at *4. See also *id.* at *5 ("Without such Procedures, the Debtors could be forced to address numerous requests by utility companies in an unorganized manner at a critical period in their efforts to reorganize."). See also *In re Great Atlantic and Pacific Tea Co., Inc.*, No. 11-CV-1338, 2011 WL 5546954 (S.D.N.Y. Nov. 14, 2011), *4 (the district court judge held that the bankruptcy court did not err in its reading of § 366 and agreed that interpreting § 366 in light of the *Lucre* decision "would either potentially place a debtor in a position where it would lose the Section 366 protections based on a utility provider's action or inaction, or it would hamstring the authority of the courts to set the amount of adequate assurance in the event that the parties could not reach an agreement on the matter").

⁶⁶Gerald H. Gline & Grant L. Cartwright, *Section 366 (c) Does Not Require DIPs to Satisfy Adequate Assurance Demands of Utilities*, 31 AM. BANKR. INST. J. 1, 69 (Feb. 2012).

⁶⁷Geida D. Sanlate, *Tilting the Scale in Favor of Debtors in Light of BAPCPA's Amendment of Section 366*, 4 RUTGERS BUS. L. J. 42, 61 (2007) ("Indeed, BAPCPA's amendment enacting section 366 (c) adversely affects Chapter 11 debtors' ability to reorganize. In effect, the amended section 366 substantially strengthens the ability of utility companies to demand cash deposits as adequate assurance of payment, or in the alternative to more easily terminate service to the debtor.").

prove crucial to the success of its reorganization efforts.⁶⁸

Former § 365(d)(4) provided that in order for the bankruptcy court to grant extensions on top of the baseline period there had to be cause shown. However, courts used to routinely grant extensions that too often allowed debtors an indefinite period to decide whether they would assume or reject their unexpired leases.⁶⁹ The upside for the pre-BAPCPA debtor was that it was afforded ample time to make an intelligent decision about which leases to assume or reject based on which leases would enhance its profits and which would only burden it with unnecessary costs.

However, the interests of the debtor are not the only ones at stake. Landlords were being held hostage, usually for several years, until they learned whether their leases would be assumed or rejected. This waiting period created “ghost-stores” that could, in turn, take down with them the host shopping malls and deprive other financially sound retailers of valuable locations.⁷⁰ Naturally, landlords have always been lobbying for greater protection. This attempt has been brought to fruition twice, the first being in 1984 with the so-called “Shopping Center Amendments.”⁷¹ It was then that Congress set for the first time a sixty-day limitation from the filing of the case for the debtor to assume or reject an unexpired lease and, additionally, gave the landlords’ claims administrative priority status regardless of whether the non-residential lease provided a benefit to the estate.⁷² However, landlords’

⁶⁸See, e.g., Gregory G. Hesse, *Issues in Commercial Leasing*, 3 J. BANKR. L. & PRAC. 189, 189 (“the ability to reorganize may be closely linked with the trustee’s ability to minimize his lease expenses both during the course of the bankruptcy proceeding and after confirmation.”); Jo Ann Brighton et al., *For Better Or Worse: Chapter 11 In The Post-BAPCPA Downturn* (First Panel in the Symposium: Into the Sunset: Bankruptcy as Scriptwriter of the Dénouement of Financial Distress), 7 DEPAUL BUS. & COM. L. J. 555, 562 (2009) (“And I use Circuit City as an example because Circuit City’s unheard of in the sense that because of these deadlines, they started a liquidation sale even before the Christmas season and normally when you’re representing retailers, you always have that one more Christmas season that you want to get through because everybody always thinks that’s going to be the season.”).

⁶⁹See *In re Wedtech Corp.*, 72 B.R. 464, 471-472 (Bankr. S.D.N.Y. 1987) (citing different cases when referring to the criteria used to examine whether an extension should be granted, noting in particular the following criteria used pre-BAPCPA: “(i) the lease is a primary asset and the ‘decision to assume or reject the lease would be central to any plan of reorganization’ in the Chapter 11 proceeding . . . ; (ii) the landlord has a reversionary interest in a building built by the tenant on the landlord’s land and the gaining of the building would represent a windfall to the landlord . . . ; (iii) the debtor has not had the time necessary to intelligently ‘ . . . appraise its financial situation and the potential value of its assets in terms of the formulation of a plan . . . ’ . . . ; and (iv) the existence of any other facts indicating the lack of a ‘reasonable time to decide whether to assume or reject’”) (internal citations omitted).

⁷⁰See *Circuit City Unplugged*, *supra* note 6 (opening statements of the Hon. Trent Franks).

⁷¹Section 365 was amended as part of the Bankruptcy Amendments and Federal Judgeship Act of 1984.

⁷²Up to then, the landlord would be afforded administrative priority only if the trustee actually occupied the premises and was deriving a benefit from them. See, e.g., *In re Bain, Inc.*, 554 F.2d 255, 256 (5th Cir. 1977); *In re Joseph C. Spiess Co.*, 145 B.R. 597, 607 (Bankr. N.D. Ill. 1992).

lobbying continued after that. The result of their intensive effort was the amendment of § 365 pursuant to BAPCPA in 2005.

New § 365(d)(4) extends the assumption/rejection period to 120 days and provides for an initial ninety-day extension.⁷³ Any other extension requires the written consent of the lessor.⁷⁴ This provision significantly enhances the landlords' position as it gives them a veto right over the debtor's extension requests beyond the 210-day period. New § 365(d)(4) stands in stark contrast with standard practice under the old regime where the courts would routinely grant extensions for the assumption or rejection of leases without having to obtain the landlords' consent. Indeed, according to the legislative history, § 365 was amended in order to "remove the bankruptcy judge's discretion to grant extensions of the time for the retail debtor to decide whether to assume or reject a lease after a maximum possible period of 210 days . . . " beyond which "the judge has no authority to grant further time unless the lessor has agreed in writing to the extension."⁷⁵

However, one cannot ignore that this shortened time-window can push debtors to reach hasty and inefficient decisions, especially when they have to decide for thousands of stores that they may be operating across the country. This danger was stressed in the testimony of Isaac Pachulski, representing the National Bankruptcy Conference, before the Subcommittee on Commercial and Administrative Law on the issue of Circuit City Chapter 11 liquidation. In this testimony he underlined the fact that the debtor will most likely not be able to make an informed decision location by location within the new time limits set by BAPCPA. Indeed, he notes, if a retailer debtor files a Chapter 11 case, for example, before the end of May, "it will have to decide whether to assume or reject its leases before it even knows the results of the holiday season, before it has any realistic opportunity to determine whether particular locations work or don't work."⁷⁶

It should be noted, however, that Congress has attempted to strike a balance by capping the amount owed to the landlord if a lease is assumed and subsequently rejected. Prior to BAPCPA, landlords were entitled to an administrative claim in the amount of the rent owed for the balance of the term. This created a burdensome administrative expense that deprived debtors of funds vital to their reorganization efforts or funds that could be distributed to

⁷³11 U.S.C. § 365(d)(4)(A), (B) (i).

⁷⁴11 U.S.C. § 365 (d)(4)(B)(ii).

⁷⁵H.R. Rep. No. 109-31, pt. 1, at 86-87, reprinted in 2005 U.S. Code Cong. & Admin. News 152-153.

⁷⁶*Circuit City Unplugged*, *supra* note 6 (testimony of Isaac Pachulski) (Pachulski continues arguing that the 210-day cap period "creates an impetus for secured lenders to push for liquidation. Because if you are a lender with a lien on inventory, you know that if the inventory is not liquidated in place, if you have to move it and sell it at a warehouse, you will get substantially less. So what you have in the back of your mind is: You have got a 210-day limit. And if the liquidation is going to occur, it better occur before then.").

their unsecured creditors.⁷⁷ Post-BAPCPA, landlords are limited to an administrative claim for “a sum equal to all monetary obligations due, . . . , for the period of 2 years following the later of the rejection date or date of actual turnover of the premises”⁷⁸ However, it is doubtful that this favorable provision will have any positive effect in practice. Premature assumptions of leases can lead to an increasing number of subsequent rejections compared to the pre-BAPCPA period, thus raising the administrative claims amount to pre-BAPCPA limits. Coupled with § 503(b)(9), which (as noted above) adds to administrative expenses certain claims of sellers of goods, it does not seem likely that the landlords’ administrative expense limitation will contribute substantively to the debtor’s liquidity.

Additionally, new § 365 reduces cash infusions to the debtor by altering the landscape in the “designation rights industry,” which is where the debtor can sell its right to assign a lease. In particular, the buyer of the assignment right will be empowered to direct the debtor to assume and assign the lease to a third party that the buyer will have located.⁷⁹ It follows, then, that three are the main parties involved in such sales: the *buyer* of the assignment right, the *assignee* to whom the lease will be typically assigned for a year,⁸⁰ and of course the *debtor-seller* of the right.⁸¹ This industry was created by the option that the Bankruptcy Code gives debtors to override anti-assignment clauses in lease contracts.⁸² As the bankruptcy court stated in *In re Ames Dept. Store, Inc.*, § 365(f) “performs an important function for maximizing the value in an estate of creditors.”⁸³ “It protects,” the court continues, “the body of creditors as a whole from provisions, typically in leases, that

⁷⁷Steven E. Ostrow, *What you Need to Know about the Treatment of Commercial Leases under the Bankruptcy Reform Act*, 22 No. 1 Prac. Real Est. Law 27 (2006).

⁷⁸11 U.S.C. § 503(b)(7).

⁷⁹See Susan G. Talley & Harris Ominsky, *Assignments of Retail Leases in Bankruptcy, Part 2—On the Right Track?*, 19 APR PROB. & PROP. 42 (2005).

⁸⁰James S. Carr And Robert L. Lehane, *Gaining Ground: The Landlord Perspective On Retail Bankruptcy Cases In The Wake Of The 2005 Bankruptcy Code Amendments*, Practising Law Institute, Real Estate Law and Practice Court Handbook Series, PLI Order No. 8781, 965, 976-978 (October-December 2006). See also *In re Ames Dept. Stores, Inc.*, 287 B.R. 112, 114 n.2 (Bankr. S.D.N.Y. 2002) (where the court briefly describes the way the designation rights industry operates).

⁸¹It should be noted however that post-BAPCPA a fourth constituent, that of landlords is added. Indeed, usually, designation-rights sales cannot be completed within the seven-month period set forth by new § 365. Since securing another extension requires the landlord’s written consent, it follows that the latter has to be included in the negotiations. See Robert N. H. Christmas, *Designation Rights—A New Post-BAPCPA World*, American Bankruptcy Institute (February 1, 2006) (“the era of retail debtors’ use of unilateral omnibus motions to assume and assign leases . . . , seeking to “steamroller” undesirable lease provisions and landlord opposition, is a thing of the past.”), available at <http://www.abiworld.org/AM/Template.cfm?Section=Home&CONTENTID=42452&TEMPLATE=/CM/ContentDisplay.cfm>.

⁸²11 U.S.C. §365(f)(1) (“notwithstanding a provision in an executory contract or unexpired lease of the debtor, or in applicable law, that prohibits, restricts, or conditions the assignment of such contract or lease, the trustee may assign such contract or lease under paragraph (2) of this subsection.”).

⁸³316 B.R. 772, 795 (Bankr. S.D.N.Y. 2004).

frustrate the estate's ability to convert the economic value in leases into cash that can increase creditor recoveries."⁸⁴

The debtor's right to sell these lease-assignment rights is mainly premised on § 363(b)(1) of the Bankruptcy Code, under which "[t]he trustee, after notice and a hearing, may use, sell, or lease, other than in the ordinary course of business, property of the estate . . ." Distressed firms can sell their right to designate a proposed assignee, achieving a twofold benefit: shifting the carrying costs of the lease to the buyer while obtaining immediate liquidity. The 210-day cap, however, makes the purchase of such rights less appealing to the buyer who now, in order to make a profit, must quickly market the lease and find an assignee. Indeed, a designation-rights sale will usually not be completed during the debtor's seven-month period to assume or reject the lease. It follows that fewer buyers will be willing to purchase such rights since their chance for profit is largely decreased. As a consequence, it is likely that lease-assignment rights will be sold more cheaply now compared to the pre-BAPCPA period, depressing both the debtor's liquidity and creditors' recoveries.⁸⁵

v. *Making Conversions and Dismissals Easier for Creditors to Win*
(§ 1112)

Finally, the 2005 amendments have made it easier for creditors to achieve conversion or dismissal of the Chapter 11 case. In particular, prior to 2005, § 1121 of the Bankruptcy Code provided that if certain criteria were met, the bankruptcy court had *discretionary* authority to convert or dismiss a Chapter 11 case. The 2005 amendments modified § 1112 by greatly limiting this discretion of the court.⁸⁶ In particular, under the modified § 1112, "on request of a party in interest, and after a notice and a hearing, the court *shall* convert . . . or dismiss . . . , for cause . . ." ⁸⁷ unless "the court finds and specifically identifies unusual circumstances establishing that converting or dismissing the case is not in the best interests of the creditor and the es-

⁸⁴*Id.*

⁸⁵See Pamela Holleman, *Statutory Construction under BAPCPA*, American Bankruptcy Institute, 13th Annual Northeast Bankruptcy Conference, 15-16 n.46 (July 2006), available at <http://www.sandw.com/assets/htmldocuments/Statutory%20Construction%20under%20BAPCPA%20b0544174.pdf> (citing to Rafael Klotz, *BAPCPA's Impact on 363 Sales under the Bankruptcy Code*, Bankruptcy Court Practice 2006 16th Annual Bench Meets Bar Conference, Boston Bar Association (May 17, 2006)). But see *In re Eastman Kodak Company*, 495 B.R. 618 (Bankr. S.D.N.Y. 2013) (Judge Gropper decided in a case of first impression that assignment of a lease can occur outside the deadline for assumption set forth by § 365(d)(4) of the Bankruptcy Code. Undoubtedly, this decision affords debtor with greater flexibility.).

⁸⁶See, e.g., Cho, *supra* note 37, at 81; Nichole Wong, *Chapter 11 Bankruptcy Under The Bankruptcy Abuse Prevention and Consumer Protection Act: The Need For Big Brother*, 29 WHITTIER L. REV. 237, 266 (2007).

⁸⁷11 U.S.C. § 1121 (b)(1) (emphasis added).

tate.”⁸⁸ As a result, creditors can now exert more pressure on the debtor by threatening to make a motion to convert or dismiss the Chapter 11 case.

II. LITERATURE REVIEW

The past few years have seen an increase in empirical studies of business bankruptcies within the Chapter 11 forum. Several scholarly articles have attempted to establish and quantify causal relationships between various microeconomic and macroeconomic factors and Chapter 11 outcomes. However, until now there has been no empirical study taking into consideration the effect that the 2005 amendments might have had on the Chapter 11 landscape.

Dahiya et al. examine the effect that DIP financing has on the bankruptcy process.⁸⁹ Testing a sample of 548 firms that filed for Chapter 11 between January 1988 and December 1997,⁹⁰ they find that DIP financing leads to positive net present value projects that increase the likelihood of a successful reorganization. The theoretical argument behind this is that DIP lenders perform both a screening and monitoring role that allows them to identify which of the distressed firms are more likely to emerge quickly, and in fact help these firms emerge quickly. The results of the study indicate that DIP financing is also associated with reduced time in bankruptcy, especially when the DIP financier is a pre-existing lender.

Similarly, Carapeto examined a sample of large U.S. firms that filed for Chapter 11 bankruptcy between 1986 and 1997.⁹¹ The sample is further divided into firms that did and did not obtain DIP financing. The results of her study suggest, among other things, that DIP financing is associated with a greater likelihood of a successful reorganization.⁹²

Abraham and Habbu study how the tightening of DIP financing in the post-recession era has affected bankruptcy outcomes.⁹³ Marking as the starting point of the financial recession the Lehman Brothers' bankruptcy, they compare pre-crisis and post-crisis datasets consisting of firms with at least \$100 million in debt that were able to secure post-petition financing.⁹⁴ The study indicates that post-crisis firms obtained DIP financing with higher interest rates. At the same time there was a statistically significant increase in

⁸⁸11 U.S.C. § 1121 (b)(2).

⁸⁹Sandeep Dahiya et al., *Debtor-in-Possession Financing and Bankruptcy Resolution: Empirical Evidence*, *Journal of Financial Economics* 69.1 (2003): 259-80.

⁹⁰Financial services firms were excluded as well as six Chapter 11 cases that involved tort claimants.

⁹¹Maria Carapeto, *Does Debtor-In-Possession Financing Add Value?* (October 6, 2003) (unpublished working paper, City University London).

⁹²*Id.* at 21.

⁹³Nikhil Abraham & Aditya Habbu, *DIP Lending and the Death of Emergence: Reorganization Outcomes Post-Crisis*, *International Corporate Rescue*, Vol. 8, Issue 4 (2011).

⁹⁴*Id.*

the number of sales as well as in private-equity fund involvement in the DIP process. Based on these findings, the authors argue that DIP loans have stopped serving their traditional goal of allowing a firm to emerge from bankruptcy, and instead are used as a path to sale.

Finally, Ayotte and Morrison examined the effect of creditor control and conflict on Chapter 11 outcomes by examining a sample of 153 large Chapter 11 cases filed in the latter half of 2001.⁹⁵ They found evidence that creditors rather than debtors are in control of the Chapter 11 case, and they identify a new conflict that can distort the reorganization process: conflict between senior and junior classes of debt. The results of their study indicate a statistically significant, non-monotonic relationship between the ratio of secured debt-to-assets and the bankruptcy outcome. In particular, the data show that a pre-plan sale is more likely when creditors are over-secured, and correspondingly less likely among firms with under-secured lenders. Reorganization is also more likely in cases where there is no secured debt, since unsecured creditors will favor lengthy proceedings in an attempt to increase their recoveries.

The present study aims to shed light on the effect that the 2005 amendments had on Chapter 11 practice. To this end, and as described in the following section, a multivariate logistic regression model is employed.

III. HYPOTHESIS AND METHODOLOGY

A. BAPCPA'S EFFECTS ON THE BUSINESS BANKRUPTCY LANDSCAPE

i. *Hypothesis*

BAPCPA changed the Chapter 11 landscape by taking privileges away from the debtor, depleting it of cash, shortening its timeframe for making strategic decisions, and enhancing creditors' rights and control over the case. Starting, therefore, from the hypothesis that the 2005 amendments have made bankruptcy more difficult and burdensome for the debtor, I predict that BAPCPA has increased the proportion of Chapter 11 cases that are disposed of rapidly. Indeed, it seems that the post-2005 debtor has less time and money than the pre-2005 debtor and, therefore, is less likely to undergo a full-blown Chapter 11 case. Given the increased likelihood of administrative insolvency at an early stage of the Chapter 11 filing, it is likely that debtors will not waste time in negotiating with their creditors to write down debt, but they will instead seek a strategic buyer at the outset of the case, or liquidate rapidly within Chapter 11. As a result, we expect to see a rise in § 363 sales of all or substantially all debtor assets, either piecemeal or as a

⁹⁵Kenneth M. Ayotte & Edward R. Morrison, *Creditor Control and Conflict in Chapter 11*, Columbia University Center for Law & Economics Research Paper No. 321.

going concern. Indeed, a great advantage of such pre-plan sales is that they offer the debtor the opportunity to exit the Chapter 11 case within a few months of the filing date. Furthermore, and according to what is widely maintained, we expect to see a decrease in the proportion of firms that emerge from Chapter 11.

An alternative theory, however, would be that the bankruptcy courts' attempts to strike a better balance between creditors' and debtors' interests by interpreting the new provisions in a light favorable to the debtor have mitigated BAPCPA's effects on the Chapter 11 landscape. Additionally, it could be the case that debtors and the non-debtor parties, exactly because of the shorter timeframes and liquidity constraints that BAPCPA imposes, will tend to engage in extensive pre-bankruptcy strategic planning, thus increasing the chances for a traditional reorganization. Indeed, it seems that the proportion of pre-negotiated and prepackaged bankruptcies has almost doubled compared to the pre-BAPCPA period, as shown in Figure 1.

ii. *Sample Selection*

The first study focuses on large publicly traded corporations that filed for Chapter 11 between 1997 and 2011. The sample of firms with these characteristics was drawn from Lynn LoPucki's Bankruptcy Research Database ("BRD"),⁹⁶ yielding a total of 680 filings. Repeat filings are treated as separate filings. Professor LoPucki's Bankruptcy Research Database includes financial and other data for public debtor-companies with assets of \$100 million or more, measured in 1980 dollars, as of the last 10-K filed prior to bankruptcy.⁹⁷ I identified the industry of the debtors by the SIC Division⁹⁸ in which they are classified, and excluded those under Division H, namely finance, insurance, and real estate companies.⁹⁹ Finance and insurance companies differ from other firms because they are subject to special regulations and follow different accounting rules. Consequently, the initial sample was reduced to 604 corporations. For this sample of 604 corporations, balance-sheet and income-statement financial data were gathered for the fiscal year in which the firms filed for bankruptcy and for up to two preceding fiscal years. The source of these financial data was Compustat.¹⁰⁰ Other necessary non-

⁹⁶Lynn M. LoPucki, Bankruptcy Research Database, <http://lopucki.law.ucla.edu/>.

⁹⁷See Protocols for the UCLA-LoPucki Bankruptcy Research Database, *available at* <http://lopucki.law.ucla.edu/>. Additionally, in order for a firm of this size to be included in Professor LoPucki's database, it should have submitted annual report filings (Form 10-K) with the Securities and Exchange Commission for a year ending not less than three years prior to the filing of the bankruptcy case.

⁹⁸SIC is an acronym for Standard Industrial Classification, a system that classifies industries by a four-digit code (http://www.osha.gov/pls/imis/sic_manual.html).

⁹⁹Division H is further divided into seven major groups: 1) depository institutions, 2) non-depository credit institutions, 3) security and commodity brokers, dealers, exchanges and services, 4) insurance carriers, 5) insurance agents, brokers and service, 6) real estate, and 7) holding and other investment offices.

¹⁰⁰Compustat is a database that contains financial data for a vast number of companies worldwide.

financial data were drawn from the Bankruptcy DataSource,¹⁰¹ press releases, and news articles. Data were fully available for 506 companies, the sample studied.

Tables 1 and 2 give summary descriptive statistics for the sample. Manufacturing firms consist of 36% of the total firms, and thus dominate the sample. Transportation, communications, electric, and gas firms follow with 22%, while services firms account for 18% of the total companies. Retailers comprise 12% of the sample.¹⁰² The sample is also divided by possible Chapter 11 outcomes as follows: a) “§ 363 Sales” including both piecemeal and going-concern pre-plan sales, b) traditional reorganizations, namely Chapter 11 cases in which the debtor-firm negotiated with its creditors, wrote down debt, and emerged from bankruptcy as a stand-alone company, c) asset sales pursuant to a plan, d) liquidating plans, e) mergers, and f) conversions/dismissals.¹⁰³ Firms that underwent a § 363 sale seem less leveraged than those that did not.

Figures 2 and 3 show the raw number of § 363 sales for each of the years examined by year of case filing and the percentage of § 363 sales in relation to the total Chapter 11 cases that were completed (by any means, including a confirmed plan, sale, dismissal or conversion). The number of Chapter 11 filings is larger during and near periods marked as recessions, as shown in Figure 2. Indeed, in the pre-BAPCPA period we observe an increase in Chapter 11 filings around the 2001 recession period. Similarly, in the post-BAPCPA era, Chapter 11 filings show a steep rise in 2009.

iii. *Regression Models and Variable Selection*

The purpose of the first study is to examine and quantify the specific impact of BAPCPA on rapid Chapter 11 dispositions effectuated through the use of § 363 of the Bankruptcy Code. The dataset indicates that the percentage of § 363 sales largely increased after the enactment of the 2005 amendments.¹⁰⁴ This increase was measured to be statistically significant at 1% level.¹⁰⁵ In order to reach accurate results, however, the impact of other factors potentially affecting the outcome should be simultaneously examined, as this percentage discrepancy could be the result of other macroeconomic or microeconomic conditions. Periods of economic recession as well as the firms’ financial strength as reflected in leverage and liquidity levels could influence Chapter 11 outcomes. For example, the company’s level of debt as well as its

¹⁰¹Bankruptcy DataSource covers public companies that are in bankruptcy and contains, among other things, company profiles and reorganization plans.

¹⁰²See *infra* Table 1.

¹⁰³See *infra* Table 2.

¹⁰⁴See *infra* Figure 4.

¹⁰⁵Double-sided univariate test calculating the p-value for t-test for difference in percentages found that this increase was statistically significant at 1% level.

ability to satisfy its current liabilities when they come due or quickly turn assets into cash could affect whether the firm will have the chance to go through a full-blown Chapter 11 proceeding or instead be disposed rapidly. In order, therefore, to measure more accurately BAPCPA's effect on § 363 sales and test whether this effect could be adequately described by other factors, a multivariate logistic regression framework is used. The set of variables is briefly described below.

The dependent variable in this model is “§ 363 sales.” It includes all cases in which there was a pre-plan sale of all or substantially all assets. These outcomes are coded as 1. Any other Chapter 11 outcome is coded as 0.

The following seven independent variables were identified as potentially affecting Chapter 11 outcomes. These are financial ratios that measure the strength of the company as close as possible to the bankruptcy filing. Financial data to calculate these ratios were drawn from Compustat and correspond to either the 10-K filed during bankruptcy or the 10-K filed for the last fiscal year before bankruptcy. If such data were not available, the ratios correspond to the financial data included in the 10-K filed for the second-to-last fiscal year before bankruptcy. “Total assets” are reported on a book value basis.

The first ratio used is a leverage ratio. In particular, the following ratio was considered:

- Long-Term Secured Debt¹⁰⁶ / Total Debt¹⁰⁷

A liquidity ratio measuring the company's ability to satisfy its short-term obligations by either using cash or turning short-term assets into cash was also added. In particular, the following liquidity ratio was used:

- Current Assets¹⁰⁸ / Total Assets

A ratio measuring the firm's financial strength and profitability was also taken into account:

- EBITDA / Total Assets

The size of the distressed firm might also affect its Chapter 11 outcome. To this end, I included in the logistic regression a relevant variable. In particular, and similarly with Dahiya et al.,¹⁰⁹ I used as a proxy of the firm's size the logarithm of the book value of the company's total assets.

- Firm Size—the logarithm of the book value of the firm's total assets as

¹⁰⁶Based on Compustat's definition, “secured debt” represents all long-term debt secured or collateralized by mortgage, property, receivables, stock or other assets.

¹⁰⁷Compustat does not contain a “total debt” item. In order, therefore, to calculate “total debt”, Compustat's item “debt in current liabilities” was added to its “long-term debt” item.

¹⁰⁸Otherwise known as “current ratio.” Specifically, Compustat defines “current assets” as representing cash and other assets that are expected to be realized in cash or used in the production of revenue within the next 12 months.

¹⁰⁹*Supra* note 89.

reported for the fiscal year of the bankruptcy filing event or for up to two preceding fiscal years.

The categorical variables of “BAPCPA” and “economic recession” were added and coded as follows:

- BAPCPA: a binary variable that takes the value 1 if a corporation filed for Chapter 11 on or after October 17th, 2005. For debtors that filed before this date, this variable takes the value 0.
- Economic Recession: a binary variable for the periods of economic recession in the United States as measured by the National Bureau of Economic Research (NBER).¹¹⁰ According to the NBER, contractions start at the peak of the business cycle and end at the trough. Based on this definition, this binary variable takes the value of 1 if firms filed for Chapter 11 within a recession; otherwise the value is 0. In the present sample, two sets of firms fall within periods of economic recession: those that filed between March 2001 and November 2001, and those that filed between December 2007 and June 2009.

Finally, the macroeconomic variable of GDP was added:

- GDP (annual percentage growth rate)

The second study aims to examine whether the enactment of the 2005 amendments has lowered the rate of debtor emergences. To this end, a multivariate regression model is once again employed.

This time the dependent variable is “non-emergence.” It includes all Chapter 11 cases from which the debtor did not emerge. In particular, following BRD’s codification, a debtor did not emerge if no operating company exited bankruptcy or if the case was converted to Chapter 7. Furthermore, the debtor did not emerge if, in case of an acquisition or merger, its assets were merely incorporated into an existing business of the acquirer or merger partner.¹¹¹ On the contrary, a debtor did emerge even if acquired by another company provided that the acquirer operated the debtor as a separate business.¹¹² A company also emerged if a plan of reorganization was confirmed. “Non-emergence” outcomes are coded as 1, and “emergence” outcomes as 0. The same independent variables identified above are again used.

iv. Results

Quantifying BAPCPA’s effect on § 363 sales of the debtor’s all or substantially all assets would be a first step towards understanding the extent to which the 2005 amendments have helped change the Chapter 11 landscape.

¹¹⁰National Bureau of Economic Research (NBER), <http://www.nber.org/>.

¹¹¹Unless the merger partner was small in relation to the debtor.

¹¹²See BRD’s Protocols where it is also stated that a company emerges only if, at the time of the relevant order (confirmation or sale), the company was operating and had the intent to continue to operate indefinitely.

Table 3 quantifies the effect of BAPCPA on such rapid dispositions and displays the results of the multivariate logistic regression.

Initially, we observe that the constant term is negative as expected and in accordance with the fact that the majority of companies did not undergo § 363 sales. At this point, however, it should be noted that the number of companies that underwent § 363 sales is understated because it does not take into account cases in which the distressed firm, in the course of the Chapter 11 process, sold assets that constituted a majority of a firm's value but did not reach the point to qualify as "substantially all." Furthermore, the sign of the EBITDA-to-total assets ratio's coefficient is negative, indicating that the stronger a company is, the less likely it is to be forced to a § 363 sale. The same holds for larger companies, as the "firm size" variable indicates. Additionally, the coefficient of the leverage ratio considered, namely that of secured debt-to-total debt, is positive indicating that there is greater probability for firms with higher levels of secured debt to be led to a swift § 363 sale.

BAPCPA, the variable that is of main concern here, is positively correlated with § 363 sales with a p-value¹¹³ of 2% even when accounting for other microeconomic and macroeconomic factors. Therefore, and as the dataset initially suggested, the 2005 amendments have contributed to the large increase of rapid dispositions through the form of pre-plan sales of all or substantially all debtor assets. It seems that as BAPCPA has shortened the timeframe within which strategic decisions can be made and has imposed additional liquidity constraints, the debtor, fearing that it will not be able to survive a full-blown Chapter 11 case, resorts to swift sales of all or substantially all assets. This increase in the proportion of § 363 sales may also explain a result that is contrary to what we expected: the lower rate of conversions in the post-BAPCPA period. Indeed, since the hypothesis is that the 2005 amendments increased the costs of bankruptcy and made the confirmation of a plan less likely, we would expect a higher rate of conversions in the post-BAPCPA period. Not only that, but, as mentioned under Part I, the amendments themselves seem to favor conversions and dismissals by making it easier for creditors to win such motions. It is, therefore, likely that the aforementioned rise in the proportion of § 363 sales indicates that bankruptcy courts are increasingly comfortable in using § 363(b) of the Bankruptcy Code as a liquidation vehicle, dispensing with the need to convert to a Chapter 7 case.

¹¹³In hypothesis testing the p-value is the probability of getting a test statistic equal to or more extreme than the sample result given that the null hypothesis is true. In regression specifically, the null hypothesis is that a coefficient is equal to 0. Therefore, the p-value quantifies the probability that the association between the dependent and the independent variable, indicated by a coefficient that is different from 0, is real and not due to chance.

In order to conduct robustness checks, I ran the regression model multiple times using a different combination of independent variables. While most other factors fluctuated, both in terms of directionality and p-values, BAPCPA was always positively correlated to § 363 sales and statistically significant at either 1% or 5% level.¹¹⁴

But has BAPCPA adversely affected the probability of debtor emergences, as its opponents allege? Table 4 displays the results of the multivariate logistic regression. First and foremost we observe that BAPCPA is not statistically significant. In fact, the data show that BAPCPA had had no statistically significant effect on the debtor's likelihood of emergence. What instead seems to have a strong effect on emergences is recessions: the recession variable is positively correlated with Chapter 11 liquidations at a statistically significant level of 5%.¹¹⁵ Furthermore, we observe that the larger the company is the less likely it is to liquidate. This is consistent with the findings of Dahiya et al. In particular, assuming that the asset size can be used as an indicator of available collateral, Dahiya finds that larger firms are better able to secure DIP financing, and thus constitute more likely candidates for emergence.¹¹⁶

The results of these studies indicate that, contrary to what its opponents maintain, BAPCPA did not increase the proportion of distressed firms that do not emerge from their Chapter 11 filing. What BAPCPA did, however, was to change traditional bankruptcy practice by encouraging fast-track pre-plan sales of all or substantially all debtor assets.

The following section examines whether the same conclusions hold for retailers, the group that has allegedly been the biggest victim of the 2005 amendments.

B. THE SPECIFIC CASE OF RETAILERS

i. Hypothesis

The group of firms that due to its inherent characteristics is assumed to be most heavily stricken by the 2005 amendments are retailers. As mentioned in Part I, BAPCPA reduces the period within which a debtor can decide whether to assume or reject leases. This can be specifically harmful

¹¹⁴For example, I re-ran the regression using a different combination of liquidity ratios. In all cases, BAPCPA remained statistically significant at either 1% or 5% level. Furthermore, additional macroeconomic factors were taken into account. In place of the economic recession variable included in the previous regression model, the risk-lending premium variable was added. The risk-lending premium was calculated as the difference between the prime rate and the yield on short-term (one year) treasury bonds. The prime rate data were gathered from the WSJ Prime Interest Rate History. Historical treasury bond yields were drawn from the U.S. Department of the Treasury. BAPCPA was statistically significant at 1% level.

¹¹⁵Its p-value is 2%.

¹¹⁶*Supra* note 89.

for retailers that operate thousands of stores nationwide since they cannot quickly make an intelligent decision on which leases are best to assume or reject. At the same time, vendors of goods, with whom retailers are in a symbiotic relationship, are elevated to administrative creditor status for some pre-petition deliveries, strongly increasing the probability that the debtor will become administratively insolvent at an early stage of the case. It is for these reasons that BAPCPA has been blamed, almost exclusively, for the alleged increasing proportion of distressed retail firms that end up being liquidated in Chapter 11. Notably, and as mentioned above, the 2009 liquidation of Circuit City was the subject of a hearing before the Subcommittee on Commercial and Administrative Law of the House of Representatives.¹¹⁷ Many scholars and practitioners arguing before this Committee, maintained that BAPCPA's amendments have made it especially difficult for retailers to reorganize, leaving them with no option but fast-track liquidating sales with the attendant loss of thousands of jobs. Even though more research is necessary, at this point it should be noted that as a general matter, it seems that, compared to companies from other sectors, bankrupt retailers are less likely to emerge. Indeed, a bankruptcy case study of 86 business debtors that was conducted by Fitch showed that the vast majority of the identified liquidation outcomes involved retailers. In particular, of these 86 cases, 14 resulted in liquidations, 11 of which were liquidations of retailers.¹¹⁸

This study will examine whether the 2005 amendments pushed retailers to fast-track dispositions, namely pre-plan sales of all or substantially all assets, and whether they have adversely affected retailer-debtor emergences. The hypothesis is that post-2005 fewer retailers will be able to undergo a full-blown Chapter 11 reorganization. Instead, more of them will either rapidly liquidate within Chapter 11 or attempt to sell themselves as going concerns. Additionally, we would expect to observe a statistically significant correlation effect of the 2005 amendments on the decreasing proportion of retailers that emerge from Chapter 11.

ii. *Sample Selection*

This study focuses specifically on retailers, namely companies with a four-digit SIC code¹¹⁹ ranging from 5200 to 5960, that filed for Chapter 11 between 1990 and 2012. Our sample was drawn from the SDC Platinum database, in particular its Corporate Restructuring component, which yielded a total of 387 filings. This database provides a basic financial profile of all

¹¹⁷See *Circuit City Unplugged*, *supra* note 6.

¹¹⁸Fitch: Mixed Recoveries for Creditors in U.S. Retail Bankruptcies (a summary of this report is available at <http://www.businesswire.com/news/home/20130416006123/en/Fitch-Mixed-Recoveries-Creditors-U.S.-Retail-Bankruptcies>) (the full report is available at www.fitchratings.com).

¹¹⁹As described above, *supra* note 98, SIC is an acronym for Standard Industrial Classification, a system that classifies industries by a four-digit code (http://www.osha.gov/pls/imis/sic_manual.html).

U.S. companies with more than \$10 million in assets that have filed for Chapter 11. Repeat filings are treated as separate filings.

Once the sample of retailers was drawn, the next step was to identify the disposition for each of the 387 cases. For companies with more than 50 million in assets, our main source for dispositions was the Bankruptcy DataSource. The Bankruptcy DataSource includes summaries of plans of reorganizations as well as news articles and press releases relating to any debtor that meets the aforementioned asset threshold. Examining the plan summaries, news articles, and press releases for each of the debtors I was able to identify the corresponding dispositions, i.e. whether a plan of reorganization was confirmed or the case was converted or dismissed, and whether the debtor underwent a piecemeal or going-concern pre-plan sale of all or substantially all assets. For debtors that did not meet the \$50 million-asset threshold I resorted to public filings, namely, 10-Ks and 8-Ks, as well as to news articles and press releases. From all sources, I was able to identify Chapter 11 outcomes in 376 out of the total of 387 cases. For further information relating to § 363 sales, e.g., date of announcement or closure of the deal, identity of the acquirer, etc., I used the Mergerstat M&A database. Mergerstat provides information on mergers, acquisitions, and divestitures that have been publicly announced.

Figures 5 and 6 show the yearly proportion of § 363 sales of all or substantially all assets relative to total Chapter 11 filings. In Figure 5 we clearly see an increase in the proportion of § 363 sales over the years.¹²⁰ Figure 6 displays § 363 sales of all or substantially all assets as a percentage of all completed cases for the periods before and after the enactment of BAPCPA. We observe that post-2005 the proportion of § 363 sales almost doubled, and the increase was measured to be statistically significant at the 1% level.

These initial results are consistent with the hypothesis that confirmation of a plan of reorganization is more difficult for retailers in the post-BAPCPA era. However, in order to reach accurate conclusions we should take into account other financial and macroeconomic factors that might affect Chapter 11 outcomes. To this end, balance sheet and income statement financial data, as well as other macroeconomic data, were gathered for the sample of 376 firms for which the form of disposition could be identified. All necessary financial data were drawn from SDC Platinum and correspond to either the year of bankruptcy or the last year before bankruptcy. If such data were not available, the ratios were calculated using financial data for the second year before bankruptcy. “Total assets” are reported on a book value basis. Table 5 provides descriptive statistics for the sample of firms for which financial data were available.

¹²⁰The slope for the § 363 sales rate line is positive: 0.01829816.

iii. Regression Models and Variable Selection

The study of retailers aims to examine and quantify the specific impact of BAPCPA on retail Chapter 11 cases. As mentioned in the Sample Selection section, I find a statistically significant increase in § 363 sales in the post-BAPCPA period. In order to verify these results, however, the impact of other, microeconomic or macroeconomic, factors potentially affecting the outcome should be simultaneously examined. Therefore, in order to measure more accurately BAPCPA's effect on pre-plan dispositions and test whether this effect could be adequately described by other factors, a multivariate logistic regression framework is used. The set of variables is briefly described below.

Once again, the dependent variable in the present model is "§ 363 sales." It includes all cases in which there was a pre-plan sale of all or substantially all debtor assets. These outcomes are coded as 1. Any other Chapter 11 outcome is coded as 0.

The following five independent variables were included in the regression model as potentially having an impact on Chapter 11 outcomes. These are financial ratios that measure the strength of the company close to its bankruptcy filing. Financial data to calculate these ratios were drawn from SDC Platinum and correspond, in order of preference, to either the year of bankruptcy or the last year before bankruptcy. If such data were not available, the ratios correspond to the financial data available for the second-t year before bankruptcy. "Total assets" are reported on a book value basis. Macroeconomic variables were also taken into account.

Once again, the logarithm of the book value of the firms' "total assets" item is used as a measure of their size. The following variable was, therefore, included in the regression model:

- Firm Size—the logarithm of the book value of the firm's total assets as reported for the filing year or the first or second preceding year.

The following leverage ratio was also included:

- Total Liabilities / Total Assets

The categorical variables of "BAPCPA" and "economic recession" were added and coded as follows:

- BAPCPA: a binary variable that takes the value 1 if a corporation filed for Chapter 11 on or after October 17, 2005. For debtors that filed before this date, this variable takes the value 0.
- Economic Recession: a binary variable for the periods of economic recession in the United States as defined by the NBER.¹²¹ As previously, this binary variable takes the value of 1 if firms filed for Chapter 11 within a recession; otherwise the value is 0. In the retailers sample,

¹²¹National Bureau of Economic Research (NBER): <http://www.nber.org/>.

three sets of firms fall within periods of economic recession: those that filed between July 1990 and March 1991; those that filed between March 2001 and November 2001; and those that filed between December 2007 and June 2009.

Finally, as before, the following macroeconomic variable was used:

- GDP

The next step will be to examine and quantify the relationship between the enactment of the 2005 amendments and the alleged decreasing rate of retailer-debtor emergences. To this end, a multivariate regression model is once again employed.

The dependent variable is “non-emergence,” and it includes all Chapter 11 cases from which the debtor did not emerge. Similarly with before, and following the same reasoning with the BRD codification for the main sample,¹²² a debtor is considered not to have emerged if no operating company exited bankruptcy. Conversions to Chapter 7 are also treated as non-emergences. Furthermore, the debtor did not emerge if, in case of an acquisition or merger, its assets were merely incorporated into an existing business of the acquirer or merger partner. However, a debtor did emerge if a successful reorganization plan implementing a restructuring of debts and obligations was confirmed, or if the debtor was acquired by another company that operated the debtor as a separate business.¹²³ “Non-emergence” outcomes are coded as 1, and “emergence” outcomes as 0. The same independent variables mentioned above were included in the regression model. Data on the debtor’s emergence were gathered from the Bankruptcy Database, which provides, among other things, summary reorganization plans. Press releases and news articles were also used.

iv. Results

Quantifying BAPCPA’s effect on pre-plan sales of distressed retail firms would help answer whether the 2005 amendments have put retail debtor Chapter 11 cases on the fast track. Table 6 displays the results of the multivariate logistic regression.

BAPCPA, the variable that is of main concern here, is statistically significant at 5% level, with a p-value of 4%. This suggests that the 2005 amendments have indeed made it more difficult for the retailer-debtor to remain within the Chapter 11 proceeding. Instead, it seems that post-2005 the retailer-debtor is forced to resort to a rapid disposition of the case through an early-stage sale or liquidation of the firm. As mentioned under Part I, distressed retailers now have less time to make intelligent strategic decisions, especially when it comes to which leases they should assume or reject. Be-

¹²²See *supra* Part III, section A, iii “Regression Models and Variable Selection”.

¹²³See BRD’s Protocols.

cause of this tightened timeframe, lenders are eager to conduct, if necessary, going-out-of business sales within the brief 210-day period in order to ensure that the inventory will be marketed in the debtor's store locations. Furthermore, the elevation of trade creditors to administrative status and the expansion of the reclamation right hurt the chances of traditional reorganization by depleting the debtor of cash and leading to an early-stage administrative insolvency, leaving it with little option other than to engage in fast-track sales.

Moving forward, the effect of BAPCPA on retail-debtor emergences is also examined. Table 7 displays the results of the logistic regression that quantifies the relationship between the 2005 amendments and the likelihood of emergence in the retail Chapter 11 cases.

We observe that the "firm size" variable is negatively correlated with the dependent variable at a statistically significant level of 1%. Again, this is consistent with the findings of Dahiya et al., suggesting that larger firms will obtain DIP financing more easily, and thus are more likely to emerge from Chapter 11.¹²⁴ What is of concern here, however, is the BAPCPA variable and its effect on liquidations. The results of the study indicate that the 2005 amendments have no statistically significant effect and, therefore, have not affected retailer emergences.

IV. CONCLUSION

An increasing number of scholars and practitioners argue that Chapter 11 should be reformed.¹²⁵ The main arguments are that modern Chapter 11 does not fulfill its intended goals and instead leads distressed firms to swift sales or liquidations. BAPCPA's effect on business reorganizations has been at the center of this debate. The studies presented in this paper reveal that the enactment of the creditor-friendly statute BAPCPA has changed the traditional Chapter 11 landscape by giving rise to rapid dispositions through pre-plan sales of all or substantially all debtor assets. The 2005 amendments changed the debtor-creditor balance by enhancing creditors' rights and control over the case and correspondingly weakening the debtor's position. What is interesting is that it seems that BAPCPA has affected not only, or not just mainly as it was initially assumed, retailers, but also firms from all other corporate sectors as well. However, it does not seem that the enactment of these 2005 amendments has adversely affected the proportion of firms that are able to emerge from Chapter 11 whether these firms belong to

¹²⁴See *supra* note 89.

¹²⁵Richard Levin & Kenneth Klee, *Rethinking Chapter 11*, 21 J. BANKR. L. & PRAC. 5 Art. 1 (2012) (noting that "several efforts are underway among the practicing bar to rethink chapter 11, with a view toward making it work with today's (and tomorrow's) economic and financial system," and discussing within this context the potential reform of corporate governance, post-petition financing, sale of all or substantially all debtor's assets, plan voting and distribution issues).

the retail or another industry division. The trend of *liquidating Chapter 11s* identified by scholars and practitioners is not associated with the enactment of the 2005 amendments and, according to Professor Lynn LoPucki, the proportion of debtors that ended up liquidating was increasing even before then. Particularly, Professor LoPucki has found that “41 firms that filed bankruptcy as public companies each with assets exceeding approximately \$218 million liquidated in 2002, although no more than 8 such firms did so in any year prior to 1999.”¹²⁶ It follows that repealing the specific 2005 amendments blamed for the unsuccessful business Chapter 11 cases will not help increase the debtor’s rehabilitation chances.

¹²⁶Lynn LoPucki, *The Nature of the Bankrupt Firm—A Respond to Baird and Rasmussen’s The End of Bankruptcy*, 56 Stan. L. Rev. 645, note 5 (2003).

TABLES

Table 1

Sample Debtors by Industry

This table displays the raw and percentage number of sample firms divided by the industry in which they belong based on the SIC code that has been assigned to them. The upper part of the cell reports the number and percentage of firms from each corporate sector; these figures then are further decomposed for each of the pre-BAPCPA and post-BAPCPA periods.

Raw and Percentage Number of Firms by
SIC Industry Division

Services	91 (18%)	
	68 (18%)	23 (17%)
Retailers	63 (12%)	
	48 (13%)	15 (11%)
Wholesale trade	23 (4%)	
	22 (6%)	1 (1%)
Manufacturing	189 (36%)	
	122 (32%)	65 (48%)
Mining	25 (5%)	
	18 (5%)	7 (5%)
Construction	9 (2%)	
	4 (1%)	5 (4%)
Transportation, Communications, Electric, Gas	116 (22%)	
	96 (25%)	20 (14%)
Agricultural Products	3 (1%)	
	2 (1%)	1 (1%)

Table 2

Characteristics of Large Publicly Traded Firms that Filed for Chapter 11 between 1997 and 2011, by Chapter 11 Outcome

For the total of 506 companies, the financial data correspond to either the fiscal year of the filing event, or the last or second-to-last fiscal year before the filing event, whichever were available. All financial data were obtained from Compustat. For each ratio the upper part of the cell reports the corresponding statistic, i.e. the mean and, in parenthesis, the median, for the firms in the category.

	§ 363 Sales	Traditional Reorganizations	Plan Sales	Mergers	Liquidation Plans	Conversions/Dismissals
Number of Firms	120	290	14	19	52	11
Liabilities/Total Assets	1.002 (0.865)	1.516 (1.078)	0.939 (0.92)	1.01 (1.048)	0.821 (0.818)	0.67 (0.733)
Secured Debt/ Total Assets	0.223 (0.189)	0.217 (0.077)	0.151 (0.068)	0.189 (0.008)	0.161 (0.033)	0.095 (0.022)
Current Assets/ Current Liabilities	1.51 (1.33)	1.28 (1.004)	1.039 (0.939)	1.038 (0.956)	1.943 (1.249)	1.91 (0.966)
Cash/Current Liabilities	0.289 (0.082)	0.307 (0.1)	0.161 (0.051)	0.183 (0.11)	0.357 (0.089)	0.598 (0.011)
Cash & Short-Term Investments / Total Debt	0.122 (0.034)	0.091 (0.04)	0.055 (0.034)	0.048 (0.03)	0.178 (0.07)	0.546 (0.013)
Cash & Short-Term/Total Assets	0.08 (0.03)	0.077 (0.047)	0.052 (0.026)	0.05 (0.023)	0.108 (0.073)	0.133 (0.011)
Current Assets/Total Assets	0.41 (0.424)	0.351 (0.340)	0.324 (0.32)	0.291 (0.216)	0.459 (0.489)	0.367 (0.316)
EBITDA/Total Assets	-0.076 (-0.026)	-0.119 (-0.011)	-0.059 (0.044)	-0.043 (-0.031)	-0.1412 (-0.031)	-0.03 (0.021)

Table 3

Effect of BAPCPA on § 363 sales

The financial information is for the fiscal year in which the company filed for Chapter 11 (year 0). If such data were not available, financial data correspond to the first (year 1) or the second (year 2) to last year before bankruptcy. The sample consists of financially distressed firms that filed for Chapter 11 from 1997 to 2011, a total of 506 companies. All financial data were obtained from Compustat. The logarithm of the book value of the firm's total assets is used as a proxy of the firm's size.

	Coefficient	P-Value
Constant	-1.4023	17%
Long-Term Secured Debt/Total Debt	0.0756	56%
Economic Recession	-0.1447	71%
BAPCPA	0.8041	2%**
Current Assets/Total Assets	1.5673	1%***
GDP	-2.1443	81%
Firm Size	-0.1996	51%
EBITDA/Total Assets	-0.0039	99%

••• significant at 1%, ** significant at 5%, * significant at 10%

Table 4

Effect of BAPCPA on Non-Emergences

The financial information is for the fiscal year in which the company filed for Chapter 11 (year 0). If such data were not available, financial data correspond to the first (year 1) or the second (year 2) to last year before bankruptcy. The sample consists of financially distressed firms that filed for Chapter 11 from 1997 to 2011, a total of 506 companies. All financial data were obtained from Compustat. The logarithm of the book value of the firm's total assets is used as a proxy of the firm's size.

	Coefficient	P-Value
Constant	-0.1343	88%
Long-Term Secured Debt/Total Debt	0.0851	42%
Economic Recession	0.8332	2%**
BAPCPA	-0.1072	75%
Current Assets/Total Assets	-0.2212	69%
GDP	10.1177	24%
Firm Size	-0.2606	33%
EBITDA/ Total Assets	-0.1478	75%

••• significant at 1%, ** significant at 5%, * significant at 10%

Table 5

Characteristics of Retail Firms that Filed for Chapter 11
between 1990 and 2012

For the total of 376 companies, financial data are drawn from the filing year or, if that data was unavailable, from the first or second year before filing. All financial data were obtained from SDC Platinum. Cells report the mean and, in parenthesis, median value.

	§ 363 Sales of All or Substantially All Assets	Not § 363 Sales of All or Substantially All Assets
Number of Firms	87	289
Firm Size	2.264 (2.267)	2.105 (2.141)
Total Liabilities/Total Assets	0.663 (0.663)	3.052 (0.967)

Table 6

Effect of BAPCPA on § 363 Sales of Retailers

Financial data were drawn from, in order of preference, the filing year, the year before filing, or the second year before filing. The sample consists of financially distressed retailers that filed for Chapter 11 from 1997 to 2011, a total of 376 companies. All financial data were obtained from the SDC Platinum database. The logarithm of the book value of the firm's total assets is used as a proxy of the firm's size.

	Coefficient	P-Value
Constant	-6.0995	9%
Economic Recession	0.4043	65%
BAPCPA	6.66	4%**
Total Liabilities/Total Assets	-1.8104	1%***
GDP	-12.0651	60%
Firm Size	0.2279	67%

•• significant at 1%, ** significant at 5%, * significant at 10%

Table 7

Effect of BAPCPA on Non-Emergences of Retailers

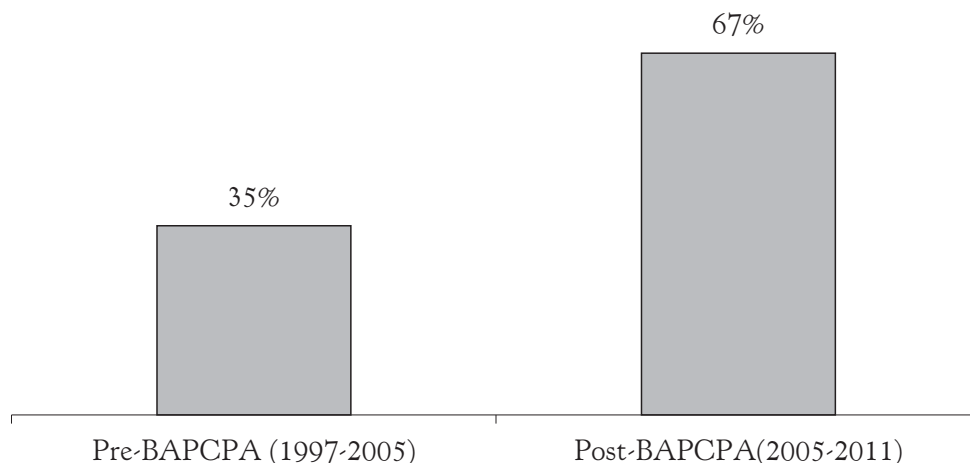
Financial data were drawn from, in order of preference, the filing year, the year before filing, or the second year before filing. The sample consists of financially distressed retailers that filed for Chapter 11 from 1997 to 2011, a total of 376 companies. All financial data were obtained from the SDC Platinum database. The logarithm of the book value of the firm's total assets is used as a proxy of the firm's size.

	Coefficient	P-Value
Constant	2.8734	8%
Economic Recession	0.8006	33%
BAPCPA	-0.0053	99.5%
Total Liabilities/Total Assets	-0.0643	63%
GDP	-29.5818	20%
Firm Size	-1.6848	0.38%***

•• significant at 1%, ** significant at 5%, * significant at 10%

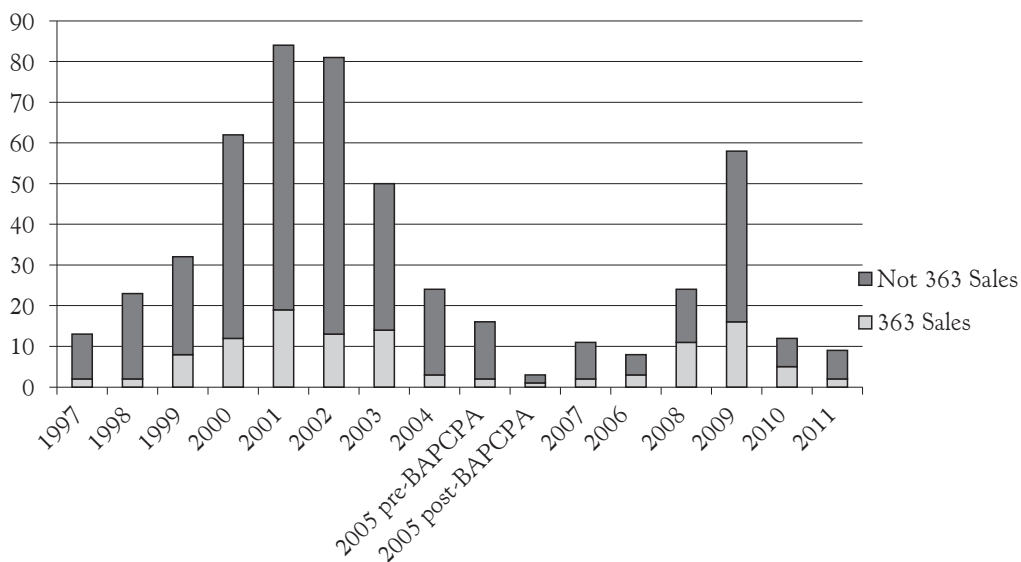
FIGURES

Figure 1
 Prepackaged and Prenegotiated Bankruptcies as a Percentage of All Chapter 11 Filings between 1997 and 2011



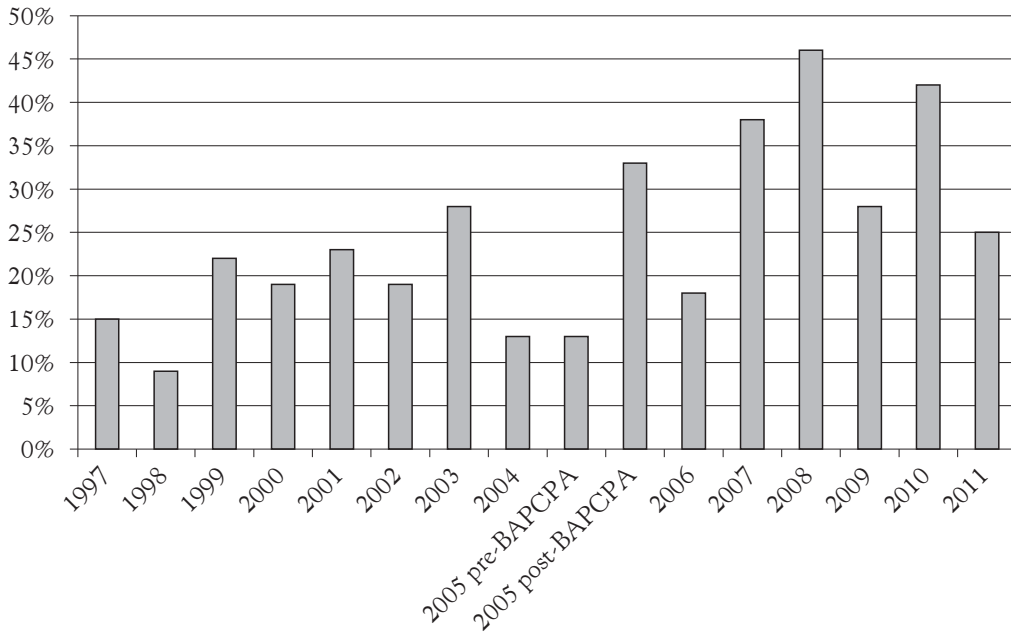
Data drawn from Lynn M. LoPucki, Bankruptcy Research Database, <http://lopucki.law.ucla.edu/>

Figure 2
 Number of 363 Sales as of the Total of Chapter 11 Cases Disposed, by Year of Case Filing



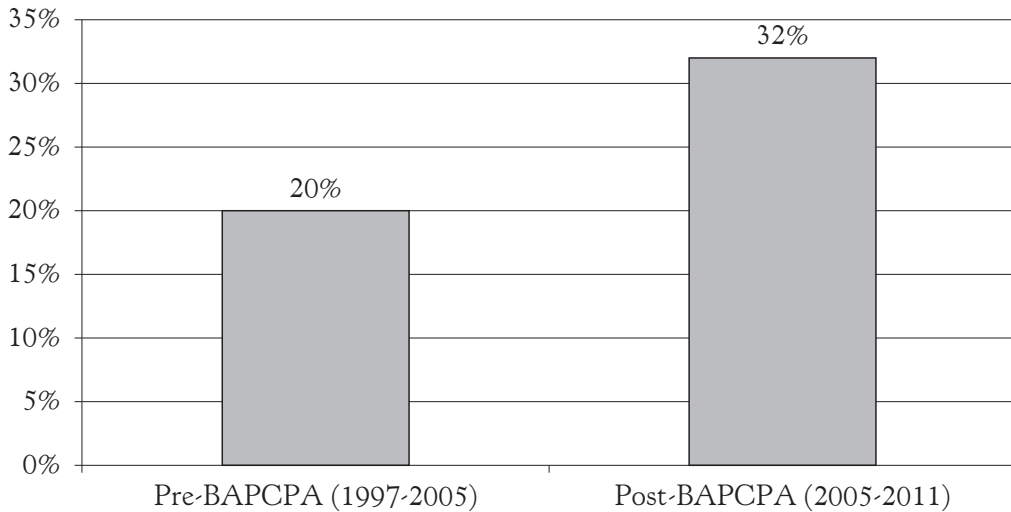
Recession (I): March 2001-November 2001
 Recession (II): December 2007-June 2009

Figure 3
 363 Sales as a Percentage of all Chapter 11 Cases Disposed, by Year of Case Filing



Recession (I): March 2001-November 2001
 Recession (II): December 2007-June 2009

Figure 4
 363 Sales as a Total Percentage of all Chapter 11 Cases Disposed, by Year of Case Filing, for the Periods Before and After BAPCPA



p-value=1%, double-sided test

Figure 5
 § 363 Sales of All or Substantially All Assets in Retailer Chapter 11
 Cases for the Period 1990-2012

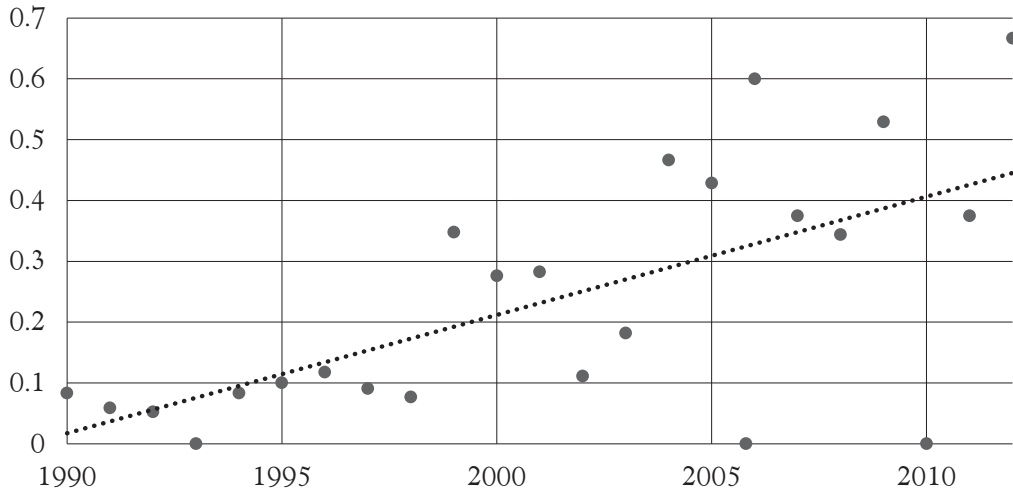
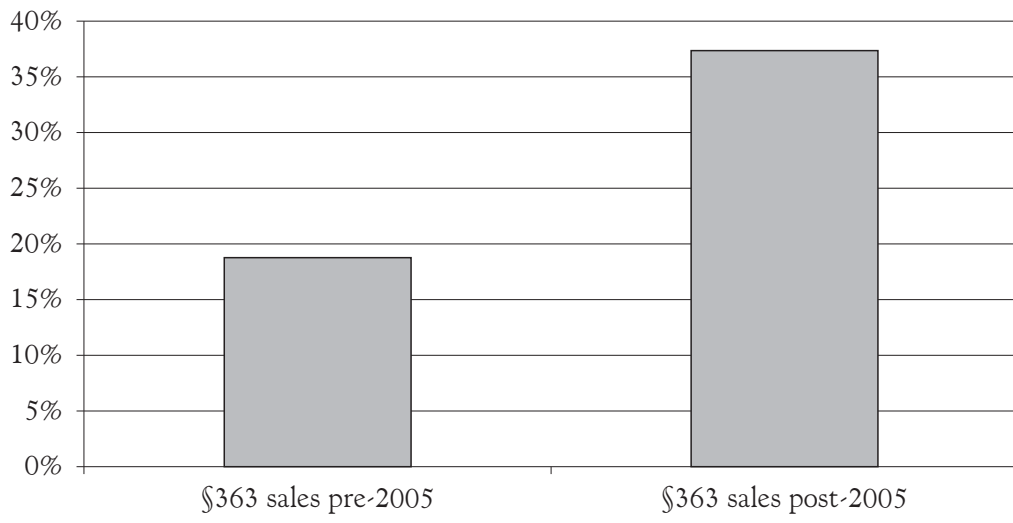


Figure 6
 Percentage of § 363 Sales in Retailer Chapter 11 Cases for the periods
 before and after BAPCPA (1990-2012)



p-value=0.04%; double-sided test

