5-1-2015

Preserving Value in the Post-BAPCPA Era — An Empirical Study

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Abstract

Through the use of a multivariate regression model, this article studies the effect on debtor reorganization values of the shortened reorganization timeframe imposed by the Bankruptcy Abuse Prevention and Consumer Protection Act ("BAPCPA"). The study shows that BAPCPA is positively correlated at a statistically significant level with higher reorganization recoveries. This result is attributed to the increased proportion of prepackaged and prenegotiated bankruptcies observed in the post-2005 era, as these "fast-track" bankruptcy cases entail lower costs and better preserve the firm's value.

INTRODUCTION

The Bankruptcy Abuse Prevention and Consumer Protection Act[1] ("BAPCPA"), enacted in 2005, and its effects on the Chapter 11 reorganization process have been the focus of extensive scholarly literature.[2] Critics of BAPCPA argue that, by shortening the timeframe during which a debtor can reach strategic decisions, the statute adversely affects the debtor's rehabilitation chances.[3] This view contrasts with one of the other longstanding criticisms of

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*I am grateful to my supervisor, Professor Richard Squire, for invaluable comments and suggestions on earlier drafts of this project. I would also like to thank Professor Sean Griffith and Professor Michael Simkovic for their insightful comments and suggestions.

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

[2] *See e.g.,* Harvey R. Miller, *Chapter 11- From Boom to Bust and into the Future*, 81 AM. BANKR. L.J. 375, 388 (2007) (characterizing the 2005 amendments as "ill-conceived"). *See also* Richard Levin & Alessia Raney-Marinelli, *The Creeping Repeal of Chapter 11: The Significant Provisions of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005*, 79 AM. BANKR. L.J. 603 (2005); Kara J. Bruce*, Rehabilitating Bankruptcy Reform*, 13 NEV. L. J. 174, 202 (2012); Biana Burokhovic*, BAPCPA: The Nail in the Coffin for Retailers, Pratt's Journal of Bankruptcy Law*, Vol. 6 No. 5 (2010) (focusing on the effect that BAPCPA may have on the reorganization of retailing companies); Bruce S. Nathan et al., *BAPCPA Rollback as a Cure to Unsuccessful Reorganizations? Not so Fast!* Bus. Reorg. Comm. Newsl. (American Bankruptcy Institute, Alexandria, Va.) (March, 2010) (arguing that BAPCPA is not to blame for the perceived increase in unsuccessful Chapter 11 reorganizations); 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 (2011); Foteini Teloni, *The Bankruptcy Abuse Prevention and Consumer Protection Act: An Empirical Examination of the Act's Business Bankruptcy Effects*, 88 AM. BANKR. L. J. 237 (2014) (examining empirically the theoretical assertions regarding BAPCPA and its effects on the Chapter 11 process).

[3] *See e.g*., Levin & Raney-Marinelli, *The Creeping Repeal of Chapter 11*, *supra* note 2, at 603 (arguing that the 2005 amendments will "adversely affect the ability of businesses to reorganize."); Bruce, *supra* note 2, at 20 (noting that the new exclusivity period is insufficient for exceptionally large debtors); Jeffrey M. Schlerf, *BAPCPA's Impact on Exclusivity is Hard to Gauge* (July, 2007), *available at*: http://www.turnaround.org/Publications/Articles.aspx?objectID=7707 (assessing the potential impact of the cap placed on the exclusivity extension).). *See also 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) (where scholars and practitioners offered their views on whether and how BAPCPA helped lead to the liquidation of Circuit City) (hereafter, "Circuit

Chapter 11: protracted delays. Indeed, scholars and practitioners have mainly viewed the traditional Chapter 11 route as lengthy and costly.[4] The formulation of a consensual plan of reorganization often requires intensive bargaining among the debtor's stakeholders over the firm's value, and compliance with elaborate disclosure and voting requirements. These factors allegedly drag out the reorganization process, driving up costs.

Previous empirical research has shown that after the enactment of the 2005 amendments the length of reorganization cases fell by 32%.[5] This reduction is attributed to new and modified provisions that accelerate the traditional Chapter 11 process.[6] In particular, BAPCPA set a time limit beyond which the debtor cannot request extensions of its exclusivity period, namely the period when it is the only party in interest able to propose a plan of reorganization.[7] Additionally, BAPCPA limited the overall timeframe during which the debtor may decide whether to assume or reject commercial leases in which it is the lessee.

That same study also showed that after the 2005 amendments, the proportion of debtors undergoing "fast-track" bankruptcies, namely prepackaged and prenegotiated cases (collectively termed hereafter "preplanned" bankruptcies) increased. Preplanned bankruptcies differ from traditional reorganization cases in that the debtor has a reorganization plan already in place when it files its Chapter 11 petition. As a result, the time spent in reorganization proceedings is much shorter. This rise in prepackaged and prenegotiated cases was anticipated, as the shortened timeframe during which the post-2005 debtor must make strategic decisions encourages extensive pre-bankruptcy planning. Indeed, the proportion of debtors that underwent a prepackaged or prenegotiated case in the post-BAPCPA era increased by 23%.[8] The amendments' addition of section 1125(g) and section 341(e) to the Bankruptcy Code may also have made preplanned bankruptcies more attractive. These provisions have the effect of specifically promoting and facilitating the employment of preplanned cases. Under § 1125(g), and contrary to the case before BAPCPA took effect, the debtor can complete post-petition a solicitation process that it began pre-petition even if there is *not* a court-approved disclosure

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City Unplugged"). *But see* Teloni, *The Bankruptcy Abuse Prevention and Consumer Protection Act, supra* note 2, at 262, 267 (finding no statistically significant correlation between the implementation of the 2005 amendments and unsuccessful reorganizations of debtors).

[4] This appeared to be especially the case before the enactment of BAPCPA in 2005. For scholarly literature referring to the period before the 2005 amendments took effect, *see, e.g.,* James J. White, *Harvey's Silence*, 69 AM. BANKR. L.J. 467, 474 (1995) (arguing that Chapter 11 is a lengthy process characterized by increased costs); Lawrence Weiss, *Bankruptcy Resolution: Direct Costs and Violation of Priority Claims*, 27 J. Fin. Econ. 285 (1990) (finding that the direct costs of bankruptcy comprise 3% of the firm's total assets); Edward Altman, *A Further Empirical Investigation of the Bankruptcy Cost Question*, 39 J. Fin. 1067, 1077 (1984) (examining a sample of 18 firms and finding that total bankruptcy costs comprise 16.7% of firm value in the year of bankruptcy). *But see* Elizabeth Warren & Jay L. Westbrook, *The Success of Chapter 11: A Challenge to the Critics*, 107 MICH. L. REV. 603, 626 (2009), (providing data indicating that cases move forward more quickly than what it is believed by most scholars and practitioners); Stephen Lubben, *The Direct Costs of Corporate Reorganization: An Empirical Examination of Professional Fees in Large Chapter 11 Cases*, 74 AM. BANKR. L. J. 509 (2000) (arguing that the costs of Chapter 11 are nominal).

[5] Foteini Teloni, *Chapter 11 Duration, Preplanned Cases and Refiling Rates: An Empirical Analysis in the post-BAPCPA Era*, AM. BANKR. INST. L. REV. (forthcoming, 2015) (on file with the author).

[6] *Id.*

[7] 11 U.S.C. § 1121 (as amended by BAPCPA).

[8] *See* Teloni, *Chapter 11 Duration, Preplanned Cases and Refiling Rates*, *supra* note 5.

statement.[9] And under § 341(e), the court may, on request of a party in interest, order the U.S. Trustee *not* to convene a creditors' meeting, if the debtor was able to solicit acceptances before the commencement of its case.[10] By contrast, under the pre-BAPCPA regime, a creditor's meeting was always required, and therefore the Chapter 11 process was often unnecessarily delayed.

Additionally, previous research has found that shorter Chapter 11 duration is associated with higher reorganization values.[11] If this holds, then a natural question is whether post-BAPCPA debtors, which, as mentioned above, tend to emerge from their Chapter 11 proceedings more quickly than before through the use of preplanned Chapter 11s, are also able to exit bankruptcy with higher values. In other words, did the shortened Chapter 11 case duration with the attendant increase in the proportion of preplanned cases, imposed by BAPCPA, have an effect on debtors' reorganization values? The study presented here answers this question in the affirmative, and shows that BAPCPA is indeed positively correlated with higher reorganization recoveries. This, in turn, suggests that the faster resolution of Chapter 11 cases in the post-2005 era, especially through the use of prepackaged and prenegotiated bankruptcies, allows the debtor to exit its Chapter 11 proceedings having incurred lower costs and preserved more value.

This article proceeds as follows: Part I reviews the 2005 amendments that had the effect of accelerating the reorganization process and encouraging preplanned bankruptcies. Additionally, the route to traditional plan confirmation is described and distinguished from the trajectory that preplanned cases follow. This distinction serves to indicate how prepackaged and prenegotiated bankruptcy cases can preserve more value for the debtor. Part II states the study's hypothesis and reviews previous relevant scholarly literature. Part III describes the methodology used and presents the article's finding of statistically significant evidence that post-2005 Chapter 11 debtors emerge from their reorganization proceedings with higher values. Finally, Part IV contains the conclusion and identifies further research questions.

I. ACCELERATING THE CHAPTER 11 PROCESS

A. SHORTENING THE DEBTOR'S DECISION TIMEFRAME – AMENDING SECTIONS 1121 AND 365

Congress enacted BAPCPA in October 2005. Be it the result of intensive lobbying efforts that aimed to promote certain interests, as some suggest,[12] or not, the fact is that BAPCPA effectuated a comprehensive reform of the Chapter 11 reorganization process. These 2005

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[9] 11 U.S.C. § 1125 (g).
[10] 11 U.S.C. § 341 (e).
[11] Lynn M. LoPucki & Joseph W. Doherty, *Bankruptcy Fire Sales*, 106 MICH. L. REV. 1, 26 (2007). *See infra* Part II (B).
[12] *See e.g.,* Miller, *Chapter 11- From Boom to Bust and into the Future*, *supra* note 2, at 388 (characterizing the enactment of BAPCPA as "perhaps special interests' biggest victory."); Levin & Raney-Marinelli, *The Creeping Repeal of Chapter 11*, supra note 2,at 603 ("In general, these changes reflect active lobbying by certain creditor groups to improve their positions in bankruptcy cases, particularly in Chapter 11, vis-à-vis debtors and other creditors…").

amendments altered the debtor-creditor balance by responding, among other things, to mounting pressure regarding quick resolution of the debtor's case.[13] With respect to this, BAPCPA aimed and succeeded at accelerating the time to plan confirmation by setting a maximum timeframe within which the debtor may take certain actions and make strategic decisions.[14] Specifically, BAPCPA sped up business reorganization cases by modifying two key sections of the Bankruptcy Code, namely § 1121 and § 365.

Section 1121 provides the debtor with one of the most important rights designed to promote the debtor's rehabilitation:[15] the right to be the only party in interest that can propose a plan of reorganization within the first 120 days of commencement of the Chapter 11 case.[16] This "exclusivity" right provides the debtor with significant control over its reorganization case, and thus enhances the debtor's bargaining position in the critical early days of its bankruptcy. The debtor is insulated from competing plans that could otherwise be submitted by creditors disinterested in the distressed firm's successful emergence, and therefore has a meaningful chance of rehabilitation.[17] If the debtor files a plan of reorganization within these first 120 days, it gets another 60 days to solicit acceptances.[18] Both the debtor's exclusivity and acceptance solicitation periods can be extended, but *only* for cause.[19] The "for cause" wording of the statute was included by Congress in recognition that, apart from the debtor's interest in reorganizing and restructuring its balance sheet, there are creditor interests that should be also taken into consideration and protected.[20] However, before the enactment of the 2005 amendments, courts

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[13] *See Circuit City Unplugged*, *supra* note 3, (prepared statement of Professor Todd J. Zywicki) (arguing that the shortened timeframe imposed by BAPCPA was intended to "deal with a particular problem, especially in a lot of cases, which is cases that would just sit in the bankruptcy courts, and do nothing, much to the frustration of creditors, landlords, and everybody else.").

[14] *See* Teloni, *Chapter 11 Duration, Preplanned Cases and Refiling Rates*, *supra* note 5.

[15] Indeed, the cornerstone of Chapter 11 was intended to be the promotion of the debtor's rehabilitation. *See, e.g.*, *NLRB v. Bildisco & Bildisco,* 465 U.S. 513, 528 (1984) (where the Supreme Court differentiated between reorganization and liquidation, stating that, contrary to liquidation, the very purpose of reorganization is to prevent the loss of jobs as well as the possible misuse of economic resources.); *In re Ionosphere Clubs Inc*., 98 B.R. 174 (Bankr. S.D.N.Y. 1989) where it is emphasized that: "the paramount policy and goal of chapter 11, to which all other policies are subordinated…, [which] is the rehabilitation of the debtor."). *See also* H.REP. NO. 595, 95th Cong., 2d Sess. 220 (1978), *reprinted in* 1978 U.S.C.C.A.N. 5787, 6179 (stating that "[t]he purpose of a business reorganization case … is to restructure a business's finances so that it may continue to operate, provide its employees with jobs, pay its creditors, and produce a return for its stockholders.).

[16] 11 U.S.C. § 1121 (b).

[17] *See* J. Bradley Johnston, *The Bankruptcy Bargain*, 65 AM. BANKR. L. J. 213, 294 (1991). Not only that, but this level of control afforded to the debtor incentivizes the timely filing of its Chapter 11 petition. In other words, the debtor's management does not postpone the inevitable out of fear that it will lose control, and, therefore, it does not delay the bankruptcy filing up to a point that there would be no meaningful chance of reorganization. *See* H.R. Rep. No. 595, 95th Cong., 1st Sess., at 231-232. H.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.").

[18] 11 U.S.C. § 1121 (c) (3).

[19] 11 U.S.C. § 1121 (d) (1) (emphasis added).

[20] Before the enactment of the Bankruptcy Code in 1978, the debtors' exclusivity right was unlimited. Naturally, creditors were unhappy about this, and successfully lobbied for a change. Their efforts culminated to the enactment of § 1121 as part of the Bankruptcy Code of 1978. Section 1121 set forth for the first time a limit to the debtor's exclusivity period. *See* H. 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… At the same time, the bill recognizes the legitimate

would more often than not find that "cause" existed, and would grant the debtor with the extension of the exclusivity period it requested. As a result, the debtor's exclusivity period could stretch to maybe even several years, while creditors were held "hostage," unable to submit their own plans.

In response to this abuse of the exclusivity-period extension, BAPCPA amended § 1121 to place a cap on the period during which the debtor can be the only party in interest to file a plan of reorganization. Under amended § 1121, any extension of the exclusivity period cannot exceed 18 months,[21] while the period for solicitation of acceptances of the plan cannot be extended beyond 20 months after commencement of the case.[22] This amendment marked a significant deviation from the pre-BAPCPA status quo and triggered the opposition of debtors and debtor-friendly parties, who argued that even the maximum period available under the new law is too short for the formulation of a viable reorganization plan.[23]

The other amendment that had the effect of significantly accelerating the debtor's Chapter 11 case was § 365. Section 365 establishes the timeframe during which the debtor-lessee may assume or reject commercial leases. Before the enactment of BAPCPA, the debtor's 60-day deadline could be extended for cause.[24] Once again, the courts would almost always find that "cause" existed for such extensions, thereby stretching the assumption/rejection period at the debtor's will, often until confirmation of the plan of reorganization.[25] Courts would see this extension of the debtor's assumption/rejection period as contributing to the debtor's chances for successful rehabilitation: the debtor was allowed the time it deemed necessary to make an informed decision and avoid the repercussions that premature evaluations of leases might entail. To be sure, a premature rejection of a commercial lease that would later be proved to be beneficial would have the effect of depriving the company of a valuable location, while a premature assumption of a lease, which would be subsequently rejected, would entitle the landlord to administrative expense priority for the *entire* post-petition rent owed.[26]

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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.").

[21] 11 U.S.C. § 1121 (2) (A).

[22] 11 U.S.C. § 1121 (2) (B).

[23] *See e.g.*, Bruce*, supra* note 3. *See also Circuit City Unplugged*, *supra* note 3 (prepared statement of Professor Jack F. Williams) (noting regarding the 18-month exclusivity period that "[m]any constituencies in retail bankruptcy cases have concluded that it is more difficult to move to a consensual plan and may provide a disincentive to certain parties in interest in seeking a consensual plan so that such parties may propose their own plan. Moreover, additional time in a bankruptcy case would allow a greater opportunity to obtain exit financing, a difficult task at the present time when the financial systems are dysfunctional.").

[24] 11 U.S.C. § 365 (d) (as this was stated before the enactment of BAPCPA).

[25] Ira L. Herman, *Statutory Schizophrenia and the New Chapter 11*, 25-JAN AM. BANKR. INST. J. 30, 92 (2007).

[26] *See* David R. Kuney, *Protecting the Landlord's Recent Claim in Bankruptcy: Letter of Credit and Other Issues*, SUO48 ALI-ABA 811 (June 6-8 2013), ("… prior to BAPCPA, case law had generally supported the notion that if a debtor assumes a lease, and then later "breaches" or rejects the lease, all of the damages are entitled to an administrative priority payment."). Within this context, it should be noted that, post-BAPCPA, the landlord is entitled to administrative expense priority for the amount of rent owed for only the two years following the later of the rejection date or the date of the premises turnover. *See* 11 U.S.C. § 503 (b) (7). This provision was likely enacted in recognition that the expedited decisions that the debtor will now have to reach might lead to the assumption of an increased number of premature leases that should be eventually rejected.

Once again, creditors' interests were not in the picture. BAPCPA took this into consideration and gave voice to landlords, who until then had virtually no input into the reorganization process.[27] Specifically, the 2005 amendments extended the assumption/rejection period that the debtor enjoys to 120 days. This period can be extended for "cause" for an additional 90 days.[28] However, any further extension requires the consent of the lessor.[29] It is, therefore, obvious that the 2005 amendments provide landlords with the right to veto the debtor's request for any extensions beyond these initial 210 days. As a result, the debtor must now decide quickly which leases it should keep and which it should reject. Empirical evidence verifies that post-2005 debtors do reach quicker decisions about how to treat the leases in which these debtors are the lessees. In particular, a study conducted by Kenneth Ayotte examines, among other things, the timeframe within which post-2005 debtors decide whether to assume or reject leases and other executory contracts.[30] The sample studied consisted of large Chapter 11 debtors that filed for bankruptcy between 2003 and 2007. The author found that under the pre-BAPCPA regime, debtors would usually postpone the decision about which commercial leases to keep or discard. However, this changed after 2005. According to this study, few post-2005 debtors were able to negotiate an extension of their lease assumption/rejection decision-making period. Specifically, the data indicated that while the pre-BAPCPA debtor reached a decision regarding its leases after 210 days in 48.2% of the cases, the same percentage after the enactment of BAPCPA was only 12.7%.[31]

From the above it is apparent that the post-2005 debtor has less time to resolve its Chapter 11 case. Apart, however, from accelerating the traditional Chapter 11 process, these provisions had the additional effect, as mentioned before, of encouraging and promoting the employment of prepackaged and prenegotiated Chapter 11s, a type of inherently quick bankruptcies.[32] This increased use of preplanned cases was further encouraged by another set of 2005 amendments, analyzed below,[33] that aimed specifically at promoting and facilitating this type of Chapter 11 cases.

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[27] *See Circuit City Unplugged*, *supra* note 3 (opening statements of Hon. Trent Franks) (arguing that "[t]he 2005 reform,…, carefully struck a better balance in Chapter 11's provision affecting relations between retail vendors and their mall and shopping-center landlords.").
[28] 11 U.S.C. § 365 (d) (4) (B) (i).
[29] 11 U.S.C. § 365 (d) (4) (B) (ii) provides, in pertinent part, that: "If the court grants an extension under clause)i_, the court may grant a subsequent extension only upon prior written consent of the lessor in each instance.").
[30] Kenneth Ayotte, Leases and Executory Contracts in Chapter 11, (unpublished manuscript, *available at*: http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2462892).
[31] *Id.*
[32] *See* Teloni, Chapter 11 Duration, Preplanned Cases and Refiling Rates, supra note 5.
[33] *See infra* Part I B (c).

B. TRADITIONAL REORGANIZATION VERSUS PREPLANNED BANKRUPTCIES

a. THE ROAD TO PLAN CONFIRMATION

Uncertainty over the firm's value is at the root of delay in Chapter 11 cases.[34] Once a Chapter 11 petition is filed, intensive negotiations begin among the firm's various classes of creditors and equityholders to reach a consensus as to which will be the value that will be assigned to the reorganized firm. This valuation uncertainty can, naturally, be subject to strategic manipulation. Depending on her level of priority over the firm's assets, and in an attempt to extract as much value out of the reorganization as possible, each stakeholder will advance a different estimate. The higher the level of priority is, the lower the estimate of the firm's value is going to be, and vice versa. For example, a secured creditor will advance a lower estimate of the firm's value in order to end up receiving the whole company. On the contrary, unsecured creditors and equity-holders will advance higher estimates in order to be given the opportunity to participate in the reorganized firm.[35] From the above it is obvious that deciding the firm's value is far from a simple task. Within this context, the Bankruptcy Code has set forth various mechanisms to prevent deadlocks and minimize delay.[36] However, a traditional Chapter 11 process, briefly described below, is still much slower than alternatives that a Chapter 11 debtor may enjoy.

The first step in a Chapter 11 proceeding is the filing of a petition with the bankruptcy court. Once a company enters Chapter 11, the various stakeholders are grouped into classes based on the nature and relative priority of their claims.[37] All impaired classes are then called to vote on the proposed plan of reorganization that sets forth the new capital structure of the company.[38] This voting mechanism is designed to prevent hold-outs that could veto the confirmation of the plan. More specifically, a class is considered to be "impaired," if the reorganization plan alters that class's claims in any way.[39] For the impaired class to accept the plan, 2/3 in amount of the allowed interests and 1/2 in number of those voting have to vote in favor of the plan.[40] Dissidents are bound by the class' acceptance and are protected under the "best interests" test. This means that in order for the plan to be confirmed over the objection of certain claimants, these claimants must receive under the plan at least what they would have

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[34] *See generally* Johnston, *supra* note 17, at 285 (1991); Douglas G. Baird & Donald S. Bernstein, *Absolute Priority, Valuation Uncertainty, and the Reorganization Bargain*, 115 YALE L. J. 1930 (2006); Lucian A. Bebchuck, *A New Approach to Corporate Reorganizations*, 101 HARV. L. REV. 775, 778 (1988) ("… the existing reorganization process resolves the problem of division in a way that suffers from substantial imperfections. These imperfections are all rooted in the *problem of valuation*.") (emphasis added). *See also* Kerry O'Rourke, *Valuation Uncertainty in Chapter 11 Reorganizations*, 2005 COLUM. BUS. L. REV. 403 (2005).

[35] *See, e.g.,* Mark Roe, *Bankruptcy and Debt: A New Model for Corporate Reorganization*, 83 COLUM. L. REV. 527, 537-538 (1983).

[36] For example, contrary to what was happening in the pre-Bankruptcy Code era, a plan of reorganization is confirmed if it is accepted by the various classes of claimants without the need for a judicial valuation that would entail further delay.

[37] 11 U.S.C. § 1123 (1), (2), (3).

[38] 11 U.S.C. § 1126 (a).

[39] Conversely, a class is not considered to be impaired if according to the terms of the proposed plan, that class receives exactly what it was owed. A class that is not impaired is deemed to have accepted the plan, and, therefore, it is not called to vote on the plan.. *See* 11 U.S.C. § 1124.

[40] 11 U.S.C. § 1126 (c), (d), (e).

received from a Chapter 7 liquidation.[41] Adherence to the best interests test requires the determination of the company's liquidation value, something that can introduce further delay of the Chapter 11 process.[42] In the optimistic scenario that all impaired classes vote in favor of the plan, the plan will be submitted to the bankruptcy court for confirmation and the debtor will exit the Chapter 11 case.

However, there is always the possibility that a class as a whole will oppose the proposed reorganization plan. In this case, the Bankruptcy Code provides for a mechanism that permits the uninterrupted advancement of the debtor's reorganization process. Namely, if a class rejects the plan, then the plan can still go forward and eventually be confirmed by the bankruptcy court, if it is "crammed down" upon that dissenting class.[43] The cramdown proceeding starts with the proponent of the plan requesting the bankruptcy court to confirm the plan over the dissenting class' rejection. The court will cram down the plan if certain requirements are met.[44] In particular, the plan must not discriminate unfairly against the dissenting class, and must be fair and equitable as to that dissenting class. Satisfaction of these requirements necessarily implies a judicial valuation, which in turn implies further delay of the Chapter 11 process.

From the above, it is obvious that the road to plan confirmation in a traditional Chapter 11 case can be lengthy and subject to unpredictable reactions by the various classes. Opposition to the plan by a class as a whole will trigger a judicial valuation in the context of a cramdown proceeding that will necessarily further delay the debtor's Chapter 11 case. As a result, debtors have increasingly employed strategies to reduce their time in bankruptcy. One of these strategies involves "quickie" bankruptcies, which can be either prepackaged or prenegotiated cases. These cases greatly reduce the time spent in Chapter 11 because the debtor obtains approval of the plan from its major constituencies before it files for bankruptcy.

b. PREPLANNED BANKRUPTCIES IN GENERAL

Section 1121 (a) provides, in pertinent part, that:

> "The debtor may file a plan with a petition commencing a voluntary case, or at any time in a voluntary case or an involuntary case."[45]

This provision of the Bankruptcy Code explicitly allows the negotiation and formulation of the reorganization plan to take place *before* the filing of the Chapter 11 petition. In other words, § 1121(a), along with several other provisions, inserts into the Chapter 11 process a non-traditional type of bankruptcy, that is, "prepackaged" and "prenegotiated" bankruptcies.

[41] 11 U.S.C. § 1129 (a) (7).

[42] However, it should be noted that in practice the debtor's management offers an estimate of the debtor's liquidation value, and the court accepts this estimate without requiring expert testimony. As a result, there is no significant delay of the reorganization proceedings.

[43] 11 U.S.C. § 1129 (b) (1).

[44] 11 U.S.C. § 1129 (b) (1).

[45] 11 U.S.C. § 1121 (a). *See* Hon. Brian K. Tester et al., *Need for Speed: Prepackaged and Prenegotiated Bankruptcy Plans*, ABI 17th Annual Northeast Bankruptcy Conference, 511 (2010).

Prepackaged and prenegotiated bankruptcies made their appearance in the late 1980s. Since then they have proven to be an exceptionally useful tool for distressed companies that need to delever their balance sheets.[46] Even though prepackaged and prenegotiated bankruptcies follow slightly different paths, their common feature is that they are much shorter and, therefore, entail lower costs than a traditional Chapter 11 case.[47] As a result, debtors have been increasingly employing this type of bankruptcy to minimize the time they spend under Chapter 11 protection, and incur, as it is natural, lower costs. Creditors benefit from the lower costs associated with this type of case, as more value is available for distribution.[48]

Prepackaged bankruptcies provide a distressed company the quickest alternative to a traditional Chapter 11 process, and are even quicker than prenegotiated cases.[49] In a prepackaged bankruptcy, and contrary to what happens in a traditional Chapter 11 case, the debtor starts negotiating with all impaired creditors and interest-holders before the filing of its Chapter 11 petition. Once the debtor obtains the classes' acceptances of its proposed plan, it files for Chapter 11 with the reorganization plan already in place. In other words, the debtor skips the intermediate stages of a traditional Chapter 11 process and proceeds directly to the confirmation of the plan.

In a prenegotiated bankruptcy, negotiations once again take place before the filing of the Chapter 11 petition, but, contrary to what happens in a prepackaged bankruptcy, acceptances are solicited after the commencement of the formal Chapter 11 case. The consensus of the parties is secured by "plan-support," or "lock-up," agreements that have been negotiated pre-petition between the debtor and its major stakeholders. These plan-support agreements provide that the stakeholders will support the reorganization plan in the subsequent voting that will take place under the umbrella of Chapter 11.[50]

Whether the debtor will elect to undergo a traditional Chapter 11 or a prepackaged or prenegotiated bankruptcy depends on a variety of factors. Undeniably, though, both types of

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[46] *See* Dennis J. Connolly, *Current Issues Involving Prepackaged and Prenegotiated Plans*, Norton Annual Survey of Bankruptcy Law (2004); Sandra E. Mayerson, *Current Developments in Prepackaged Bankruptcy Plans*, 838 PLI/Comm 337 (2002). *See also* Theodore Eisenberg & Lynn M. LoPucki *Shopping for Judges: An Empirical Analysis of Venue Choice in Large, Chapter 11 Reorganizations*, 84 CORNELL L. REV. 967, 980-981 (1998-1999) (characterizing the use of prepackaged and prenegotiated bankruptcies as a "recent phenomenon" that made its appearance in the 1990s.).

[47] *See* Eisenberg & LoPucki, *supra* note 46, at 979. *See also* Hon. Brian K. Tester et al., *supra* note 45, at 520-521.

[48] *See infra* Part II.B. for relevant scholarly literature. For the purposes of this article, I set aside the concerns expressed by scholars and practitioners about the effect that these "quickie" bankruptcies may have on the debtors' successful emergence from bankruptcy, as this is measured by a potential subsequent refiling. Indeed, a study has found that the enactment of the 2005 amendments is correlated at a statistically significant level with a higher proportion of refilings. *See* Teloni, *Chapter 11 Duration, Preplanned Cases*, and Refilings, *supra* note 5.

[49] It should be noted, though, that out-of-court restructurings are even quicker. *See* Ronald Lease et al., *Prepacks as a Mechanism for Resolving Financial Distress: The Evidence*, Journal of Applied Corporate Finance, Volume 8:4 (1996) (conducting an empirical study and showing that out-of-court restructurings are the quickest to achieve.) The downside, however, of out-of-court restructurings is that they cannot eliminate the hold-out problem.

[50] *See* Kurt A. Mayr, *Unlocking the Lockup: The Revival of Plan Support Agreements under New § 1125(g) of the Bankruptcy Code*, 15 J. BANKR. L. & PRACT. 6 ART. 1 (2006). *See also* Howard Seife, *Delaware Bankruptcy Court's Rulings Threaten Use Of "Lockup Agreements" In Prenegotiated And Prepackaged Plans,* 121 Banking L.J. 459 (2003).

preplanned bankruptcies provide an appealing alternative to debtors, as they are resolved much more quickly than traditional Chapter 11 cases and therefore entail lower costs.[51]

c. PREPLANNED BANKRUPTCIES IN THE POST-BAPCPA ERA

As mentioned before, the enactment of certain 2005 amendments accelerated the debtor's decision timeframe.[52] Debtors responded to this shortened timeframe by engaging in pre-bankruptcy planning and, therefore, by increasingly structuring their case as a prepackaged or prenegotiated bankruptcy. Additionally, another set of provisions that was enacted in 2005 were specifically intended to facilitate and encourage these "fast-track" bankruptcies. Indeed, sections 1125(g) and 341(e) of the Bankruptcy Code, added by BAPCPA, provide the debtor with greater flexibility, and thus greater incentive, to undergo a preplanned Chapter 11 case.

Under § 1125(b), an acceptance or rejection of the plan can be solicited after the commencement of the Chapter 11 case only if there is a court-approved disclosure statement. A disclosure statement contains all necessary information regarding the debtor's financial condition, including projections about its operational future.[53]

Before the 2005 amendments, and based on this wording of the statute, any solicitation that commenced pre-petition but was completed post-petition without a court-approved disclosure statement could be deemed to violate § 1125(b). Such a violation would result in the designation of those votes in connection with confirmation of the reorganization plan.[54] The risk of violating § 1125(b) existed even in cases where mere technicalities, like the signing of plan-support agreements, would take place after the filing of the Chapter 11 petition absent a court-approved disclosure statement. It follows then that the filing of an involuntary bankruptcy case

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[51] A number of empirical studies have explored the time to confirmation in prepackaged bankruptcies. *See, e.g.*, Edward I. Altman, *The Role Of Distressed Debt Markets, Hedge Funds And Recent Trends In Bankruptcy On The Outcomes Of Chapter 11 Reorganizations*, 22 AM. BANKR. INST. L. REV. 75, 99 (2014) (finding that prepackaged bankruptcies are completed within four months compared to the 16.6 months that a traditional reorganization case needs to be completed.); *See* Lease et al., *supra* note 49 (examining a sample of 49 firms that filed for Chapter 11 and finding that companies that undergo a traditional Chapter 11 spend on average 23.2 months in bankruptcy, while companies that choose to undergo a prepackaged bankruptcy spend on average 3.3 months under bankruptcy protection.); Dennis A. Meloro et al., *The Fast and Laborious: Chapter 11 Case Trends*, ABI JOURNAL (March 2013) (examining a sample of large companies that filed for Chapter from January 1, 2008, to December 31, 2012 and finding that those Chapter 11 cases that were filed in late 2012 concluded more quickly than those filed in early 2008, attributing, further, this phenomenon to the increased use of prepackaged and prenegotiated bankruptcies.).

[52] *See supra* Part I.A.

[53] *See* 11 U.S.C.§ 1125 (b). The disclosure statement is an integral part of the voting process. To be sure, in order for all classes to be able to cast their vote intelligently, they have to be sufficiently informed, among other things, as to the debtor's current and future financial status. This need is served by the disclosure statement that is approved by the bankruptcy court, and contains all relevant information. This court-approved disclosure statement is sent to all stakeholders along with the plan or a court-approved summary of the plan, allowing them to reach an informed decision as to how they will cast their vote in connection with the proposed plan.

[54] *See*, *e.g.*, *In re NII Holdings Inc.*, No. 02-11505 (MFW) (Bankr. D. Del. Oct. 22, 2002); *In re Stations Holding Co., Inc.*, No. 02-10882 (MFW) (Bankr. D. Del. Sept. 25, 2002).

would render useless all prior negotiations, as the debtor would need to obtain a court-approved disclosure statement in order to be able to continue the solicitation process.[55]

This changed with the addition of subsection (g) in 2005.[56] Section 1125(g) provides, in pertinent part, that:

> "notwithstanding subsection (b), an acceptance or rejection of the plan may be solicited from a holder of a claim or interest if such solicitation complies with applicable nonbankruptcy law and if such holder was solicited before (emphasis added)[57] the commencement of the case in a manner complying with applicable nonbankruptcy law."

Under this provision, the debtor can complete post-petition, even before there is a court-approved disclosure statement, a solicitation process that had commenced pre-petition, provided that the requirements set forth by subsection (g) are met.[58] It follows then that post-BAPCPA an incomplete pre-petition solicitation avoids the risk of being invalidated by a subsequent bankruptcy filing. This provision allows the debtor to be more flexible during the negotiations with its major stakeholders and thus makes preplanned cases more attractive.[59]

Additionally, the enactment of another 2005 provision, that is, § 341(e), further shortened preplanned cases and therefore encouraged debtors to choose to undergo such fast-track bankruptcies. In particular, section 341(e) provided an exception to subsection (a). Under § 341(a), the United States Trustee is required to convene and preside over a meeting of creditors. However, on request of a party in interest, and contrary to pre-BAPCPA law, the court can order the U.S. Trustee *not* to convene a creditors' meeting if the debtor was able to obtain acceptances before the commencement of its Chapter 11 case.[60] The apparent logic behind § 341(e) is that,

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[55] The National Bankruptcy Review Commission expressed its concern over this and,, in 1997, it recommended that solicitation be allowed to be continued post-petition (Nat'l Bankr. Rev. Comm'n, 1 Report of the National Bankruptcy Review Commission (1997)).
[56] 11 U.S.C. § 1125 (g).
[57] Emphasis added.
[58] *See, e.g.*, *In re Reddy Ice Inc.*, 12-32349 (Bankr. N.D. Tex. Apr. 12, 2012) (debtors used § 1125 (g) in order to complete after the commencement of the case the solicitation process that they had commenced pre-petition. Had it not § 1125 (g) been enacted, the solicitation process could not have been completed post-petition, rendering the entire pre-bankruptcy planning useless). *See also In re CIT Group, Inc.*, 09-16565 (ALG) (Bankr. S.D.N.Y. Dec. 8 2009).
[59] *See* James H.M. Sprayregen et al., *Need for Speed: Utilizing Hybrid Solicitation Strategies to Shorten Ch. 11 Cases*, 24 BBLR 1351 (2012), also available at: http://www.kirkland.com/siteFiles/Publications/BloombergBNA_Oct%202012.pdf. (citing the prenegotiated case of Reddy Ice Inc., which was completed within 36 days from filing. A mentioned before, *supra* n.65, the debtor, Reddy Ice, utilizing § 1125 (g), was able to commence the solicitation process before the filing of the petition and complete it post-petition without having to wait for the approval of a disclosure statement, shortening, therefore, its Chapter 11 case significantly.).
[60] 11 U.S.C. § 341 (e) provides, in pertinent part, that: "Notwithstanding subsections (a) and (b), the court, on the request of a party in interest and after a notice and a hearing, for cause may order that the United States trustee not convene a meeting of creditors or equity security holders if the debtor has filed a plan as to which the debtor solicited acceptances prior to the commencement of the case.".

provided that the debtor was able to obtain a sufficient number of acceptances pre-petition, a creditor meeting would serve no function.[61]

II. PRESERVING VALUE IN THE POST-BAPCPA ERA – EMPIRICAL EVIDENCE

A. HYPOTHESIS

The purpose of this study is to examine whether BAPCPA had any statistically significant effect on debtors' reorganization values. The hypothesis is that the shortened timeframe that the 2005 amendments imposed on debtors to conclude their Chapter 11 cases, coupled with the attendant increase of the proportion of prepackaged and prenegotiated bankruptcies, had a positive effect on reorganization recoveries. The rationale is that these faster cases entail lower costs and better preserve the firm's value.

To be sure, previous research has found an inverse relationship between time in bankruptcy and reorganization recovery ratios.[62] Starting, therefore, from the premise that shorter duration in bankruptcy is associated with higher reorganization recoveries, and based on the observation that Chapter 11 cases filed after the enactment of the 2005 amendments tend to be disposed more quickly than in the past, we expect to find a positive and statistically significant relationship between the 2005 amendments and reorganization recoveries. Especially, given the low administrative expenses and other costs associated with prepackaged and prenegotiated cases, we would expect to observe a positive and statistically significant relationship between the increased use of this type of bankruptcies and debtor reorganization values.

B. LITERATURE REVIEW

As mentioned above, one previous study examined the effect of the 2005 amendments on the duration of Chapter 11 cases as well as the increased use of preplanned bankruptcies. That

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[61] *See* Hon. Brian K. Tester et al., *Need for Speed: Prepackaged and Prenegotiated Bankruptcy Plans*, ABI 17th Annual Northeast Bankruptcy Conference, 511, 520-521 (2010). *See* also *In re Xerium Technologies Inc.*, 2010 WL 3313079 (Bankr. D. Del. May 12, 2010) (the court directed the U.S. Trustee not to convene a creditor meeting).

[62] *See infra* III (B). *See also* LoPucki & Doherty, *Bankruptcy Fire Sales*, *supra* note 12. The authors do not provide an interpretation of their finding. However, a finding like this could be interpreted in several possible ways. First, lingering in bankruptcy could indicate the distressed company's weak financial position. This, in turn, could suggest that the companies that are eventually able to reorganize in the post-BAPCPA Chapter 11 forum, given the fact that they have to do so in a much shorter time than before, are companies that, on average, enter bankruptcy in better financial shape than companies that were able to reorganize under the pre-BAPCPA regime. Furthermore, a prolonged stay in Chapter 11 might signal to investors the rather weak financial health of the firm, implying that the more efficient thing to do would be for the company to liquidate. This, in turn, could result in the emerging firm's stock trading in lower prices compared to the trading prices of companies that were able to exit Chapter 11 and return to their normal operations faster. Speedy bankruptcies, on the other hand, may signal that the company has value and is worth continuing as a going-concern. Secondly, such a finding could be interpreted as indicating that lingering in bankruptcy is itself a cause for reorganization recoveries to drop, as the diversion of management attention from the debtor's operations for a protracted period of time hurts the debtor's value. Within this context, it seems that the 2005 amendments greatly reduce the direct and indirect costs that the debtor incurs in bankruptcy.

study's sample consisted of large public companies that both filed and exited Chapter 11 between 1997 and 2014.[63] The results indicated that BAPCPA is associated with shorter Chapter 11 case duration. Indeed, the length of traditional Chapter 11 cases fell by 32% in the post-BAPCPA period. In addition, the study found a statistically significant relationship between the 2005 amendments going into effect and the increased use of prepackaged and prenegotiated cases. The proportion of debtors that underwent a preplanned bankruptcy case after the effective date of these 2005 amendments rose by 23%.[64]

Several empirical studies have tested relationships among variables such as liquidity, profitability, duration, and reorganization values or Chapter 11 costs.[65] However, no previous study has examined whether this shortened timeframe that the 2005 amendments imposed on debtors, with the attendant increase of prepackaged and prenegotiated bankruptcies, had any effect on debtors' reorganization values.

For example, Professors LoPucki and Doherty conducted a study that dealt extensively with bankruptcy recoveries. In their article, *Bankruptcy Fire Sales,*[66] LoPucki and Doherty compared the going-concern values of thirty § 363-sales with the reorganization values of thirty reorganization cases. All Chapter 11 cases studied had occurred between 2000 and 2004. The authors calculated the recovery ratios for a sample of § 363 sales, with the ratio defined as sale price divided by the debtor's asset value reported on its Chapter 11 petition. Similarly, recovery ratios were calculated as the debtor's post-emergence value divided by the debtor's asset value listed in its petition.[67] In their regression analysis, LoPucki and Doherty controlled for the number of days between filing and the entry of the sale order or reorganization, respectively. The authors found that bankruptcy duration affected § 363-sale and reorganization cases in opposite

[63] Teloni, Chapter 11 Duration, Preplanned Cases, and Refiling Rates, *supra* note 5.
[64] *Id.*
[65] Though not directly relevant to the present study, it should be noted that M. Carapeto has explored the effect of DIP financing in the Chapter 11 process. She examined a sample of companies that filed a Chapter 11 petition over the period 1986-1997. This sample was further divided to a subsample of companies that secured DIP financing, and a subsample of companies that did not obtain DIP financing. The author found evidence that even though obtaining DIP financing does not seem to affect recoveries, its size does matter. In fact, according to Carapeto, the size of DIP financing seems to have a positive impact on recovery rates. *See* Maria Carapeto, Debtor-in-Possession Financing: Size Does Matter (unpublished manuscript, London Business School, 1998).
[66] LoPucki & Doherty, *supra* note 12.
[67] Reorganization value was calculated as the market value of shares outstanding the first date that the stock began trading after the plan's effective date plus all liabilities as shown on the reorganized companies' balance sheets as of the effective date of the plan. Total assets, as reported in Exhibit A, were used as a proxy for the firm's value. *Id*. at 19. However, it should be noted that this method of calculating reorganization value was heavily criticized by James White in his article *Bankruptcy Noir*, 106 MICH. L. REV. 691 (2008). In particular, White argues that LoPucki and Doherty should have included in the reorganization value only the interest-bearing debt of the company and not its total liabilities. To prove his point, White reran LoPucki and Doherty's regression substituting total liabilities with long-term debt and reached different conclusions. White's article prompted a reply from LoPucki and Doherty through their paper, *Bankruptcy Verite*, 106 MICH. L. REV. 721, 729 (2008). Among other things, LoPucki and Doherty argue that if White wanted to take into account only the company's interest-bearing debt, he should have considered not only its long-term debt, as it seems it was the case, but its short-term debt as well.

directions: more time in bankruptcy was associated with higher sales recoveries but lower reorganization recoveries.[68]

Further, Ronald Lease examined a sample of 49 firms that filed a preplanned Chapter 11 case between 1986 and June 1993.[69] Comparing the results with the results from other studies that examined out-of-court restructurings and traditional Chapter 11s, Lease's study found that the direct costs of prepackaged and prenegotiated bankruptcies, that is, court costs and professional fees, were higher than the costs of out-of-court restructurings but lower than the costs of traditional Chapter 11 reorganizations. The same relationship held for creditor recoveries: creditor recovery rates in prepackaged cases were higher than in traditional Chapter 11 cases but lower than in out-of-court restructurings.[70]

Brian Betker, who also examined a sample of 49 preplanned bankruptcies filed between 1986 and 1993, reached results that are contrary to those of Ronald Lease's study. Betker's data indicated that the direct costs of preplanned bankruptcies are not lower but rather are comparable to those of traditional Chapter 11 cases. However, the study went one step further to quantify a Chapter 11 case's indirect costs such as the costs of losing customers, suppliers, and employees. With respect to this the study found that preplanned bankruptcies entail lower indirect costs compared to traditional Chapter 11 reorganizations.[71]

A later study by Brian Betker contradicted the aforementioned results as to the direct costs of preplanned bankruptcies. In particular, Betker examined an updated sample of companies that had underwent a preplanned bankruptcy and, contrary to what he had found previously, he concluded that direct costs in preplanned bankruptcies are indeed lower than those in traditional Chapter 11s.[72]

Based, therefore, on the finding of previous scholarly literature that creditors recover more when a reorganization case is shorter, and that prepackaged and prenegotiated bankruptcies are cheaper, this article will attempt to answer the question whether the 2005 amendments have affected creditor recoveries in Chapter 11 cases.

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[68] LoPucki & Doherty, *supra* note 14, at 26. LoPucki and Doherty mention as a plausible interpretation of this result that lingering in bankruptcy causes recoveries to drop. *But see* n.112 where the authors express their skepticism about this of this interpretation since they have found in another study that more time in bankruptcy is associated with a lower refiling rate. In particular, in their article, *Why are Delaware and New York Bankruptcy Reorganizations Failing?*, 55 VAND. L. REV. 1933 (2002), LoPucki & Doherty find a negative statistically significant correlation between speed and refiling rates in a bivariate analysis. However, this statistical significance was lost when speed was added as a variable to a multivariate regression model controlling for additional factors.

[69] Ronald Lease et al., *supra* note 49.

[70] *Id*.

[71] Brian L. Betker, *An Empirical Examination of Prepackaged Bankruptcy*, FIN. MGMT. (Spring 1995).

[72] Brian L. Betker, *The Administrative Costs of Debt Restructurings: Some Recent Evidence*, FIN. MGMT. (Winter 1997).

III. METHODOLOGY AND RESULTS

i. Sample Selection and Dependent Variable Calculation

To study the effect of BAPCPA on traditional reorganization values, a sample of companies that filed for Chapter 11 before and after the enactment of the 2005 amendments was examined. The sample of companies was extracted from the UCLA-LoPucki Bankruptcy Research Database (hereafter "BRD") and included large public companies that filed for Chapter 11 between 1997 and 2014.[73] This initial sample was further reduced by excluding finance, real estate, and service companies because these companies follow different accounting rules and are subject to special regulations. From the remaining companies, only those that were able to emerge as public companies after having undergone a traditional Chapter 11 reorganization were included in the final sample.[74] In particular, for a company to qualify for inclusion in the sample, the company had to have a) emerged from a traditional Chapter 11 reorganization process, that is, it must have emerged after effectuating a traditional restructuring of its terms and obligations;[75] and b) filed a 10-K form post-confirmation.[76]

The next step was to calculate each company's reorganization value. Following the methodology that LoPucki and Doherty used in their study, *Bankruptcy Fire Sales*,[77] I calculated reorganization values as the ratio of the company's post-emergence value over that firm's value when it filed for Chapter 11 (hereafter referred to as "recovery ratio").

The numerator of the recovery ratio, that is, the company's post-emergence value, corresponds to the total enterprise value (TEV) of the emerging company. In particular, the TEV was calculated as the sum of the company's market capitalization, that is, shares outstanding multiplied by stock price at the first trading date after the plan's effective date, plus the reorganized company's debt as of the effective date of the plan. Data for stock prices and the number of shares outstanding were gathered from the Center for Research in Security Prices (CRSP).[78] If such data were not available in CRSP, then market capitalization data were extracted from Bloomberg Professional.[79] The reorganized company's debt is computed as the sum of long-term and short-term debt as of the effective date of the plan.[80] Data for the

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[73] The UCLA-LoPucki Bankruptcy Research Database includes data for large public companies with assets of $ 100 million or more that have filed for bankruptcy. These companies must have also filed a 10-K form with the Securities Exchange Commission, for a year ending not less than three years prior to the filing of the bankruptcy case.

[74] These fields were taken from the BRD.

[75] Plan sales were not included in the sample, even if the debtor company emerged as a stand-alone entity.

[76] Publicly traded companies are required to disclose information on an ongoing basis. A company's 10-K form includes financial statements and provides a comprehensive overview of the company's business and financial condition. *See* http://www.sec.gov/answers/form10k.htm

[77] LoPucki & Doherty, *supra* note 11, at 19.

[78] CRSP provides securities date for all companies that trade in one of the major stock exchanges. Access to CRSP is provided through the wrds-web.wharton.upenn.edu.

[79] The Bloomberg Professional Service provides a vast array of financial data for companies worldwide. Access to this service is enabled through the Bloomberg Terminal.

[80] Including capital leases and current portion of long-term debt.

reorganized company's debt were gathered from the successor company's balance sheets as shown on its first post-confirmation 10-K.

Finally, the amount of assets that the debtor reported when it filed its Chapter 11 petition (hereafter referred to as "listed assets") is used as a proxy for the firm's value at the time of the filing event.[81] Relevant data were gathered from the BRD.

All data were available for 51 companies. This final sample was further divided into two subsamples that reflect the pre-BAPCPA and post-BAPCPA periods.[82]

Table 1 displays descriptive statistics for the companies of the sample. All financial data were collected from Compustat and correspond to the last fiscal year before the filing event.[83] If data for the last fiscal year before the filing event were not available, then data for the second-to-last fiscal year are used.

Table 1

Descriptive Statistics (Corresponding to the pre-filing period)

For the total of 51 companies, financial data were gathered from Compustat and correspond to the last fiscal year before the filing event. If data for the last fiscal year before the filing event were not available, then data for the second-to-last fiscal year are used. The cells reflect the means, and in parentheses the corresponding medians, for each item for the periods before and after BAPCPA. For the assets and liabilities, the means and medians presented correspond to the logarithm of the respective quantities measured in millions of dollars.

	Pre-BAPCPA	**Post-BAPCPA**
Number of Firms	31	20
Total Assets	3.45 (3.43)	3.41 (3.45)
Total Liabilities	3.46 (3.39)	3.57 (3.78)
Net Income / Total Assets	-0.32 (-0.15)	-0.23 (-0.22)

[81] Data for "listed assets" were gathered from the BRD.
[82] The earliest Chapter 11 case in the sample was filed in 1997 and the latest in 2013.
[83] Compustat is an extensive database that provides financial data for companies worldwide. Access to Compustat is provided through the wrds-web.wharton.upenn.edu.

EBIT / Total Assets	-0.04 (-0.03)	-0.02 (-0.004)
Current Assets / Current Liabilities	0.91 (0.8)	1.01 (0.93)

Companies before and after BAPCPA seem to have entered Chapter 11 with a similar pre-filing financial profile. However, it is interesting to note that firms that reorganized and emerged as public companies post-BAPCPA had a slightly higher EBIT-to-total assets ratio. Though this increase was measured not to be statistically significant,[84] perhaps it is an indicator that in the post-BAPCPA era a company has to enter bankruptcy in a better shape to have a chance to reorganize in the traditional sense.

Table 2 compares the means of recovery ratios for the period before and after the enactment of BAPCPA. At an initial level, we observe that the recovery ratio mean rose from 0.51 in the pre-BAPCPA period to 0.8 in the post-BAPCPA period. Additionally, this difference in means is statistically significant at 10% confidence level. Table 3 reports the recovery ratio means separately for preplanned and non-preplanned cases in the pre-BAPCPA and post-BAPCPA period. The proportion of preplanned cases for the periods before and after the effective date of the 2005 amendments is also displayed.

Table 2

T-test Comparing the Means in Recovery Ratios Before and After BAPCPA

One-tail t-test comparing the means of traditional reorganization recovery ratios for the period before and after the enactment of BAPCPA. For the calculation of the companies' recovery ratios, data were gathered from CRSP, the BRD, as well as the emerging companies' 10-K forms.

	Pre-BAPCPA	**Post-BAPCPA**
Mean	0.51	0.8
Observations	31	20
t Stat	-1.37	
P-value	9%	
t Critical	1.67	

Statistically significant at the 10% level.

[84] The two-tail t-test did not return any statistically significant results.

Table 3

Recovery Ratio Means for Preplanned and Non-Preplanned Cases for the Periods Before and After BAPCPA's Effective Date

For the calculation of the companies' recovery ratios, data were gathered from CRSP, the BRD, as well as the emerging companies' 10-K forms.

	Pre-BAPCPA	**Post-BAPCPA**
Recovery Ratio Means (preplanned cases)	0.77	1.01
Recovery Ration Means (non-preplanned cases)	0.389	0.393
Proportion of Preplanned Cases	32%	65%

ii. Regression Model and Variable Selection

As mentioned above, in order to examine whether there has been any statistically significant change in traditional reorganization recoveries in the post-BAPCPA era, the recovery ratio was calculated for each company. Also, as the t-test indicated, post-2005 debtors emerge with higher reorganization values.

However, this difference in means may be attributable to additional factors. For example, as the descriptive statistics above indicated, post-2005 debtors enter Chapter 11 with slightly higher pre-filing earnings. As a result, this might have positively affected these debtors' eventual reorganization recoveries. Also, periods of economic recession could have an adverse effect on the values at which companies are able to reorganize. Therefore, to take account of other factors potentially affecting the outcome, a multivariate regression model is employed. The variables included in the regression are briefly described below.

As mentioned before, the dependent variable in the regression model is the companies' recovery ratio, that is, the TEV-to-listed assets ratio. The higher the ratio is, the higher the recovery.

The independent variables included are the binary variables of BAPCPA and economic recession, as well as variables measuring the strength, profitability, and liquidity of the company. Financial data correspond to the fiscal year before bankruptcy. If such data were not available, then they correspond to the second-to-last fiscal year before bankruptcy. Additionally, the regression model controlled for the company's post-confirmation leverage. "Total assets" are reported on a book value basis.

In particular, the regression model consists of the following independent variables:

- BAPCPA: the "BAPCPA" variable is a binary variable that takes the value of 1 if the company filed for Chapter 11 after October 17, 2005 (BAPCPA's effective date), and 0 if a Chapter 11 bankruptcy was filed before the aforementioned date.

- Economic Recession: a binary variable that takes the value of 1 if the company filed for Chapter 11 within a period of recession, and 0 if not. In the present sample we observe two recession periods: March 2001 to November 2001, and December 2007 to June 2009.[85]

- EBIT-to-Total Assets: a variable that measures the company's pre-filing earnings relative to its total assets.

- Net Income-to-Total Assets: a variable that measures the company's pre-filing profitability relative to its total assets.

- Current Assets / Current Liabilities: a variable that measures the company's pre-filing liquidity.

- Liability / Total Assets (pre-filing): a ratio measuring the company's leverage in the last or second-to-last year before the filing event.

  Price-to-earnings: To control for changes in stock-market performance that might have affected recoveries, the Shiller price-to-earnings ratio for the S&P 500 was used. The ratio used corresponds to the month in which each company started trading its shares.[86]

- Total Debt-to-Total Assets (post-confirmation): The final variable included in the regression model was the company's post-confirmation leverage ratio. As mentioned above, the reorganized companies' total debt is computed as the sum of their long-term and short-term debt after they emerged. Relevant data were extracted from the first 10-K form filed after the debtors' emergence from their Chapter 11 proceedings.[87]

iii. Results

Table 4 displays the results of the multivariate regression model that was employed to examine BAPCPA's potential effect on traditional reorganization values.

[85] I identify periods of recession based on the U.S. cycle of expansions and contractions dates as these are defined by the National Bureau of Economic Research (www.NBER.org/cycles/cyclesmain.html).
[86] Data are available at: www.multpl.com/shiller-pe/table?f=m.
[87] Including capital leases and current portion of long-term debt.

Table 4

Effect of BAPCPA on Recoveries

Financial data correspond to the last fiscal year before bankruptcy. If such data are not available, then they correspond to the second-to-last fiscal year before bankruptcy. All financial data were drawn from Compustat. The total debt-to- total assets ratio corresponds to the debtor's post-confirmation period. Data for the numerator of this ratio, that is, total debt, were gathered from the companies' first post-confirmation 10-K forms. Data for the denominator of the ratio, that is, total assets, were gathered from the BRD.

	Coefficient	**P-value**
Constant	0.15	84%
BAPCPA	0.48	8%*
Economic Recession	-0.51	10%*
EBIT / Total Assets	0.34	62%
Net Income / Total Assets	-0.15	68%
Current Assets / Current Liabilities	-0.0005	100%
Total Liabilities / Total Assets	0.25	20%
Price-to-Earnings	0.0009	97%
Total Debt /Total Assets (post-confirmation)	0.3	63%

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

Consistent with the univariate results presented above,[88] we observe that BAPCPA is positively correlated with traditional reorganization recoveries at a statistically significant level. In particular, the p-value corresponding to the "BAPCPA" variable is 8%. The variable of economic recession seems to affect traditional reorganization recoveries as well. In particular, the variable of economic recession has a p-value of 10% and is negatively correlated with recoveries, indicating that in recession periods recoveries tend to be lower. Furthermore, the EBIT-to-assets ratio is positively correlated with the dependent variable of the regression model, indicating that a stronger company has a greater probability of achieving a higher reorganization value. The same results hold if we additionally control in the regression model for firm size.[89] In particular, and similarly with what LoPucki and Doherty observe,[90] I find that firm size does not affect recoveries. At the same time, the inclusion of the "firm size" variable in the regression model did not affect the "BAPCPA" variable, which remained positively correlated with higher reorganization values at a statistically significant level.[91]

Summarizing the results of the regression model, we observe that the debtor's pre-filing financial profile did not seem to have a significant impact on the debtors' reorganization recoveries. However, the variable that is of main concern here, BAPCPA, is positively correlated with the dependent variable of reorganization recoveries. In particular, the results of the regression show that companies that undergo a traditional reorganization in the post-BAPCPA period emerge with higher reorganization values. The question raised, therefore, is to which characteristic of the post--BAPCPA reorganization era could this increase be attributed.

A potential answer to the aforementioned question could be the reduced timeframe within which Chapter 11 cases tend to be resolved after BAPCPA took effect. Indeed, as previous research has shown, Chapter 11 cases that were filed after the effective date of the 2005 amendments tend to be resolved in less time compared to the pre-BAPCPA bankruptcies, encouraging and promoting extensive pre-bankruptcy planning.[92] Indeed, as a result of the enactment of BAPCPA, debtors increasingly choose to structure their case as a prepackaged or pre-negotiated bankruptcy.[93] Naturally, and as previous literature has shown, this type of Chapter of 11s entail lower costs compared to the traditional Chapter 11 plan process.[94]

To test the validity of the aforementioned hypothesis, the association of prepacks with higher reorganization recoveries had to be examined. Therefore, the BAPCPA independent variable was replaced with a binary variable for prepackaged and prenegotiated Chapter 11 cases. Data regarding whether each Chapter 11 case was preplanned or not were gathered from the BRD. The same independent variables included in the first regression model were also used here.

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[88] *See infra* Part II (ii) (Table 2).
[89] The logarithm of the total book value of the assets was used as a proxy for firm size.
[90] LoPucki & Doherty, *supra* note 11, at 31.
[91] In particular, the p-value for BAPCPA remained significant at the 10% confidence level even when controlled for firm size.
[92] *See* Teloni, *Chapter 11 Duration, Preplanned Cases and Refiling Rates*, *supra* note 5.
[93] *Id.*
[94] *See, e.g.*, Ronald Lease et al., *supra* note 49.

The results of this regression, displayed in Table 5 below, indicated that preplanned cases are positively correlated with traditional reorganization recoveries at a statistically significant level. In particular, the p-value corresponding to the independent variable of "preplanned Chapter 11s" is 3%.

Table 5

Effect of Preplanned Cases on Recoveries

Financial data correspond to the last fiscal year before bankruptcy. If such data are not available, then they correspond to the second-to-last fiscal year before bankruptcy. All financial data were drawn from Compustat. The total debt-to- total assets ratio corresponds to the debtor's post-confirmation period. Data for the numerator of this ratio, that is, total debt, were gathered from the companies' first post-confirmation 10-K forms. Data for the denominator of the ratio, that is, total assets, were gathered from the BRD. Data regarding the type of case, i.e. whether it was a prepackaged or prenegotiated reorganization, were drawn from the BRD.

	Coefficient	**P-value**
Constant	0.74	26%
Preplanned Chapter 11s	0.51	3%**
Economic Recession	-0.28	32%
EBIT / Total Assets	0.81	32%
Net Income / Total Assets	-0.04	91%
Current Assets / Current Liabilities	-0.04	81%
Total Liabilities / Total Assets	0.16	40%
Price-to-Earnings	-0.014	52%

Total Debt /Total Assets (post-confirmation)	-0.22	72%

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

As anticipated, and given that it has already been shown that BAPCPA is positively correlated with preplanned bankruptcies, when the regression model included as independent variables both the "BAPCPA" variable and the "Preplanned Chapter 11s" variable, both lost statistical significance.

Concluding, higher reorganization recoveries in the post-BAPCPA era appear to be associated with the increased frequency of prepackaged and prenegotiated cases. This increased use of prepacks is, in turn, attributed to the favorable regime that BAPCPA enacted for the employment of such strategies.

IV. CONCLUSION AND FURTHER RESEARCH QUESTIONS

The 2005 amendments have shortened Chapter 11 reorganizations.[95] While it is debatable whether shortened timeframes reduce a debtor's chances of reorganizing, this Article has shown that, when debtors nonetheless can reorganize, creditors recover more than they did before the 2005 amendments. Higher recoveries are the result of the increased frequency of preplanned cases, which are faster and cheaper than traditional reorganization cases.

A question for further research is whether the 2005 amendments have affected sales prices in § 363 sales. Previous research has established a significant increase in § 363-sales as a proportion of bankruptcy cases since 2005.[96] The condensed bankruptcy timeframe post-2005 implies lower sales prices, but this implication has yet to be tested empirically. If sales prices are indeed lower, the question raised is why do creditors nonetheless push for sales rather than reorganizations.

Given that the 2005 amendments have led to more preplanned cases, which are faster and cheaper than traditional cases, another interesting question is whether the proportion of foreign debtors that file for Chapter 11 protection in order to avail themselves of these benefits has increased. Very few foreign legal regimes allow preplanned bankruptcies. We thus can anticipate that more foreign debtors especially now attempt to effectuate a U.S. prepackaged bankruptcy in order to reduce the time and costs of complex and expensive cross-border insolvencies.[97]

[95] *See* Teloni, Chapter 11 Duration, Preplanned Cases, and Refiling Rates, *supra* note 5.
[96] *See* Teloni, *The Bankruptcy Abuse Prevention and Consumer Protection Act*, *supra* note 2.
[97] *See* Mayr, *supra* note 50, (discussing the benefits that prepackaged bankruptcies can confer to the reorganization cases of foreign debtors).