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## SYSTEMIC RISK & CHAPTER 11

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*The systemic risk to the automotive industry and the overall U.S. economy are [sic] considerable, just as the bankruptcy of Lehman had a ripple effect throughout the financial industry. . . . Based upon exhaustive analysis, these risks outweigh the benefits of a bankruptcy based approach to the Company's restructuring.<sup>1</sup>*

### I. INTRODUCTION

The U.S. economy lost more than 650,000 jobs in February of 2009, and the unemployment rate hit eight percent, the highest rate since the early Reagan administration.<sup>2</sup> It would have seemed inconceivable six months ago to consider General Electric (“GE”) a risky investment, but as of this writing, GE is trading in the credit default swap (“CDS”) market<sup>3</sup> with “points upfront,” typically an indication of a high near-term probability of default.<sup>4</sup> In early September of 2008, just before Lehman Brothers entered bankruptcy, there were about seventy-five companies trading “upfront.” By March of 2009, the number was 260.<sup>5</sup>

In this context, chapter 11 is notable in its absence. Chapter 11 is the thing that wrecked Lehman Brothers and perhaps the credit markets.<sup>6</sup> It is the thing that the Federal Reserve and Treasury worked so hard to keep AIG and Bear Stearns

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1. GEN. MOTORS CORP., 2009–2014 RESTRUCTURING PLAN 103 (2009), available at <http://graphics8.nytimes.com/packages/pdf/business/20090217GMRestructuringPlan.pdf>.

2. Peter S. Goodman & Jack Healy, *Job Losses Hint at Vast Remaking of U.S. Economy*, N.Y. TIMES, Mar. 7, 2009, at A1.

3. Under a CDS contract, the protection buyer agrees to make periodic payments to the protection seller. The protection seller agrees to pay the buyer if a “credit event” occurs with regard to a third party (GE in the example in the text). Stephen J. Lubben, *Credit Derivatives and the Resolution of Financial Distress*, in THE CREDIT DERIVATIVES HANDBOOK: GLOBAL PERSPECTIVES, INNOVATIONS, AND MARKET DRIVERS 47, 49 (Greg N. Gregoriou & Paul U. Ali eds., 2008).

4. In mid-March of 2009, S&P downgraded GE to AA+. GE had held a AAA rating from both major rating agencies since 1967. Binyamin Appelbaum, *Berkshire, GE Lose Top Credit Ratings*, WASH. POST, Mar. 13, 2009, at D01, available at <http://www.washingtonpost.com/wpdyn/content/article/2009/03/12/AR2009031203580.html?nav=emailpage>. Even at the reduced rating, this indicates less risk of default than the CDS market implied.

5. Information on the CDS market used in this paragraph comes from [www.markit.com](http://www.markit.com). Markit, <http://www.markit.com> (last visited Aug. 23, 2009) (paid access required).

6. See Paul Krugman, Op-Ed., *Banking on the Brink*, N.Y. TIMES, Feb. 23, 2009, at A27, available at <http://www.nytimes.com/2009/02/23/opinion/23krugman.html> (noting that when United States allowed Lehman Brothers to collapse into chapter 11, credit-market-dependent world financial system was nearly destroyed).

away from,<sup>7</sup> and the thing that General Motors and Chrysler were working so hard to avoid.<sup>8</sup> Chapter 11 is something to be feared, not part of the solution.<sup>9</sup>

This apprehension of chapter 11 predates the recent financial crisis. Asset securitization, the premiere new financial vehicle of the last decade, represents a straightforward effort to exploit formalities to avoid chapter 11.<sup>10</sup> In a typical securitization transaction, income-producing assets are sold to a newly created legal entity.<sup>11</sup> This entity's governing documents are designed with features that prevent a voluntary bankruptcy filing, and the entity is limited in purpose to avoid creation of creditors who might support an involuntary filing.<sup>12</sup>

Similarly, credit derivatives originally developed as a kind of insurance against default, but speculative trading in these instruments grew from the belief by many investors that it was better to trade in "debt" that came unburdened by the other roles accompanying traditional debt ownership, including potential obligations to work with a debtor toward a restructuring.<sup>13</sup> More broadly, in 2005 the derivatives industry obtained a broad exemption from the key provisions of chapter 11, primarily based on the dubious argument that chapter 11 represented a threat to the overall financial system.<sup>14</sup>

In a rather ironic twist, both proponents of the alleged sources of the current financial crisis—credit derivatives and asset securitization—and those that would

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7. See Joe Nocera, *Propping Up a House of Cards*, N.Y. TIMES, Feb. 28, 2009, at B1 (discussing federal plans to rescue AIG); Andrew Ross Sorkin, *JP Morgan Pays \$2 a Share for Bear Stearns*, N.Y. TIMES, Mar. 17, 2008, at A1 (noting that cut-rate deal for Bear Stearns's stock was done at Federal Reserve's behest).

8. See Brian J. O'Connor, *Pain and Gain Await Chrysler in Bankruptcy Court*, DETROIT NEWS, May 1, 2009 (explaining Chrysler's expected execution of bankruptcy and highlighting negative aspects); John Reed & Bernard Simon, *GM Issues Warning on Cash and Sales*, FIN. TIMES (London), Mar. 6, 2009, at 1 (discussing GM liquidity crisis and possible bankruptcy). Chrysler filed its chapter 11 petition on April 30, 2009. O'Connor, *supra*.

9. See Jonathan C. Lipson, *The Shadow Bankruptcy System*, 89 B.U. L. REV. 1609, 1612 (2009) (noting widespread fear and distrust of chapter 11 evidenced in recent economic crisis).

10. See Stephen J. Lubben, *Beyond True Sales: Securitization and Chapter 11*, 1 N.Y.U. J. L. & BUS. 89, 94–95 (2004) (discussing how securitization reduces costs associated with bankruptcy filing because it can protect assets from bankruptcy estate); Steven L. Schwarcz, *Structured Finance: The New Way to Securitise Assets*, 11 CARDOZO L. REV. 607, 613–19 (1990) (discussing ways to keep special vehicles or trusts which hold securities separate from bankruptcy).

11. Cf. Baher Azmy, *Squaring the Predatory Lending Circle*, 57 FLA. L. REV. 295, 315–16 (2005) (discussing process of securitization, including assignment of loans to special purpose vehicles, which are typically set up as trusts).

12. See Lubben, *supra* note 10, at 93–95 (discussing securitization's financial benefits and role in preventing piercing the corporate veil).

13. Stephen J. Lubben, *Credit Derivatives and the Future of Chapter 11*, 81 AM. BANKR. L.J. 405, 410–11 (2007); see also Anna Gelpern, *Domestic Bonds, Credit Derivatives, and the Next Transformation of Sovereign Debt*, 83 CHI.-KENT L. REV. 147, 169 (2008) (explaining that investors use credit default swap contracts to relieve themselves of risk of holding debt).

14. See Franklin R. Edwards & Edward R. Morrison, *Derivatives and the Bankruptcy Code: Why the Special Treatment?*, 22 YALE J. ON REG. 91, 97 (2005) (discussing effects of legislation and congressional reasoning as evidenced in legislative history).

rescue us from the crisis share a common skepticism of chapter 11. In this puzzling context, it bears asking if the fear of chapter 11 is warranted.

In particular, what role does chapter 11 play in a time of widespread financial distress? Does it matter if the financial distress affects financial firms like Lehman and AIG, or traditional industrial firms like GM? And if chapter 11 has a role to play, what accounts for the suspicion of chapter 11 among nonlegal professionals?

I begin to examine these questions by probing the fear of chapter 11, which is often premised on the speculation that if one firm in an industry were to enter chapter 11, then proximate firms would follow in a domino effect—that is, chapter 11 will create systemic risk.<sup>15</sup> The lack of any actual examples of an industry-wide cascade of failure in the century-long history of American corporate reorganization undermines the notion that chapter 11 could be the cause of such an occurrence. Particular industries have experienced waves of the financial distress—at present, the newspaper industry is experiencing one—but this seems to be most often caused by the similar assets owned or the common business cycles faced by these firms, rather than any particular aspect of chapter 11.<sup>16</sup>

In short, I reject the foundational premise for much of the fear of utilizing chapter 11 in the present crisis. The start of the present financial crisis involved two problems: a lack of lending and a lack of investment. Now the crisis appears to have evolved, with declining home prices, retirement account balances, and low consumer confidence stalling the economy; the initial alarm being replaced with protracted investor insecurity about the basic competence of key financial institutions and their executives. Chapter 11 does not obviously exacerbate any of these problems, and indeed chapter 11 has a role to play in dissipating panics through the automatic stay.<sup>17</sup>

Having cracked open the door for a potential role for chapter 11, I next directly examine the use of chapter 11 in times of systemic crisis. In particular, I examine the utility of chapter 11 with regard to the different types of debtors. There seems to be no reason why an industrial firm like GM should not use chapter 11—these kinds of debtors were exactly the firms that Congress had in mind when it adopted the chapter in 1978.<sup>18</sup> As recent events have shown, the belief that

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15. Systemic risk is the risk that the failure of a firm will result in market-wide failures as a result of the firm's interconnectedness with other comparable firms in the market. See Steven L. Schwarcz, *Systemic Risk*, 97 GEO. L.J. 193, 196–204 (2008) (defining systemic risk as: “the risk that (i) an economic shock such as market or institutional failure triggers (through a panic or otherwise) either (X) the failure of a chain of markets or institutions or (Y) a chain of significant losses to financial institutions, (ii) resulting in increases in the cost of capital or decreases in its availability, often evidenced by substantial financial-market price volatility”).

16. Cf. Jean Helwege, *Financial Firm Bankruptcy and Systemic Risk*, 20 J. INT'L FIN. MARKETS, INSTITUTIONS & MONEY, Feb. 2010, at 1, 2 (arguing that bankruptcies of financial firms “are symptomatic of common factors in portfolios that lead to wealth losses regardless of whether any particular firm files for bankruptcy”).

17. See 11 U.S.C. § 362 (2006) (codifying automatic stay).

18. See Douglas G. Baird & Robert K. Rasmussen, *The End of Bankruptcy*, 55 STAN. L. REV. 751, 758–59 (2002) (noting that origins of corporate reorganization law arose from failing industrial firms such as railroad companies).

bankruptcy would mean GM goes “bust” reflects either a serious misunderstanding of chapter 11 or an intentional effort to create fear and panic about chapter 11 to support the case for a bailout.

Financial firms represent a more difficult task.<sup>19</sup> Because investment banks like Lehman Brothers are entirely dependent on their credit rating and reputation (to the extent those are different things), reorganization is unlikely to be an option. Nevertheless, chapter 11 provides an effective means of liquidating a larger corporation and thus can play a role here too.<sup>20</sup> I thus argue that the Treasury Secretary’s recent plan to create a new system for the liquidation or reorganization of financial firms represents an unnecessary duplication of existing structures.<sup>21</sup>

Beneath this analysis is an argument that Lehman’s chapter 11 filing did not cause the current credit crisis, but rather Lehman’s *failure* caused the crisis. That failure was likely to occur with or without chapter 11, unless the government prevented it or mitigated its consequences, as in the case of AIG. Chapter 11 has (or at least had) a role to play here, by providing a framework for government intervention that avoids the need for the kind of intervention we have recently been seeing on an ad hoc basis. The company in question enters chapter 11, which provides a kind of breathing space that prevents a “run on the bank,” at which point the government can step in to save counterparties from their exposure to the debtor if policymakers feel that such a step is warranted.

The key caveat to all of this is the unbridled fear of chapter 11. Companies avoid chapter 11 because key players argue that chapter 11 will make matters worse. Accepting this argument at face value, Congress has largely acquiesced by creating new exceptions from chapter 11.<sup>22</sup> The “chancellor’s umbrella” that once protected firms from financial storms has become so perforated that it barely serves its function anymore.<sup>23</sup> The brisk demise of Circuit City, rooted in large part in the landlord-friendly 2005 amendments to § 365(d)(4),<sup>24</sup> is but the most obvious example of this phenomenon in action.<sup>25</sup>

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19. See generally Kenneth Ayotte & David A. Skeel, Jr., *Bankruptcy or Bailouts?*, 35 J. CORP. L. (forthcoming 2010) (manuscript at 13–17), available at <http://ssrn.com/abstract=1362639> (discussing bankruptcy and governmental bailouts in context of financial institutions).

20. See Stephen J. Lubben, *Business Liquidation*, 81 AM. BANKR. L.J. 65, 68–69 (2007) (explaining basic features of chapter 11 liquidation and its possible benefits as compared to chapter 7 cases).

21. See Davis Polk & Wardwell Client Memo, Treasury’s Proposed Resolution Authority for Systemically Significant Financial Companies, at 11–12 (Mar. 30, 2009), available at <http://www.davispolk.com/1485409/clientmemos/2009/03.30.09.resolution.authority.pdf> (explaining that proposed legislation would fail to create single, uniform bankruptcy code).

22. See H.R. REP. NO. 109-31, pt. 1, at 20 (2005), reprinted in 2005 U.S.C.C.A.N. 88, 105–06 (creating exceptions to reduce systemic risk in financial industry).

23. See generally Richard Levin & Alesia Ranney-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) (discussing how BAPCPA’s changes to chapter 11 reorganization law generally adversely affect businesses’ ability to reorganize).

24. Under the current provision, retail debtors have an extremely short period of time to decide whether to assume (perform) or reject (breach) a commercial lease agreement. See 11 U.S.C. § 365(d)(4) (2006) (allowing court to extend time for maximum of ninety days). In a retail chapter 11 case, these

I conclude by arguing that the obsessive focus on bankruptcy avoidance in the last decade—a consequence of the fear of chapter 11—moved the financial industry’s focus away from credit analysis. Once achieved, the apparent goal of avoiding any interaction with chapter 11 took priority over a real analysis of the risks of the underlying loan transaction. But avoiding chapter 11 is clearly not the same thing as avoiding default. This is yet another reason why it may be time to reconsider the piecemeal erosion of chapter 11 and return to the more inclusive bankruptcy process that Congress enacted in 1978.

## II. SYSTEMIC RISK AND THE FEAR OF CHAPTER 11

Avoidance of chapter 11 is often based on fears of systemic risk.<sup>26</sup> For example, as highlighted by the quote at the start of this paper, General Motors recently justified its efforts to restructure outside of chapter 11 in terms of the systemic risks that would allegedly result from such a bankruptcy case.

When firms or creditors say that a particular chapter 11 case would create systemic risk, they argue that the debtor in question has become so intertwined with the economy that the debtor’s failure will leave a hole in some relevant market, with collateral effects for all the nondebtor firms whose future depends on the debtor. The GM quote at the outset of this Article and the case of AIG, which was reportedly saved by the government to avoid the effects of AIG’s default on the broader CDS market,<sup>27</sup> are recent examples of such a systemic risk argument.

But this is not really an argument about chapter 11. The systemic risk in both the GM and AIG examples is not a creation of chapter 11, but rather this risk was created at the point when these companies became “too big to fail.”<sup>28</sup> A chapter 11 filing may represent the point when this risk is realized or even the point at which the risk becomes understood and known to the markets, raising important questions regarding the efficiency of these markets, but chapter 11 does not create any new systemic risk in this instance.

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decisions are central to the debtor’s reorganization plan, yet often the debtor must decide well before a plan is sensibly negotiated. Before 2005, bankruptcy courts had the ability to extend the time for assumption or rejection until much later in the case, at which point a debtor could make the decision in conjunction with its overall reorganization plans. See An Act to Establish a Uniform Law on the Subject of Bankruptcies, Pub. L. No. 95-598, § 365(b)(2), 92 Stat. 2549, 2576 (1978) (codified at 11 U.S.C. § 365(b)(2)) (allowing court to extend debtor’s decision to assume or reject commercial lease).

25. Circuit City, one of the largest electronics retailers in the country, liquidated after it was unable to find a buyer for its stores before its financing terminated. Jonathan Birchall, *Circuit City to Liquidate All Stores*, FIN. TIMES, Jan. 16, 2009, available at <http://www.ft.com/cms/s/0/d974178c-e3eb-11dd-8274-0000779fd2ac.html>.

26. See Karen P. Ramdhanie, Note, *Derivatives Contracts of Insolvent Companies: Preferential Treatment Under the Bankruptcy Code of the United States and the Insolvency Laws of the United Kingdom*, 18 N.Y.L. SCH. J. INT’L & COMP. L. 269, 297–98 (1999) (discussing congressional concerns about systemic risk); see also H.R. REP. No. 109-31, pt. 1, at 3, reprinted in 2005 U.S.C.C.A.N. 88, 90 (noting legislative provisions designed to reduce systemic risk).

27. Posting of Felix Salmon to Reuters Blogs, *Are CDS a Good Thing?*, <http://blogs.reuters.com/felix-salmon/2009/04/24/are-cds-a-good-thing> (Apr. 24, 2009).

28. See *infra* notes 29–30 and accompanying text for an explanation of why it seems doubtful that GM fits into the typical systemic risk story, inasmuch as it is not interconnected with its peer firms.

Even the example of derivative contracts and the putative need to avoid chapter 11 because of increased systemic risks represent an effort to tar chapter 11 with the risks inherent in the current nature of the derivatives markets. Initially, note that the systemic risk argument only holds with regard to financial firms. Financial firms buy and sell derivative contracts, whereas, as I have argued elsewhere, nonfinancial firms do not present the same question of interlocking derivative contracts inasmuch as they are only on the “buy side” of derivative transactions.<sup>29</sup> Manufacturing firms also do not have the same kind of horizontal relationships with their peers that financial firms have (for example, GM does not have significant contracts with Toyota or Ford). This raises the question of whether a failure of a firm like GM can ever be said to involve systemic risk.

In this context, the failure of a real economy firm does not present the counterparty with the loss of protection needed to guard against losses in another security or to balance a portfolio.<sup>30</sup> For this reason, the recent amendments to the Bankruptcy Code are at the very least overbroad, inasmuch as they move all derivative contracts outside of the bankruptcy system.<sup>31</sup>

**Table 1: Top Recipients of AIG Collateral Payments**

<i>Recipients</i>	<i>Billions of U.S. Dollars</i>
Societe Generale	\$4.1
Deutsche Bank	\$2.6
Goldman Sachs	\$2.5
Merrill Lynch	\$1.8
Calyon	\$1.1
Barclays	\$0.9
UBS	\$0.8
DZ Bank	\$0.7
Wachovia	\$0.7
Rabobank	\$0.5
KFW	\$0.5
JPMorgan	\$0.4

*Source: [http://www.aig.com/aigweb/internet/en/files/CounterpartyAttachments031809\\_tcm385-155645.pdf](http://www.aig.com/aigweb/internet/en/files/CounterpartyAttachments031809_tcm385-155645.pdf)*

29. See generally Stephen J. Lubben, *Derivatives and Bankruptcy: The Flawed Case for Special Treatment*, 12 U. PA. J. BUS. L. 61 (2009).

30. Lubben, *supra* note 13, at 413–17.

31. See Kenneth C. Kettering, *Securitization and its Discontents: The Dynamics of Financial Product Development*, 29 CARDOZO L. REV. 1553, 1648 (2008) (describing Bankruptcy Code amendment exempting over-the-counter derivative contracts).

In the instance of financial firms, the case of AIG offers a ready example of how the structure of derivatives trading—particularly trading in credit derivatives—can create systemic risk, but even here there is little support for the notion that subjecting these firms to the Bankruptcy Code would create any additional systemic risk.

In its June 2008 Form 10-Q, AIG reported that “[a]pproximately \$307 billion of the \$441 billion in [credit default swaps written by AIG were] written to facilitate regulatory capital relief for financial institutions primarily in Europe.”<sup>32</sup> There is some tension between this statement and the more recent disclosure that Goldman Sachs and Merrill Lynch were among the biggest recipients of AIG’s more than \$22 billion in collateral postings;<sup>33</sup> presumably there is a fairly direct correlation between exposure to AIG and the amount of collateral received, yet the recipients do not appear to be “primarily” European. Nevertheless, these two sources of information provide a picture of the interlocking effects of credit default swaps.

In particular, if AIG were to have immediately ceased operations in the period after Lehman’s collapse and filed under the Bankruptcy Code, the banks listed on Table 1 would have suffered losses or have been required to write down their assets in an amount at least equal to, and probably much greater than, the collateral payments listed thereon.<sup>34</sup> One could imagine that this may have precipitated a chain reaction of bankruptcy filings, rippling through the financial industry with obviously dire consequences.<sup>35</sup> Thus it is said that an AIG bankruptcy would have increased overall systemic risk.

This analysis confuses the effects of chapter 11 with the failure of the banks listed on Table 1 to engage in sound risk management procedures when dealing with a distressed counterparty.<sup>36</sup> Moreover, it implicitly assumes that avoidance of bankruptcy is the equivalent of avoidance of failure. However, the secondary effects of AIG’s failure were avoided not by avoiding a bankruptcy filing, but rather by the federal government’s decision to fund AIG’s continued operations.<sup>37</sup> The

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32. Am. Int’l Group, Inc., Quarterly Report (Form 10-Q), at 42 (Aug. 6, 2008).

33. This financial information, as well as that in Table 1, comes from the AIG web page. See generally AIG, Collateral Postings Under AIGFP CDS (Mar. 18, 2009), available at [http://www.aig.com/aigweb/internet/en/files/CounterpartyAttachments031809\\_tcm385-155645.pdf](http://www.aig.com/aigweb/internet/en/files/CounterpartyAttachments031809_tcm385-155645.pdf).

34. The figures in Table 1 do not include any collateral payments that AIG made before the government’s intercession in its affairs. Goldman has since argued that its exposure to AIG was hedged with other CDS contracts, and thus it would not have suffered any losses even if it had never received AIG’s collateral. Of course, we have not been given any information on the ability of Goldman’s counterparties to perform on those CDS contracts in the fall of 2008.

35. A similar argument about the effect of a GM bankruptcy on its suppliers supports the contention that GM’s chapter 11 case would create systemic risk.

36. See James A. Fanto, *The Role of Financial Regulation in Private Financial Firms: Risk Management and the Limitations of the Market Model*, 3 BROOK. J. CORP. FIN. & COM. L. 29, 43–45 (2008) (arguing that flawed risk models, rather than government regulation, lead to credit crisis).

37. Thus when AIG asserted, “[a]n AIG failure could have similar or worse consequences on the global financial markets as that of the Lehman bankruptcy,” the truth of the statement turned on the doubtful assumption that the federal government would be as passive in the case of AIG as it was in the

government could have achieved the same result by making direct payments to the banks on Table 1, in which case AIG's bankruptcy status would have been irrelevant.<sup>38</sup> Similarly, whether or not GM filed for bankruptcy, the larger automotive industry would have faced the effects of GM's declining share of the new car market.

Indeed, one could observe that virtually any chapter 11 filing is apt to affect the financial health of nondebtor firms that do business with the debtor. What makes GM and AIG unique is their size, which would likely result in a proportionally larger number of secondary firms experiencing financial distress. But having witnessed the chapter 11 filings of Enron Corp., Worldcom, Inc., Owens Corning, Kmart Corporation, US Airways Group, Inc., Pan Am Corp., Trans World Airlines, Inc. (three times), Refco, Inc., Drexel Burnham Lambert Group, and numerous other very large firms,<sup>39</sup> all of whom defaulted on at least some of their obligations to other businesses, there is good reason to doubt that GM and AIG represent little more than an incremental extension of a process that seems to have worked reasonably well.

In short, the case for any sort of relationship between chapter 11 and systemic risk is unconvincing. Rather, systemic risk may well result from poor risk management among firms and regulatory failures that allow firms to become "too big to fail." By the time chapter 11 comes into play, the conditions leading to the failure of the firm in question have already been created. As I argue in the next section, chapter 11 may actually have a role to play in mitigating the effects of a large firm's failure.

### III. CHAPTER 11 IN TIMES OF SYSTEMIC CRISIS

Having dispatched the principal argument against chapter 11's role in a systemic financial crisis, the question remains: can chapter 11 play a positive role in resolving a crisis that involves not just a single debtor, but an entire network of firms?

At the outset, it is important to recognize the limitations of chapter 11 in this context. As noted, chapter 11 is inherently a case-by-case endeavor, with each case proceeding before distinct bankruptcy judges in judicial districts spread across the country.<sup>40</sup> Additionally, a chapter 11 case only arises after the onset of financial

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case of Lehman. AIG, Draft of AIG Risk and Bankruptcy Report 17 (Feb. 26, 2009), available at <http://www.scribd.com/doc/13112282/Aig-Systemic-090309>.

38. One obvious political reason to avoid this approach, of course, is the presence of several foreign institutions on Table 1. Nevertheless, AIG collateral postings that benefited domestic banks can be seen as hidden pieces of the larger bailout of the financial industry. Absent these collateral postings, the recipients would have required more direct aid from the government.

39. BankruptcyData.com, Major Bankruptcies Since 1986, [http://www.bankruptcydata.com/findabr\\_top.asp](http://www.bankruptcydata.com/findabr_top.asp) (search "more than \$1 billion" under "Company Assets") (last visited Nov. 1, 2009).

40. See Kenneth Ayotte & Hayong Yun, *Matching Bankruptcy Laws to Legal Environments*, 25 J.L. ECON. & ORG. 2, 26 (2009) (noting that bankruptcy courts' decisions are made on case-by-case basis).



distress.<sup>41</sup> As such, chapter 11 is ill-suited to the broader questions of policy and ex ante prevention of crisis that are better achieved through capital requirements and financial regulation.<sup>42</sup> Moreover, the fractured nature of a series of bankruptcy cases within an industry makes it difficult to implement a coordinated policy response across multiple firms.<sup>43</sup> Therefore, it is fair to acknowledge at the outset that chapter 11's role in any systemic financial crisis will be only one part of an overall solution.

On some level, chapter 11 provides the same benefits to systemically important debtors that it provides to all debtors. Namely, the filing invokes the automatic stay, which stops all collection efforts, and the debtor obtains the ability to reshape its business by using Code provisions rejecting contracts and recovering preferential and other suspect transactions.<sup>44</sup> Once the estate is remolded, the debtor benefits from the ability to bind all creditors to a plan,<sup>45</sup> overcoming holdout issues and the ability to discharge claims in exchange for proportional payment of claims.

But in the context of systemic crisis, chapter 11 offers something more. First, the automatic stay, which is often criticized for delaying the exercise of nonbankruptcy rights,<sup>46</sup> can help contain financial distress in a sensitive industry by limiting the ability of creditors to disengage from the debtor. Socially inefficient breaches of agreements because of spite, a general fear of bankruptcy, or panic are precluded by the general prohibition on termination of contracts under "ipso facto" clauses and the automatic stay's general prohibition on attempts to take the debtor's property after the bankruptcy filing.<sup>47</sup>

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41. See Barbara J. Houser, *Chapter 11 as a Mass Tort Solution*, 31 LOY. L.A. L. REV. 451, 452 (1998) (referring to chapter 11 as "a remedy of 'last resort'").

42. The point also holds for the Treasury's proposed structure for resolving financial distress among systemically significant financial firms: in the absence of ex ante regulation and monitoring, the system will be invoked only after a problem has become obvious. See generally Davis Polk & Wardwell Client Memo, *supra* note 21 (discussing Treasury's plan to create new system for liquidation or reorganization of systemically significant financial firms).

43. However, the use of chapter 11 to resolve the vexing issue of asbestos liability, with multiple firms following a template initially pioneered by the Johns Manville Company, shows that even this difficulty may not be as great as would appear at first blush. See Ronald Barliant, Dimitri G. Karcazes & Anne M. Sherry, *From Free-Fall to Free-For-All: The Rise of Pre-Packaged Asbestos Bankruptcies*, 12 AM. BANKR. INST. L. REV. 441 (2004) (explaining how case involving Johns Manville Company and chapter 11 issues started trend in prepackaged asbestos bankruptcies).

44. Timothy D. Cedrone, *A Critical Analysis of Sport Organization Bankruptcies in the United States and England: Does Bankruptcy Law Explain the Disparity in Number of Cases?*, 18 SETON HALL J. SPORTS & ENT. L. 297, 310-12 (2008).

45. 11 U.S.C. § 1141(a) (2006).

46. See, e.g., Theodore Eisenberg, *The Undersecured Creditor in Reorganizations and the Nature of Security*, 38 VAND. L. REV. 931, 958-60 (1985) (criticizing automatic stay provision for imposing risks on creditors without providing compensation over what would be recovered under state law in absence of bankruptcy proceeding); Thomas H. Jackson & Robert E. Scott, *On the Nature of Bankruptcy: An Essay on Bankruptcy Sharing and the Creditors' Bargain*, 75 VA. L. REV. 155, 188 (1989) (characterizing automatic stay as withdrawal of creditors' state-law rights of foreclosure).

47. Lubben, *supra* note 29.

More broadly, the imposition of the automatic stay can prevent the liquidation of the debtor's assets at fire-sale prices, which may have systemic effects on other, nondebtor firms.<sup>48</sup> For example, the quick liquidation of a systemically important debtor's assets could depress the value of comparable assets in the hands of competitor firms, potentially causing these firms to breach financial covenants in debt agreements, and thus resulting in further financial distress. The chapter 11 process allows the debtor to avoid dismemberment by its creditors while moving toward a rational solution for its financial distress.

Chapter 11 can play this role whether the debtor is reorganizing or liquidating. Chapter 11 is clearly better suited to reorganizing a "real economy" firm like GM. Financial firms like AIG and Lehman Brothers have traditionally employed a business model that allowed them to use their superior credit ratings to act as an intermediary between investors and security issuers. Once a financial firm's credit rating becomes less than stellar—and a chapter 11 filing is a sure way to kill a credit rating in a hurry—its very *raison d'être* evaporates. Nonetheless, chapter 11 can still provide a forum for a controlled liquidation, which is likely to result in much higher returns to creditors than a comparable chapter 7 proceeding.<sup>49</sup>

#### IV. BACK TO 1978

One of the key limitations of using chapter 11 as part of any response to a systemic crisis is the growing number of creditors who are not subject to the normal rules of chapter 11. Principally this is a result of congressional "tinkering" with chapter 11 since its enactment in 1978, a process that was greatly advanced by the 2005 amendments to the Code.<sup>50</sup> But exceptions to chapter 11 have also been judicially created,<sup>51</sup> and Congress's failure to address the difficult issues presented in these instances has also expanded the number of creditors that are exempt from all or part of chapter 11.

As originally enacted in 1978, the automatic stay had eight exceptions set forth in § 362;<sup>52</sup> today it has approximately thirty-four.<sup>53</sup> In addition, several

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48. See Edwards & Morrison, *supra* note 14, at 101–03 (discussing automatic stay's potential systemic effects).

49. See Lubben, *supra* note 20, at 80–84 (discussing study in which chapter 11 cases yielded larger recoveries for creditors and took less time than chapter 7 cases); John C. Anderson & Peter G. Wright, *Liquidating Plans of Reorganization*, 56 AM. BANKR. L.J. 29, 44–48 (1982) (explaining that chapter 11 permits liquidation, thereby avoiding duplicative efforts and reducing expenses associated with converting case to chapter 7).

50. See generally Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, Pub. L. No. 109-8, 119 Stat. 23 (codifying amendments to Code).

51. See *infra* notes 87–93 and accompanying text for a discussion of judicially created exemptions, including the "necessity of payment" doctrine.

52. Bankruptcy Reform Act of 1978, Pub. L. No. 95-598, § 362, 92 Stat. 2549, 2570 (1978).

53. The counting becomes a bit subjective with regard to provisions like 11 U.S.C. § 362(b)(2) (2006), which now contains several subsections.

exceptions to the automatic stay have been added outside of § 362(b).<sup>54</sup> And while some of those exceptions are clearly only applicable in individual bankruptcy cases,<sup>55</sup> the vast bulk of the new exceptions come into play only in chapter 11 cases, as many of them involve various derivative contracts.

When enacted in 1978, § 362 contained a limited exception from the automatic stay for the setoff of certain commodity contracts.<sup>56</sup> Congress expanded that exception slightly in 1982,<sup>57</sup> and repo agreements achieved a similar exemption in 1984, inserted into § 362(b)(7), where commodities used to be, with commodity setoffs moving to § 362(b)(8).<sup>58</sup>

All of these changes laid the groundwork for “real” derivative contracts to gain special treatment under the Bankruptcy Code, beginning in 1990 with the addition of § 362(b)(14)—later to become (b)(17)<sup>59</sup>—which took certain swap agreements out of the realm of the automatic stay.<sup>60</sup> This round of amendments was distinctive, inasmuch as Congress not only exempted the setoff of some swap transactions from the automatic stay, but also provided protection for these transactions from the debtor’s avoiding powers.<sup>61</sup> In addition, Congress expressly exempted these swap transactions from § 365(e)(1), which normally prohibits termination of a contract solely because of the debtor’s bankruptcy filing.<sup>62</sup>

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54. See, e.g., *id.* § 362(h) (terminating automatic stay with respect to certain personal property when debtor is an individual); *id.* § 362(n) (excluding certain debtors in small businesses from automatic stay provision).

55. E.g., *id.* § 362(b)(2)(E) (exempting “reporting of overdue support owed by a parent” from automatic stay); *id.* § 521(a)(6) (exempting certain personal property in chapter 7 proceeding for forty-five days contingent on certain actions of debtor).

56. The original § 362(b)(6) provided that the normal prohibition of postbankruptcy setoff in § 362(a)(7) did not apply to “the setoff of any mutual debt and claim that are commodity futures contracts, forward commodity contracts, leverage transactions, options, warrants, rights to purchase or sell commodity futures contracts or securities, or options to purchase or sell commodities or securities.” Bankruptcy Reform Act of 1978, § 362(b)(6), 92 Stat. 2570–71.

57. See Act of July 27, 1982, Pub. L. No. 97-222, § 3(c), 96 Stat. 235, 236 (codified as amended at 11 U.S.C. § 362(b)(6)) (expanding exception to, among other things, securities contracts, forward contracts, and settlement payments relating to such contracts).

58. Bankruptcy Amendments and Federal Judgeship Act of 1984, Pub. L. No. 98-353, § 392, 98 Stat. 333, 365 (codified as amended at 11 U.S.C. § 362(b)). Repo agreements are essentially a kind of secured loan, whereby one party sells securities to another party, at an amount less than the actual market value of the securities, with an agreement to buy back the securities at a fixed point in the future for an amount equal to the sale price plus interest. *In re Bevill, Bresler & Schulman Asset Mgmt. Corp.*, 67 B.R. 557, 566–67 (D.N.J. 1986).

59. Bankruptcy Reform Act of 1994, Pub. L. No. 103-394, § 501(d)(7)(B)(vii), 108 Stat. 4106, 4144 (codified as amended at 11 U.S.C. § 362(b)(17)). Congress had inadvertently enacted two section (b)(14)s.

60. Act of June 25, 1990, Pub. L. No. 101-311, § 102(3), 104 Stat. 267, 267 (codified as amended at 11 U.S.C. § 362(b)(17)).

61. See *id.* § 103, 104 Stat. at 268 (codified as amended at 11 U.S.C. § 546) (limiting circumstances under which trustee may avoid transfer under swap agreement).

62. *Id.* § 106(a), 104 Stat. at 268 (codified as amended at 11 U.S.C. § 560).

The 2005 amendments completed the work of taking all derivative contracts out of bankruptcy.<sup>63</sup> The definition of swap was extraordinarily expanded in 2005,<sup>64</sup> and expanded even further in 2006.<sup>65</sup> The current definition now includes not only swaps, but also any instrument currently used in the derivatives markets, all related agreements, such as collateral documents, and any future instrument that might be developed in the derivatives market.<sup>66</sup> This stunningly broad definition supports several other new provisions in the Code that exempt swaps from the automatic stay, and all other stays, and prohibit any attempt to characterize a swap-related transaction as a preference or a fraudulent transfer—even in situations where the holder creates a setoff position after bankruptcy.<sup>67</sup> Indeed, because the new amendments deem swap participants to have always given “value” in connection with any transfer, even a swap transfer made with “actual intent to hinder, delay, or defraud”<sup>68</sup> creditors may be difficult to recover.<sup>69</sup>

Additionally, in 2005 the Bankruptcy Code for the first time expressly blessed the derivatives industry trade group’s model documents for derivative transactions.<sup>70</sup> Under the International Swaps and Derivatives Association (“ISDA”) forms, a wide variety of derivatives are documented under a single master agreement between two counterparties.<sup>71</sup> Under bankruptcy law there is a debate whether such arrangements constitute one contract or many;<sup>72</sup> but for derivatives,

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63. See Jonathon Keath Hance, Note, *Derivatives at Bankruptcy: Lifesaving Knowledge for the Small Firm*, 65 WASH. & LEE L. REV. 711, 753 (2008) (linking removal of derivatives from automatic stay to increasingly expansive definition of derivative instruments).

64. See Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, Pub. L. No. 109-8, § 907(a)(1)(E), 119 Stat. 23, 172–73 (codified as amended at 11 U.S.C. § 101) (amending definition of swap agreements).

65. See Financial Netting Improvements Act of 2006, Pub. L. No. 109-390, sec. 5(a)(1)(D), § 101(53B), 120 Stat. 2692, 2695–96 (2006) (amending definition of swap agreements).

66. 11 U.S.C. § 101(53B).

67. See generally 11 U.S.C. §§ 362(b)(27), 362(o), 546(g), 552(a)(2)(B)(ii), 553(a)(3)(C), 553(b)(1), 560, 561 (noting in numerous sections that swap and swap-type agreements are exempt from various types of stays). There is an interesting, and perhaps unnoticed, drafting problem with the exemption written into § 552(a)(2). The exemption arguably only applies to subpart (B), leaving postbankruptcy transfers of swaps unprotected under § 552(a)(2)(A). *Id.* § 552(a)(2). There is also a general question of what the exemption in subpart (B) really means, given that it refers to a setoff in a statutory provision that otherwise does not mention setoff. That is, it is arguable that the exception language is irrelevant to the provision in question, although the bankruptcy courts have been remarkably tolerant of Congress’s drafting deficiency in interpreting the 2005 amendments to the Code. See, e.g., *In re DeSardi*, 340 B.R. 790, 812–13 (Bankr. S.D. Texas 2006) (interpreting plain language of 2005 amendments to include exemption for postbankruptcy swap transfers).

68. 11 U.S.C. § 548(a)(1)(A).

69. Compare *id.* § 548(c) (enforcing obligations or transfers made for value and in good faith not otherwise voidable to extent of value given), with *id.* § 548(d)(2)(D) (stating that swap participants receive value to extent of swap transfer).

70. See generally *id.* § 101(38A) (defining master netting agreements); *id.* § 101(53B)(A)(v) (defining swap agreement); *id.* § 362(b)(6)–(7) (defining exceptions to automatic stay).

71. Lubben, *supra* note 13, at 415 n.65.

72. See, e.g., *DB Structured Prods., Inc. v. Am. Home Mortg. Holdings, Inc. (In re Am. Home Mortg. Holdings, Inc.)*, 402 B.R. 87, 97 (Bankr. D. Del. 2009) (finding ISCA master agreement severable).

that debate is academic, as the 2005 amendments accept ISDA's argument that a derivatives master agreement and its subsidiary derivatives transactions constitute a single contract.<sup>73</sup>

Beyond derivatives, there are a host of other classes of creditors that have obtained at least partial immunity from chapter 11. In 2005, landlords obtained strict time limits on a debtor's ability to assume or reject a commercial lease under § 365.<sup>74</sup> Other counterparties have to wait until confirmation of a plan to find out if their contract will be assumed or rejected.<sup>75</sup>

In a large retail case where the debtor has myriad leases—Kmart had approximately 2,000 when it filed for chapter 11—the new time limit places an unrealistic outside date on the debtor's reorganization efforts.<sup>76</sup> Debtor-in-possession ("DIP") lenders are aware of this reality and have begun setting loan terms that call for the termination of credit if a retail debtor does not adopt a plan within the time frame for assumption or rejection of leases.<sup>77</sup> In this way, the limitations in newly amended § 365(d)(4) have become hard-and-fast time limitations on a retail chapter 11 case.

Other exemptions not only favor specific creditors, but also create liquidity issues for the debtor, further imperiling the chances for reorganization.<sup>78</sup> Utilities now have the ability to demand affirmative deposits upon bankruptcy; administrative priority no longer being sufficient under the Code.<sup>79</sup> Like derivatives traders and unlike most other creditors,<sup>80</sup> utility companies obtained the right to setoff against a deposit without notice to the bankruptcy court.<sup>81</sup>

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73. See generally 11 U.S.C. §§ 101(38A), 101(53B)(A)(iv), 561.

74. *Id.* § 365(d)(4).

75. *Id.* § 365(d)(2).

76. Debtors now have up to 210 days from the start of the bankruptcy case to assume or reject their nonresidential real property leases. *Id.* § 365(d)(4)(B)(i). If the debtor does not act within the time allotted by the statute, the lease is automatically rejected. *E.g.*, *In re Tubular Techs., LLC*, 362 B.R. 243, 246 (Bankr. D.S.C. 2006).

77. See, e.g., Debtors' Motion for Interim and Final Orders Pursuant to 11 U.S.C. §§ 105, 361, 362, 363 and 364 and Federal Rules of Bankruptcy Procedure 2002 and 4001 (I) Authorizing Debtors (A) to Obtain Postpetition Financing and (B) to Utilize Cash Collateral; (II) Granting Adequate Protection; and (III) Scheduling Interim and Final Hearings at 19, *In re Circuit City Stores, Inc.*, No. 08-35653, 2009 WL 484553 (Bankr. E.D. Va. Jan. 14, 2009) (detailing terms of DIP credit agreement).

78. See Levin & Ranney-Marinelli, *supra* note 23, at 605 (listing administrative expenses, monitoring system, and litigation made necessary by drafting ambiguities as added costs for certain types of debtors).

79. See 11 U.S.C. § 366 (2006) (detailing rights of utilities to demand assurance of payment); Bertrand Pan & Jennifer Taylor, *Sustaining Power: Applying 11 U.S.C. § 366 in Chapter 11 Post-BAPCPA*, 22 EMORY BANKR. DEV. J. 371, 379–82 (2006) (suggesting courts should read good faith requirement into utility satisfaction language in § 366 added by BAPCPA to preserve debtor-creditor balance while providing better protection for utilities).

80. Compare 11 U.S.C. § 362(a) (setting forth broad applicability of automatic stay), with *id.* § 362(b)(17) (exempting derivative instruments from automatic stay).

81. *Id.* § 366(c)(4).

General trade creditors also benefit from a host of exceptions from the normal rules. The revised “ordinary course of business” exception<sup>82</sup> to the Code’s preference rules protects a much broader range of transactions from being questioned and perhaps unwound postbankruptcy<sup>83</sup>—allowing trade creditors substantially increased leverage against distressed companies.<sup>84</sup> Newly added sections of the Code give large swaths of trade creditors administrative status<sup>85</sup> and enhanced reclamation rights beyond what the state law and the UCC provide.<sup>86</sup>

The judicially created “necessity of payment” doctrine further enhanced these statutory provisions. This doctrine allows for the full and immediate payment of prepetition claims of certain “critical” trade creditors,<sup>87</sup> even if doing so arguably violates the Bankruptcy Code. Courts originally developed the doctrine in railroad reorganization cases<sup>88</sup> where, notably, the debtor did not have the option of liquidation.<sup>89</sup> Courts then extended it, somewhat debatably, to airlines in the early 1980s.<sup>90</sup> From that point, courts have willingly allowed the payment of large masses of trade debt,<sup>91</sup> and even the leading circuit court opinion against the

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82. See 11 U.S.C. § 547(c)(2) (providing that “[t]he trustee may not avoid under this section a transfer . . . to the extent that such transfer was in payment of a debt incurred by the debtor in the ordinary course of business or financial affairs of the debtor and the transferee, and such transfer was . . . [either] made in the ordinary course of business or financial affairs of the debtor and the transferee . . . [or] made according to the ordinary business terms”).

83. See Charles J. Tabb, *The Brave New World of Bankruptcy Preferences*, 13 AM. BANKR. INST. L. REV. 425, 440–45 (2005) (describing popularity of exception to rule barring preferential creditor payments that requires showing to bankruptcy court that debt was acquired in “ordinary course of business”).

84. Cf. Vern Countryman, *The Concept of a Voidable Preference in Bankruptcy*, 38 VAND. L. REV. 713, 775–76 (1985) (advocating repeal of § 547(c)(2) because it contradicts purpose of payment preference treatment and appears unlimited in scope).

85. 11 U.S.C. § 503(b)(3); see also Alan N. Resnick, *The Future of the Doctrine of Necessity and Critical-Vendor Payments in Chapter 11 Cases*, 47 B.C. L. REV. 183, 203–05 (2005) (noting that administrative status gives certain vendors priority over others).

86. Compare 11 U.S.C. § 546(c) (setting forty-five-day time limit on reclamation), with U.C.C. § 2-702 (amended 2003) (setting “reasonable” time limit on reclamations, as well as reserving buyers’ rights in “ordinary course of business”).

87. See Melissa B. Jacoby, *The Bankruptcy Code at Twenty-Five and the Next Generation of Lawmaking*, 78 AM. BANKR. L.J. 221, 225–26 (2004) (discussing doctrine and noting bankruptcy experts’ unwillingness to propose amendment to codify doctrine).

88. See Stephen J. Lubben, *Railroad Receiverships and Modern Bankruptcy Theory*, 89 CORNELL L. REV. 1420, 1447–48 (2004) (explaining that “six month rule”—which permitted “priority payment of operating expenses”—was expanded by doctrine of necessity).

89. See David A. Skeel, Jr., *An Evolutionary Theory of Corporate Law and Corporate Bankruptcy*, 51 VAND. L. REV. 1325, 1355–57 (1998) (suggesting that liquidation option was subverted for railroad companies seen as interstate infrastructure and therefore too important to collapse).

90. E.g., *In re Ionosphere Clubs, Inc.*, 98 B.R. 174, 175–76 (Bankr. S.D.N.Y. 1989). This extension is questionable because the analogy between early railroads and airlines is flawed.

91. See Joseph Gilday, *“Critical” Error: Why Essential Vendor Payments Violate the Bankruptcy Code*, 11 AM. BANKR. INST. L. REV. 411, 414 (2003) (noting common bankruptcy court acquiescence to critical vendor doctrine, in which certain vendors “blessed by the court” receive money at beginning of case).

practice was so flippant in its reasoning that it has failed to slow the growth of the exception outside of its home circuit.<sup>92</sup>

Another judicially created exception that Congress has failed to address despite more than a decade of existence is the tendency of DIP lenders to demand that a large portion of a DIP loan be used to pay off the lender's prepetition claims against the estate.<sup>93</sup> Although the debtor often lacks any good alternatives in these situations,<sup>94</sup> and the lender often asserts that it is fully secured in any event, this sort of "rollup" of prepetition debt is nonetheless a clear instance where a creditor avoids having to endure the normal chapter 11 process with regard to its prepetition claim.

While some of these exceptions may have seemed reasonable in isolation, when taken together they represent serious challenges to the efficacy of chapter 11, especially when chapter 11 is to be used in times of systemic crisis. For example, the derivative exemptions in the Code undoubtedly weighed against using chapter 11 to resolve AIG's financial distress—even though doing so may have saved billions of taxpayer dollars—because filing would have given each of AIG's counterparties an option to terminate their agreements with AIG.<sup>95</sup> Likewise, any chance GM had to reorganize in a traditional, privately funded chapter 11 case was undercut by the reality that the cash requirements facing a debtor postfiling have increased tremendously since the 2005 amendments, further complicating an already complex chapter 11 case. More broadly, the debtor's ability to resolve its financial distress under chapter 11 is limited by the degree to which particular groups of creditors are not subject to payment and discharge under a chapter 11 plan.

In light of this, it is time for Congress to systematically evaluate chapter 11 and to consider the extent to which chapter 11 would benefit from a return to its simpler form, as enacted in 1978. Certainly debtors would benefit from a more inclusive process, and it is not clear that creditors benefit from the status quo. Of course in considering these changes, Congress should also consider the extent to which it should codify or prohibit judicially created exceptions to chapter 11—like the necessity of payment doctrine and other "first day" related procedures. Doing so might not only improve the utility of chapter 11, it might also partially

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92. See *In re Kmart Corp.*, 359 F.3d 866, 871 (7th Cir. 2004) (asserting that "'doctrine of necessity' is just a fancy name for a power to depart from the Code").

93. See Scott D. Cousins, *Postpetition Financing of Dot-Coms*, 27 DEL. J. CORP. L. 759, 800–01 (2002) (discussing commonplace "rollover" of debtor's prepetition position by taking out postpetition loans to pay off prepetition debt).

94. See *In re Ames Dept. Stores, Inc.*, 115 B.R. 34, 39–40 (Bankr. S.D.N.Y. 1990) (describing cases in which courts have refused on fairness grounds to permit debtors to make alternative financial arrangements in which creditors, and not estates, benefit).

95. See Posting of Marie Beaudette to The Wall Street Journal Blog: Bankruptcy Beat, <http://blogs.wsj.com/bankruptcy/2009/03/18/bankruptcy-for-aig-think-again/> (Mar. 18, 2009, 3:33 EST) (stating that AIG bankruptcy would cause derivative counterparties to immediately seize collateral used to secure contracts).

reduce the incentive for very large cases to concentrate in jurisdictions that are receptive to these maneuvers.<sup>96</sup>

#### V. CONCLUSION

The last decade saw the growth of what I term “chapter 11 anxiety.” This fear drove companies to avoid chapter 11 both by structural manipulations, such as asset securitization, and through legislative change, such as the derivative “safe harbors.” While it is still early for a historical account of the current crisis, it does seem as though these moves to avoid chapter 11 and bankruptcy exacerbated the general lack of risk adversity in the financial community.

Once achieved, the apparent goal of avoiding any interaction with chapter 11 substituted for a real analysis of the risks of the underlying debt transaction. But avoiding chapter 11 is clearly not the same thing as avoiding default, and it may be that too many risk management strategies were overly content with a “bankruptcy proof” investment.

In this short paper I have argued that the fear of chapter 11 is largely misguided and too often reflective of outdated notions of chapter 11. Whether this reflects a true lack of understanding, particularly among nonlegal professionals, or a deliberate attempt to disparage chapter 11 to achieve special treatment from Congress, the time has come to examine the role chapter 11 can play in times of systemic crisis.

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96. See Kenneth Ayotte & David A. Skeel, Jr., *An Efficiency-Based Explanation for Current Corporate Reorganization Practice*, 73 U. CHI. L. REV. 425, 427–29 (2006) (reviewing LYNN M. LOPUCKI, *COURTING FAILURE: HOW COMPETITION FOR BIG CASES IS CORRUPTING THE BANKRUPTCY COURTS* (2005), and arguing that Delaware’s high refiling rate is the result of efficient organization, which attracts larger, more sophisticated parties); Stephen J. Lubben, *Delaware’s Irrelevance*, 16 AM. BANKR. INST. L. REV. 267 (2008) (discussing Professor LoPucki’s series of articles accusing Delaware of diluting oversight of bankruptcy cases in order to attract large cases to the state).



