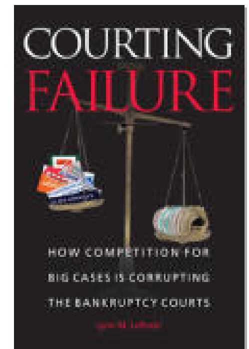
1. New York’s Game: 1980–86



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New York's Game: 1980–86

> Were [transacting business in the jurisdiction] enough [to make venue proper] large corporations would be free to roam the entire country in search of venues which might provide them with what, in their opinion, would be a more favorable hearing.
>
> —United States Court of Appeals for the First Circuit (1982)

For decades before 1980, big company bankruptcies had been rare. Some said it was because modern firms were "too big to fail." The bankruptcy lawyers saw it differently. Bankruptcy was not a financial condition. Bankruptcy was a legal proceeding. Firms filed bankruptcy when bankruptcy was in the interests of the people who made the decision: top management. Under the antiquated, Depression-era law then in effect, bankruptcy seldom was. Large public companies were supposed to file under Chapter X of the Bankruptcy Act. That chapter required the managers to surrender control of the firm to a court-appointed trustee. There were ways of getting around the law, but they were awkward and risky.

The bankruptcy lawyers complained about the trustee requirement. After a decade of study and debate, Congress gave in. In 1978, it enacted a new, "modern" bankruptcy code that gave top managers the right to remain in control of their firms during bankruptcy. The House committee that reviewed the bill was remarkably frank about the reasons for the change.

> Debtors' lawyers that participated in the development of a standard for the appointment of a trustee were adamant that a standard that led to too frequent appointment would prevent

> debtors from seeking relief under [the reorganization law] and would leave the [law] largely unused except in extreme cases.[1]

In other words, Congress concluded that if top managers could not remain in charge during bankruptcy, those managers would not take their firms into bankruptcy at all.

The new law took effect October 1, 1979, and the procession of big cases began a few months later. Three big firms filed in 1980. The annual number of big firm filings climbed steadily through the decade, reaching 16 in 1989. Each of those cases was a bonanza for the law firms involved, with fees in the millions and often the tens of millions of dollars. The largest of those filings—by Johns Manville—alone generated court-awarded fees and expenses of $82 million. Before the new code, silk-stocking law firms in New York and elsewhere had shunned bankruptcy practice as sleazy and unprofitable. In the years following enactment, those same firms began building and advertising their bankruptcy departments.

The National Science Foundation Study

In 1986, Bill Whitford and I received a grant from the National Science Foundation to study big bankruptcy reorganization cases. Bill was a colleague of mine on the University of Wisconsin Law School faculty. Neither of us knew much about big bankruptcy reorganizations, but we figured we could learn.

The Securities and Exchange Commission helped us compile a list of every case filed in the United States by or against a public company with assets of $100 million or more. Over the next four years, Bill and I read what had been written about the cases in the financial press, obtained and analyzed the plans of reorganization, conducted about 120 interviews with lawyers in the cases, and constructed a database. Ultimately, the study covered all cases filed after October 1, 1979, in which the court confirmed a plan by March 15, 1988—a total of 43 cases.

In looking over our list of cases, we noticed that many of them

had been filed in New York. That did not seem odd. New York is the financial center of the United States, and many of the country's largest firms are headquartered there. But as we learned more about the firms that filed in New York, it became apparent that many of them had only the most tenuous connections to that city. The Johns Manville Corporation, for example, filed in New York shortly after building and moving into a $40 million headquarters building in Colorado and changing its place of incorporation to Delaware. The center of Manville's operations was in Colorado; the firm had no apparent connection with New York at all. HRT, a chain of retail stores with its headquarters and center of operations in California, and Towle Manufacturing, a firm with nearly all of its operations in Massachusetts, also filed in New York. Eventually it dawned on us that many of the firms we were studying were forum shoppers.

Forum Shopping

Literally, "forum shopping" means only that a party to litigation is choosing among courts. As previously noted, the law sometimes deliberately allows such choices. Rarely do those choices threaten the legal system. Most parties use their freedom to choose courts convenient for themselves. If the courts they choose are particularly inconvenient for other parties or witnesses, the chosen courts can transfer the cases to more convenient courts.

Nevertheless, the phrase "forum shopping" is generally used as a pejorative. The phrase implies that the party choosing the court is by that choice seeking some unfair advantage. The advantage sought is usually a judge or jury biased (the squeamish may read "inclined" each time this word appears) in some manner that will benefit the party.

Laws are deliberately vague and subject to interpretation. They leave plenty of room for judges to do what they think is right, best, or expedient. The judges' decisions may be reversed on appeal. But appeals are expensive and difficult to win, so losing parties seldom take them. Even if reversal occurs, the new decision will more

likely be the result of the appellate court judges' biases than law. Good lawyers know that the identity of the judge is a crucial determinant of the outcome of the case, and they seek the judge who will be best for their client.

Judicial biases are not subtle. In the courtrooms of federal judges (and death penalty opponents) Marilyn Hall Patel and William Ingram, for example, death penalty cases are likely to remain pending for over a decade, while in the courtrooms of federal judges (and death penalty proponents) Manuel Real and Edward Rafeedie, death penalties are likely to be approved in as little as two years.[2] Debtors filing for Chapter 13 bankruptcy in San Antonio, Texas, in the early 1990s generally had to pay 100 percent of their debts, while debtors filing the same kind of case in Dayton, Ohio, generally had to pay only 10 percent of their debts.[3] The supply of such examples is virtually unlimited.

One might expect lawmakers to respond to bias by tightening the instructions to judges on how they should rule. If done effectively, that would insure the law's ideal: rules that are the same for everyone. Instead, the law's response is so peculiar that most people do not even connect it with the bias problem. Courts randomize the assignment of judges.

Most courts consist of a "panel" of judges to whom the clerk of the court can assign a particular kind of case. The number of judges on a panel commonly ranges from two to 20 or 30. Each clerk has some mechanism for assigning cases randomly among the members of the panel. For example, in the courts of Florida's Eighth Judicial Circuit, where I practiced, the clerk used tokens. Each was inscribed with the division letter of a particular judge. The clerk mixed a large number of those tokens in a drawer. When someone filed a case, the clerk reached into the drawer—while looking at the ceiling—and drew one of the tokens. The clerk assigned the case to the judge whose division letter appeared on the drawn token. Today, clerks more frequently use computers to make random assignments, but the principle remains the same.

Any effort to evade the randomness of the draw is considered a serious ethical breach. That does not keep some lawyers from try-

ing. A lawyer may be able to evade the draw by filing the case with a particular judge at the judge's home on the weekend. To do that, the lawyer must assert some "emergency" requiring that the case be filed before the clerk's office opens on Monday morning. Another technique is to assert that a newly filed case is so closely related to a case already assigned to the desired judge that the new case should be assigned to that judge without a draw. Sometimes a feared judge goes out of the draw temporarily because the judge is ill or overloaded with cases. Lawyers wait for these opportunities to file. The lawyers learn about them from friends who work in the clerks' offices.

Another way to beat the draw is to file several cases and then dismiss all but the one assigned to the desired judge. For example, Geoffrey Feiger is a Southfield, Michigan, plaintiff's lawyer famous for his successful representation of Dr. Jack Kevorkian, who assisted suicides in the 1990s. When Feiger sought to challenge a ruling of the Michigan Supreme Court in a federal district court, he filed 13 lawsuits. On the thirteenth, Feiger must have drawn the judge he wanted. He dismissed the first 12, leaving just that one pending. When the court figured out what he had done, the court sanctioned Feiger, imposing a $7,500 fine.[4] In another case, Mayer Brown & Platt, the prominent Chicago firm, was sanctioned by a Cook County circuit court. A partner and an associate of the firm filed five identical complaints in an attempt to draw one of three preferred judges. In imposing a total of $5,000 in fines, the judge expressed dismay that Mayer Brown "would cheapen itself in this fashion."[5]

What is peculiar about random judge assignments as a remedy for judicial bias is that the remedy does nothing to cure or even mitigate the problem. Random assignment makes judges no less biased. What it does is distribute the effects of judges' biases randomly among litigants. Every litigant has an equal chance of falling victim to every kind of bias. As the editors of the *Harvard Law Review* put it: "Forum shopping violate[s] fair play by allowing parties to circumvent fate."[6]

To prevent parties from circumventing their fate with respect to

judges, the system must do more than prevent them from choosing among the members of a panel. The system must also prevent them from choosing among panels. The choice of a city is the choice of one panel of judges over another. That is merely a stochastic circumvention of fate but nevertheless an important one. If the city chosen has only a single judge, the choice of city is a choice of judge, just as surely as in the scheme Geoffrey Feiger used.

Preventing litigants from choosing among judges by choosing among cities is more difficult than preventing them from choosing among judges within a city. Cases can't be randomly assigned to cities; they must be heard in cities that are reasonably convenient to the parties, their lawyers, and the witnesses. But the most convenient city for a particular case may be difficult to determine, even after a case is well under way. That is particularly true in big bankruptcy cases. At the time a big bankruptcy case is filed, even the debtor may not know who will be an active participant. The uncertainty provides cover for lawyers who choose courts for their judges' biases but claim they have chosen them for the geographical convenience of the parties.

The Bankruptcy Venue Game

Bill Whitford and I decided to look further into bankruptcy forum shopping. What we found was a highly permissive venue statute, an imaginative array of strategies for taking advantage of the statute, and a high judicial tolerance for those who simply ignored the statute and filed their cases wherever they pleased.

In the mid-1980s, approximately 300 bankruptcy judges were distributed among approximately 200 panels in the 98 federal court districts. In less populated areas, the panel often consisted of a single judge. In large cities, there were usually three or four. The panel in Los Angeles was the largest with eight; New York had five.

The bankruptcy venue statute, which has not changed since 1978, recognizes four connections between a debtor and a court, any of which makes the court a proper venue for the debtor's bankruptcy. The four connections are that the court is (1) at the "domi-

cile or residence" of the debtor, (2) at the debtor's "principal place of business," (3) at the location of the debtor's principal assets, or (4) where the bankruptcy case of an affiliate is already pending. The first of these choices, domicile or residence, would later play a major role in the forum shopping. That role is explained in chapter 2. In the 1980s cases Bill and I studied, however, it played no role at all.

Principal Place of Business

Imagine the "principal place of business" of a major corporation and you may get an image of a big industrial plant with an executive office building at the front. But even by the 1980s, that image was largely obsolete. Major U.S. corporations typically did business at numerous locations, whether those locations were industrial plants, chains of hotels or restaurants, or airline hubs.

If the bankruptcy courts were writing on a clean slate, they might have interpreted "principal place of business" to refer to the largest of those operations or the one through which the most business was done. But "principal place of business" is what the lawyers call a "term of art"—a phrase that originated in the English language but has a different meaning when used as legal jargon. Long before it appeared in the bankruptcy venue statute, "principal place of business" had been interpreted to mean the headquarters of the firm—the so-called nerve center from which the firm's operations were directed.

Now the image you get of a firm's "principal place of business" may be a gleaming skyscraper bearing the firm's name. Many firm headquarters fit that image. But the nerve center of a firm can be little more than the office of the chief executive, remote from the rest of top management. Move the chief executive officer and you at least arguably move the principal place of business. AM International, for example, had most of its operations in the Chicago area. But in the five years before it filed its first bankruptcy in 1982, the firm moved its headquarters from Chicago to Cleveland to Los Angeles and back to Chicago. The purpose of these moves was not

to manipulate venue but merely to accommodate a series of chief executive officers who did not want to move to Chicago. Each managed the business from his or her home city. Another of the 43 firms we studied, Evans Products, moved its headquarters from Portland, Oregon, to Miami, Florida, about a year before filing in Miami. Evans Products had been taken over by Miami financier Victor Posner. Posner lived in Miami and chose to run the Oregon firm from his home city.

Some of the firms we studied did move their headquarters to manipulate venue. Tacoma Boatbuilding owned and operated a shipyard in Tacoma, Washington. The shipyard was the firm's sole place of business. Not surprisingly, prior to the financial difficulties that brought Tacoma Boatbuilding to bankruptcy, the firm's headquarters were at the shipyard.

Tacoma is one of the approximately 200 cities in the United States that has both a bankruptcy court and a clerk's office. That court was certainly Tacoma Boatbuilding's natural venue. But Tacoma is in the Ninth Circuit, and the Ninth Circuit Court of Appeals at that time required firms to pay interest on their secured debts while the firms remained in bankruptcy. Tacoma Boatbuilding wanted to file in Second Circuit, where the Second Circuit Court of Appeals made debts of the kind Tacoma Boatbuilding owed interest free.

Tacoma Boatbuilding rented a small office in Manhattan, declared that office the firm's headquarters, waited the 90 days a new connection must exist before it is recognized for venue purposes, and filed its bankruptcy case in New York. The banks objected to New York venue, but Judge Burton R. Lifland ruled in favor of the company. The case stayed in New York. Among other advantages, Tacoma Boatbuilding was not required to pay interest on about $5 million in bank loans—interest the company would have been required to pay if the case had been transferred to Washington.[7] Through the entire episode, Tacoma Boatbuilding continued to list Tacoma, Washington, as its "principal executive offices" on the annual reports the firm filed with the Securities and Exchange Commission. Nobody seemed to have noticed.

Baldwin-United was another big debtor that sought to choose its

bankruptcy court by moving its headquarters. That company was a Cincinnati, Ohio, conglomerate that had begun life as a piano maker. When Baldwin-United filed in 1983 with $9 billion in assets, the firm was by that measure the largest ever to file bankruptcy. Six months before filing, Baldwin-United named Victor Palmieri, a well-known distressed property liquidator, as its chief executive officer. Instead of moving to Baldwin-United's Cincinnati headquarters, Palmieri moved into New York offices of Baldwin-United, saying that New York "was a good location for negotiation with the various Baldwin creditors."[8] Because Palmieri was in New York and directed the firm's operations from New York, New York was arguably both the nerve center of the company and a proper venue for the firm's bankruptcy filing. Baldwin-United filed in New York.

That was not, however, the end of the story. A group of creditors wanted the case heard in Cincinnati. When negotiations that might have avoided the filing broke off, the creditors raced to the Cincinnati bankruptcy court and filed a creditors' petition—just minutes *before* Baldwin-United filed in New York.

When the same bankruptcy is filed in two courts, the court in which the first filing was made decides which court keeps the case. That was the Cincinnati court. When Baldwin-United learned that the creditors had won the race to the courthouse, it faced a choice. Baldwin-United could have argued to the Cincinnati judge that he should transfer the case to New York. But the firm had already insulted the Cincinnati panel by setting up the New York "headquarters" and filing there. By arguing to the Cincinnati judge for a transfer to New York, they would have risked offending him personally. Baldwin-United dropped its New York filing and let the Cincinnati judge hear the entire case.

Principal Assets

Most of the 43 studied firms filed in the court of their headquarters city. Of the seven that did not, only Towner Petroleum relied on the location of its principal assets as the sole basis for venue. Until a few years before it filed, Towner had been an Ohio company. In

an expansion that led to the firm's financial difficulties, Towner moved its headquarters to Houston, Texas. When it filed bankruptcy a few years later, it chose the court in Oklahoma City, Oklahoma. Towner's bank lenders objected to Oklahoma City as the venue. The Oklahoma City court kept the case, agreeing with the debtor that more of the firm's oil and gas properties were in the Western District of Oklahoma than in any other district.

Manipulating the location of its assets to establish venue is not, for most big firms, a practical option. But for some it is. One of the studied cases was Seatrain Lines, a firm whose principal assets were six oil tankers Seatrain operated in the Alaskan coastal trade. By basing the tankers in different ports, Seatrain Lines could probably have made any of those ports the location of its principal assets. Seatrain chose to file at its headquarters in New York, but because of the mobility of its principal assets, it was actually choosing among numerous available courts.

A firm can change the location of the firm's principal assets without moving any of them. To illustrate, Dreco Energy, another of the studied firms, was a Canadian corporation. Just a few years before bankruptcy, Dreco's headquarters, its principal assets, and most of its employees were in Canada. Canadian bankruptcy law was then and is now less favorable to corporate debtors than U.S. bankruptcy law. Dreco established a new headquarters in Houston, Texas; sold some of its Canadian assets; and discharged some of its Canadian employees. By the time it filed for bankruptcy in Houston, it had more assets and employees in the United States than in Canada. After bankruptcy, the firm reestablished its Canadian headquarters and, through acquisitions and divestitures, within a few years again had more Canadian assets and employees than U.S. ones.[9] Dreco Energy had, in a very real sense, come to the United States to file bankruptcy and then returned to Canada.

Case of an Affiliate Pending

Businesses—consisting of people and things—exist in the real world. Corporations do not. Corporations are figments of the legal

imagination. For a few hundred dollars you can have one of your own, complete with a certificate from the secretary of state of the state of your choice attesting to your corporation's existence. You are then entitled to claim that your corporation is a person separate from yourself. Most courts in most situations will respect this otherwise outlandish claim. Your corporation may even have constitutional rights independent of your own. By virtue of the "existence" of your corporation, you can gain a variety of legal advantages that would not otherwise be available.

Large public companies typically consist of a parent corporation and dozens of wholly owned "subsidiary" corporations. The single group of managers that runs the entire company designates particular subsidiaries as the owners of particular assets. For example, a major airline may have a corporate subsidiary that owns the aircraft, another that owns the real estate, a third that employs the flight crews and conducts operations, a fourth that owns the airline's accounts receivable and borrows money against them, and a fifth that owns and operates a feeder airline. Together, the parent and these five subsidiary corporations constitute a "corporate group." Formally, each of the corporations will have its own officers and directors, but those officers and directors are likely to be the same people who are officers and directors of all of the corporations in the group. Look at this airline and you will see only a single business. But when the law looks at the same airline, it sees six corporations, each with its own assets, liabilities, employees, officers, and directors. Incorporation is a game of make-believe for adults.

Even the Supreme Court of the United States plays. In one recent case the Court referred to the directors as "changing hats" when they sat as directors of the various corporations in the group.[10] The Court was not, as you might suspect, using that term to make fun of the game before skewering the players. It was explaining why it would recognize each of the corporations as a separate person with separate rights.

Some of the corporations in a group can be in financial difficulty when others are not. But most of the time, difficulties that affect

one member of a group affect most or all of them. Corporate groups cannot, however, file bankruptcy. Only corporations can. Each corporation in the group pays an $800 filing fee and files its own petition. To put the hypothetical airline just discussed into bankruptcy, its lawyers would probably file six petitions. The court would then enter an order "consolidating" the six cases into one for purposes of administration. The "existence" of separate corporations would affect the entitlements of creditors. A creditor that loaned money to one of the six corporations would have a claim against only that corporation's assets. But for most purposes, the court would simply ignore the individual corporations and treat the group as if it were the debtor. The same lawyers would almost certainly represent all six corporations, and the same executives would manage the company as a whole.

Each of the corporations in a corporate group is by definition an "affiliate" of the others. If one affiliate is in bankruptcy, the venue statute authorizes the other affiliates to file in the same court. Allowing a corporation to file bankruptcy in the court where the bankruptcy of an affiliate is already pending may at first sound like good common sense. Dividing the bankruptcy of a single airline between two or more bankruptcy courts would be inefficient.

But the right to file bankruptcy where the bankruptcy case of an affiliate is pending looks less sensible once one sees what clever lawyers can do with it. Eastern Airlines was one of the country's major carriers when it filed for bankruptcy in 1989. At the time of Eastern's filing, its headquarters and the bulk of its operations were in Miami, Florida. But for strategic reasons, Eastern did not want to file there.

Eastern was a corporate group, with various subsidiary corporations performing different functions for the airline. One of those affiliates, Ionosphere, Inc., operated Eastern's hospitality lounges in airports. Ionosphere had less than $2 million in assets—one-twentieth of 1 percent of Eastern's $3.7 billion in assets.[11] Ionosphere, Inc., was also solvent and therefore probably not even in need of bankruptcy. But Ionosphere, Inc., had connections to New York that made it eligible to file in the New York bankruptcy court.

On the day of the filing, Eastern's lawyers took two petitions to the New York bankruptcy court. First, they handed the clerk the petition for Ionosphere, Inc. At the moment the clerk stamped it filed, Ionosphere's case was pending in the New York bankruptcy court. Six minutes later, the lawyers handed the clerk the petition for Eastern Airlines. New York was a proper venue for Eastern's filing because the case of an Eastern affiliate—Ionosphere—was pending there.

This technique is commonly used. When Dallas-based LTV Corporation sought to file in New York in 1986, it first caused a New York–based subsidiary—Chateaugay Corporation—to file in New York. Chateaugay, like Ionosphere before it, reportedly was not even in need of reorganization.[12]

Lawyers refer to the first filing in each of these sequences as the "venue hook"—something perhaps like the grappling hooks that attacking tall ships used to bind themselves to their prey. A venue hook enables a corporate group to pull itself into any court in which any of its constituent corporations can set the hook. For large corporate groups, that can include almost any bankruptcy court in the United States.

In 2001, Enron used a venue hook to get into the New York court. Enron Corporation was an Oregon corporation with both its principal place of business and its principal assets in Houston, Texas. Enron's hook was Enron Metals & Commodity Corporation, a subsidiary that was eligible to file in New York because it had its principal place of business there. At the time the Enron group filed in New York, the group had 25,000 employees, over 7,500 of whom worked at the firm's headquarters in Houston. Enron Metals & Commodity Corporation had 57 employees in New York and owned one-half of 1 percent of Enron's assets.[13] But when it comes to venue hooking, size does not matter.

Where Were the Judges?

That legal rules constrain judges and make them do things is a magnificent illusion but an illusion nonetheless. There may indeed

be a rule that tells a judge to do X, but with a little effort the judge can always find a rule that tells the judge not to do X. Judging is not following the rules but rather deciding which rules to follow.

The bankruptcy venue statute can be fairly read to authorize all of the slick tricks previously described, but another bankruptcy venue statute authorizes their undoing. That statute instructs the bankruptcy court where a case is pending to transfer the case to another district whenever transfer is "in the interest of justice or for the convenience of the parties."[14] That is, even though the debtor files in a proper venue, the court can transfer the case to a better venue.

Such transfers were what the Bankruptcy Rules Committee had in mind when it adopted the current rules in 1974. George Treister, a member of that committee, reports that committee members realized they were authorizing a wide choice of venues for business filers. They wanted to afford a wide choice so that the debtor could put the case in the best venue, expecting that if the debtor used its freedom to put the case in any other venue, the judges would correct the problem by transferring the case. The committee failed to anticipate that the judges would want the cases badly enough to retain them even in inappropriate venues. At the time, there had only been a few large cases, and the existing venue provisions had not been abused.

Transfers of big bankruptcy cases are rare, even in the face of obvious abuse. Parties seldom ask for transfers, and when they do, the judges seldom grant them. The judges' reluctance results partly from practical considerations and partly from self-interest.

The practical problem is that when the debtor files in a court, the case quickly grows roots there. Immediately on filing the case, the debtor makes "first-day motions" to the court, usually seeking authorization to borrow money on an emergency basis, to use collateral belonging to secured creditors, to pay employees and critical suppliers, and to employ lawyers and financial advisers. The judge typically must rule on these motions within a few days, in the process devoting hours—maybe dozens of hours—to becoming familiar with the case. Another public official, the United States

Trustee, appoints a creditors' committee. The committee hurriedly interviews and hires professionals so it can participate in the early, crucial stages of the case. For the largest cases, the court must make special logistical arrangements, including setting up meeting spaces, creating web pages devoted to the case, and maybe even hiring additional court personnel. Creditors, landlords, and other parties in distant cities hire lawyers in the court city. The court cannot rule on a request for a change of venue immediately on receiving it. Those who will argue for and against the change need time to prepare.

If some party makes a request to transfer the case to another city, the court will likely hear the request a month or two after the party files it. If the court were to grant a request for a change of venue, the rooting process described here would repeat in the new city. By the time that the transfer occurred, the effect would be to inconvenience just about everyone involved.

The other reason bankruptcy judges don't transfer big cases was discussed in the introduction. Many judges don't want to give up the cases. That may be because a judge seeks the high visibility big cases bring, because the judge wants to bring business to his or her local legal community, or because the judge fears the criticism he or she will get for letting the cases go.

Thus, even though the bankruptcy judges have the power to nullify the debtors' manipulation of the venue requirements, the judges rarely do it. Those who choose courts on behalf of the debtors have the final say.

What Shoppers Want

When Bill Whitford and I realized that forum shopping would be an important facet of big-case bankruptcy, we began asking our interviewees about it. Most readily admitted that shopping was pervasive in big bankruptcy cases, but they differed in their descriptions of what the shoppers were after.

The most frequently cited objective was to get "good judges" who had experience with large reorganizations. Probably the sec-

ond most cited goal was to get a court convenient to both the debtor and the debtor's lawyers. But the lawyers also reported a dark side to the shopping. Debtors were seeking judges likely to rule in their favor on key issues, and lawyers were seeking courts that would not cut their fees.

Venue hooks and headquarters moves were used to increase the odds that cases would "stick" in various cities throughout the country. But the most blatant shopping during the period of our study brought cases to New York. Six of the 43 cases we studied were filed in a city that was neither the location of the debtor's headquarters nor the location of the debtor's principal operations. Five of the six were filed in New York. Whatever forum shoppers were after was most available in New York.

During the period of our study—as remains true today—most of the leading bankruptcy professionals were located in New York. That includes not just the bankruptcy lawyers but also the workout departments of money center banks, accounting firms, and financial advisers. New York's success in attracting cases in the early 1980s fed on itself. Because the cases were in New York, the professionals there had the experience, and their experience drew more cases. New York has long been the headquarters city for many of the largest U.S. firms. As a result, New York had also been the headquarters city for many of the bankrupt firms Bill and I studied. For both the professionals and the managers, Manhattan's Foley Square was often a convenient place to go to bankruptcy court.

That is not, however, the entire story. A large bankruptcy infrastructure, such as exists in New York, requires a steady flow of cases. Cases would come only as long as the New York bankruptcy court remained an attractive place to reorganize. That put pressure on the court.

The lawyers told us that three factors besides good judges and convenient courts were important enough to attract or repel cases: extensions of exclusivity, attorney fees, and first-day orders. "Exclusivity" is short for the debtor's exclusive right to file a plan of reorganization during the first 120 days of the case and such extensions of that 120-day period as the court may allow.

The debtor's objective in a bankruptcy case is usually to win confirmation of a plan of reorganization. The plan "restructures" the bankrupt firm's obligations, reducing the amounts of the debts, providing for payment over longer periods of time, transforming creditors into shareholders, or forcing other concessions from creditors. The bankrupt firm negotiates the plan with representatives of its creditors, but like nearly all negotiations, those negotiations take place in anticipation of what will happen if the parties do not reach agreement.

That is where exclusivity comes in. As long as the court continues to grant extensions of exclusivity, what happens in the absence of agreement is that the debtor remains in bankruptcy and continues to pay nothing to its creditors. The creditors cannot move the case forward because the creditors cannot propose a plan. That barrier is removed if the court lifts exclusivity. The creditors can then file a plan, and when the court confirms it, the debtor must begin repayment. Extensions of exclusivity—granted or anticipated—prevent the creditors from moving the case forward without the debtor's agreement; their effect is to confer bargaining leverage on debtors.

During the period of our study, the New York bankruptcy court extended exclusivity until the debtor struck a bargain with the creditors in 12 of 13 cases (92 percent). Other courts extended exclusivity for that long in only 22 of 30 cases (73 percent). The effect was that in New York debtors could negotiate with greater confidence that the court would not pull the rug out from under them by lifting exclusivity. With only one exception, the New York cases went forward on the debtor's terms or not at all.

Fees were another important consideration. The key professionals representing the debtor and the creditors in a bankruptcy case are paid from the assets of the bankrupt firm. But if the firm is insolvent—as most bankrupts are—the bite of those fees may be felt more by the creditors than the debtor. What assets an insolvent debtor has left after paying the fees belong to the creditors. A dollar more in fees to the debtor's lawyer may simply mean a dollar less in payments to creditors. To keep the debtor from spending

too much of the creditors' money on fees, bankruptcy law requires that the court approve fees as reasonable and necessary before the debtor makes payment. To justify their fees, the lawyers must keep detailed records of the time they spend on the case and the particular tasks on which they spend it. They submit these time records to the court along with their applications for payment. Theoretically, the judge examines the application carefully, cuts the amounts of the fees when appropriate, and authorizes the debtor to write the checks.

As a practical matter, a bankruptcy judge can determine the reasonableness of fees only in the most general sense. Figure 1 illustrates the problem. This is one page in a fee application that runs more than 100 pages. The page contains a tremendous amount of information but not much that would be useful in trying to second-guess the lawyers as to the reasonableness of the charges. The application from which it was taken was for one of four professional firms in the case, and the application covered only a little more than the first 100 days of the case. In a big case, all the fee applications together are likely to run to hundreds or even thousands of pages.

Even if a judge read them all, the judge still could not evaluate the reasonableness of the fees. Meaningful evaluation—if it can be done at all—requires sophisticated computer analysis. In some cases, the court authorizes employment of a professional fee auditor who does such an analysis, but more often, the court does not. Cutting lawyers' fees is not a career-enhancing activity for other lawyers (what goes around comes around) or bankruptcy judges (who may need the support of the lawyers who practice before them to be reappointed).

The fee cutting that actually occurs is mostly cosmetic. If a lawyer makes the mistake of billing for more than 24 hours in a single day—lawyers have been caught doing so in some cases—the court may catch it and cut the hours back to 24.[15] But occasionally fees are cut in two more significant ways. First, the court may decide that the quality of a lawyer's work was poor and arbitrarily slash some major portion of the fee. Lawyers enjoy this kind of crit-

PROFESSIONAL	DATE	HOURS	DESCRIPTION
FLICS	07/13/99	.30	E-MAILS RE: PREPARATION FOR DIP AND EXCLUSIVITY HEARING (.20); TELEPHONE CONVERSATION WITH R. YOUNG RE: SAME (.10).
FLICS	07/14/99	.90	REVIEW DRAFT AFFIDAVIT RE: EXCLUSIVITY MOTION (.30); REVIEW ISSUES RE: PRESENTATION FOR 7-20 MEETING (.60).
YOUNG	07/14/99	3.60	TELEPHONE CALL WITH E. SCHWARTZ RE: STATUS OF MOTIONS AND NEED FOR WITNESSES (.30); TELEPHONE CALLS WITH M. FLICS RE: SAME (.20); TELEPHONE CONVERSATIONS WITH W. LOVY RE: AFFIDAVIT IN SUPPORT OF EXCLUSIVITY (.20); REVIEW DIP OBJECTION (.50); TELEPHONE CALLS WITH M. FLICS RE: SAME (.70); TELEPHONE COVERSATIONS WITH D. BLOOM AND T. NOULLES RE: SAME (.50); MEETING WITH W. LOVY RE: SAME (.40); REVIEW COLLECTED CASE LAW RE: SAME (.50); REVISE SCHOPFER AFFIDAVIT RE: EXCLUSIVITY (.30).
LOVY	07/14/99	3.70	DRAFT AFFIDAVIT IN SUPPORT OF DEBTOR'S MOTION TO EXTEND EXCLUSIVE PERIOD FOR FILING PLAN (1.70) ; RESEARCH LEGAL BASIS FOR OBJECTION OF BLACK WARRIOR TELECOMMUNICATIONS TO NEW DIP FINANCING (2.00).
YOUNG	07/15/99	5.20	TELEPHONE CALLS WITH W. LOVY RE: OBJECTION TO DIP FINANCING (.60); TELEPHONE CALLS WITH M. FLICS RE: SAME (.50); TELEPHONE CALL WITH OPPOSING COUNSEL RE: SAME (.30); REVISE RESPONSE TO OBJECTION (2.30); REVIEW UNDERLYING BLACK WARRIOR AGREEMENTS (.80); TELEPHONE CALLS WITH T. NOULLES AND EILERS RE: SAME (.70).
LOVY	07/15/99	1.00	RESEARCH LEGAL BASIS FOR OBJECTION OF BLACK WARRIOR TELECOMMUNICATIONS TO NEW DIP FINANCING (1.00).
FLICS	07/16/99	1.80	CONFERENCE WITH R. YOUNG RE: DIP OBJECTION AND PREPARE FOR HEARING (.50); REVIEW REPLY RE: DIP OBJECTION (.40); TELEPHONE-R. YOUNG RE: SAME (.10); REVIEW EXCLUSIVITY MATERIAL IN PREPARATION FOR HEARING (.80).
YOUNG	07/16/99	3.40	REVISE RESPONSE TO OBJECTION TO DIP FINANCING (.80); TELEPHONE CALLS WITH M. FLICS AND W. LOVY RE: SAME (.50); MEETING WITH M. FLICS RE: HEARING ISSUES FOR DIP FINANCING (.50); REVIEW WALSH LETTER RE: FINANCING (.40); MEETINGS WITH W. LOVY RE: TASKS FOR HEARING (.80); TELEPHONE CALLS WITH T. NOULLES RE: DIP OBJECTION (.40).

Fig. 1. One page of a fee application

icism about as much as other people do and steer a wide berth around any court inclined to do it. Second, some courts are reluctant to approve fees in excess of particular hourly rates. For example, through the 1980s, the Philadelphia bankruptcy court refused to approve fees in excess of $200 per hour for senior partners, while the bankruptcy court in New York was approving fees as high as $450 an hour. Not surprisingly, Philadelphia got none of the 43 cases in our study—and hasn't had a big case since then, either. (One of the two Philadelphia judges who imposed the $200 limit was denied reappointment in 2000, apparently solely on the basis of adverse comments received during the public comment period.)[16]

A variety of factors cause the fees of New York bankruptcy lawyers to be, on average, higher than the fees of bankruptcy lawyers in other cities. Firms' costs are higher in New York, and so are the costs of living for the lawyers the firms employ. To maintain their images as premier providers of legal services, the New York firms have tried to hire the best and the brightest on graduation from law schools and, some believe, have grossly overpaid for them. In some major cities, the cost of representation by the best local bankruptcy lawyers may be half or less what it is in New York. If the comparison is between the cost of bringing New York lawyers to St. Louis and using St. Louis lawyers in St. Louis, the differential is even greater. Lawyers travel first class, and they bill for travel time.

New York lawyers did handle cases outside New York in the 1980s. But when they did, they often stirred resentment. In each case, the New York lawyers' fees—and their reputations—were at risk. For example, Levin & Weintraub was one of the leading bankruptcy firms in New York when it represented Evans Products as debtor in the Miami bankruptcy court in 1986. After ruling against the firm's client on the merits, Bankruptcy Judge Thomas C. Britton cut Levin & Weintraub's fees by one-third, noting in a published opinion that the quality of the work of Levin & Weintraub's opponent in the case was "markedly superior" to that of Levin & Weintraub.[17] To avoid these risks, the New York lawyers tried, whenever possible, to bring the cases to New York.

Not all courts were as provincial as the one in Miami. Realizing that the New York lawyers had substantial control over the flow of cases, some courts signaled in published opinions that New York lawyers would be welcome in their districts. For example, the Oklahoma City bankruptcy court had three of the 43 cases in our study, making it the second most popular court. One of the judges of that court wrote that "outside counsel may charge rates normally charged clients in their respective regional areas for counsel time expended in these proceedings."[18] A Denver bankruptcy judge approved the payment of "New York rates" to some New York lawyers,[19] and the bankruptcy judges in Nashville opined that a New York firm practicing in the court would not be confined to Nashville, Tennessee, rates.[20]

That the New York bankruptcy court would pay New York rates—and not unduly hassle the lawyers about their fees—went without saying. Had the New York court done otherwise, New York would not have been the leading venue.

The third factor crucial to the flow of cases was first-day orders. In the view of some of the lawyers we interviewed, the practicalities of operating a business in bankruptcy reorganization were often in conflict with the requirements of the Bankruptcy Code. In New York, the code yielded to the practicalities; in Boston, and other cities, judges were inclined to the opposite view. This clash was less evident in the 1980s than in recent years, and so further discussion of it will be postponed to chapter 6.

The Judge at the Center

During the period of our study, the Manhattan division of the United States Bankruptcy Court for the Southern District of New York was a five-judge court. One judge stood out. Burton R. Lifland was a bankruptcy lawyer in New York before he became a member of the court in March 1980. Ten days after taking office, Judge Lifland drew the bankruptcy case of Penn-Dixie Industries, one of the 43 cases in our study. Before the end of 1985, he had eight of the 43. No other judge had more than three.

Judge Lifland quickly became both a bankruptcy celebrity and a center of controversy. Lifland was the judge who handled the big cases. Some of the lawyers we interviewed described him as "pro-debtor," and *Forbes Magazine* echoed that charge in 1991.[21] "Pro-reorganization" is probably a more accurate term, because Lifland's primary goal seemed to be that the company survive the bankruptcy case.

Judge Lifland had at that time an unusual style. Some bankruptcy judges set matters for hearing and let the approaching day of reckoning provide the incentives for negotiation. Judge Lifland rarely set matters for hearing. Instead, he pressured the negotiators to settle the case. In most instances that meant threatening to lift exclusivity, cut lawyers' fees, or take unspecified action that would make the lawyers sorry they hadn't settled. Of course, the terms of the settlements Judge Lifland imposed were generally favorable to those who brought him the cases.

Judge Lifland wanted the big cases, and the debtors' lawyers wanted him to have them. In the early 1980s, New York was the most attractive bankruptcy venue in the country, and Burton Lifland was the most attractive judge in that venue.

How he got the case assignments remains both a mystery and an object of suspicion. When the Eastern Airlines case was assigned to Judge Lifland in 1989, Amy Dockser of the *Wall Street Journal* referred to Lifland's "knack for landing atop the biggest cases" and noted:

> While [Eastern's] choice of New York seemed predictable, the selection of Judge Lifland raised some eyebrows because of the uncanny way he has wound up assigned to the most important and visible bankruptcies. A number of bankruptcy lawyers question whether the lottery system of assigning cases among the seven judges in New York is entirely random.[22]

Despite the existence of a random draw—or "wheel," as it was known in New York—the clerk initially assigned six of the 13 New York cases in our study to Judge Lifland and later reassigned two

more of the 13 to him when the initially assigned judges were unable to complete them. The odds that eight of 13 cases would be randomly assigned to a single judge on a five-judge court are only a little better than one in 1,000.

When Professor Ted Eisenberg and I circulated a paper reciting these odds, we drew an angry public reply from Cecelia Morris, then clerk of the New York bankruptcy court and now a U.S. bankruptcy judge in New York.[23] Morris pointed out that the court was not at full strength during the period due to a death, a resignation, and some conflicts of interest that prevented particular judges from hearing particular cases. Using the terms of the judges supplied to me by the Administrative Office of the U.S. Courts and deleting the judges that Judge Morris indicated in her reply were unavailable to receive particular assignments, I calculated that the average number of available judges at the time of the 13 initial assignments and three reassignments that delivered eight cases to Judge Lifland was slightly higher than four.[24] Ted, an accomplished statistician, calculates the odds of a particular judge on a four-judge court getting eight of 13 cases by random draw at six in 1,000.

The End of an Era

When Bill Whitford and I began our study, New York was at the height of its prominence. At the time, that prominence seemed both natural and inevitable. With all the key players there, how could New York not be the leader in big-case bankruptcy?

The surprising answer came sooner than anyone expected. Judge Lifland's extraordinary run ended in 1985, amid rumors about improprieties in case assignments. The following year, 1986, was the last good year for the New York bankruptcy court. It got four of the 10 big cases filed that year, a 40 percent market share. From 1980 through 1986, New York's market share of big-case bankruptcy averaged 32 percent. Beginning in 1987, New York's popularity declined. Over the next nine years (1987–95) the New

York court still averaged a respectable 17 percent market share. But in 1996, a lean year for big bankruptcy nationally, New York got not a single one of the 15 cases filed.

Delaware had by that time replaced New York as the big bankruptcy capital of the United States. And only a short time after that, the Delaware court's prominence seemed equally natural and inevitable.