The Big Bankruptcy Empirical Research Agenda: Some Proposals

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I would like to propose four items for discussion as part of the Big Bankruptcy Empirical Agenda, all of which relate to perceived changes in the big bankruptcy world over the past decades.

(1) Creditor Control and DIP Lending. A number of empirical studies have shown the increasing dominance of creditor control in the Chapter 11 process. One major area that has not been explored in detail, however, are the terms of DIP financing agreements. Some work has noted the increase in control covenants in DIP loan agreements, but there has not been any work that looks at the actual pricing of the loans. My sense is that DIP loans present the paradox of high return, low risk credit. This is not something that should occur in a well-functioning market. I would like to explore the dynamics of DIP financing agreements for large, public company bankruptcies in terms of both the pricing and the other relationships between the DIP lender and the debtor (pre-petition and post-petition) as a way of further examining creditor control.

(2) Derivative Safe Harbors. The derivatives safe harbor debate is basically an extension of the efficiency of secured credit debate (with the securitization bankruptcy remoteness debate being yet another iteration). Is there any correlation between the pre-bankruptcy derivatives exposure of large public companies and the outcome of their bankruptcies? Ed Morrison has argued that derivative contracts really aren’t part of going concern value, which would imply that their termination shouldn’t affect the ability to reorganize. But for many firms, as Stephen Lubben argues, derivatives are being used as hedges (e.g., airlines with fuel hedges), which seem to be critical to going concern value. If termination of derivative contracts via the safe harbors is resulting in an erosion of going concern value, we should a lower rate of reorganization success for firms with large derivative exposure pre-bankruptcy. This might present a means of testing the effects of the safe harbors.

(3) Chapter 363. The line going around now is that there are two business bankruptcy chapters: Chapter 11 and Chapter 363. The question of whether the sale paradigm in replacing the reorganization paradigm and what that might mean has been the topic of some academic debate already (see LoPucki & Doherty-Baird & Rasmussen exchange). I think there’s still a good deal to be explored about the dynamics of the 363 process. To date the focus on 363 has been about the frequency of its use. I believe there’s a good deal more work to be done examining how the 363 process is actually working: exactly what is being sold? How robust is the market? Who are the buyers? How common are objections and by whom? Answering these questions is a first step in understanding whether there are serious problems created by the absence of creditor protections in 363 that are analogous to 1129’s protections.

(4) Claims Trading. The emergence of a bankruptcy claims trading market has been one of the most important developments in Chapter 11 since the adoption of the Bankruptcy Code. Yet there is little consensus about the systemic costs and benefits of claims trading (cf. Baird & Rasmussen’s *Antibankruptcy* with Levitin’s *Bankruptcy Markets*). I am skeptical, however, that there’s any way to do an effective empirical study on claims trading, simply because we lack robust data on the claims market. (I had the misfortune of reading a business school study on the topic by non-lawyer authors who were unaware that they were only seeing data from an extremely limited and unrepresentative slice of the market—trade claims). I would be interested to hear any ideas on how the claims trading phenomenon could be approached empirically.