CHOOSING CORPORATE BANKRUPTCY COUNSEL

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INTRODUCTION

A string of high-profile corporate failures have refocused public attention on the issue of professionals in chapter 11.[1] While several articles in the last decade have illuminated the basic costs that these professionals add to the chapter 11 process,[2] little else is understood about the role of professionals in chapter 11.

Even in the rarified world of public company bankruptcies, the basic question of how debtors choose bankruptcy counsel has never been the subject of any empirical inquiry. But the choice of counsel has important implications—most notably because some have argued that debtor's counsel may steer cases to jurisdictions like Delaware and New York, with possible detrimental effects on the debtor's reorganization.[3] And similarly, very little is known about the market for debtor's counsel in big cases. Is this a competitive market? The answer plainly has implications for the degree of deference bankruptcy courts should give counsel's hourly rates.

This short Article investigates these and other questions related to the choice of debtor's counsel by examining a new sample of 275 large chapter 11 cases

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* Associate Professor of Law, Seton Hall University School of Law. Mark J. Enright was my research assistant for this Article and his help is appreciated. Comments are welcome and can be directed to me at lubbenst@shu.edu. Many thanks to Lynn LoPucki for helpful comments on the first draft and for making his data available for this Article. At various times from 1995 through 2002 I was an associate in the corporate reorganization department of a law firm that appears frequently in the sample used in this article. All information contained in this article is based upon publicly available material. The opinions expressed in this article are my own, and must not be taken to reflect the opinions of my former employer or any former client.

[1] *E.g.*, Richard Truett, *Filing for Bankruptcy Can Be an Expensive Proposition*, CRAIN'S DETROIT BUS., April 4, 2005, *available at* 2005 WLNR 5371433 (elaborating upon high costs of legal fees incurred through filing chapter 11 bankruptcy); Rick Desloge, *Lawyers, Auditors Rack Up $3.8 Million in Falcon Bankruptcy*, ST. LOUIS BUS. J., July 4, 2005 ("Falcon Products' first three months in bankruptcy cost the firm more than $3.8 million, with nearly all the money going to accountants, lawyers and financial advisers on the East and West coasts."); Joe Rauch, *Winn-Dixie's Fees Top $9 Million*, JACKSONVILLE BUS. J., July 24, 2005, *available at* http://jacksonville.bizjournals.com/jacksonville/stories/2005/07/25/story3.html (describing how Winn-Dixie has incurred over $9 million in consulting and attorneys' fees and expenses associated with chapter 11 reorganization).

[2] *See* Lynn M. LoPucki & Joseph W. Doherty, *The Determinants of Professional Fees in Large Bankruptcy Reorganization Cases*, 1 J. EMPIRICAL LEGAL STUD. 111, 140 (2004) (reporting average ratio of fees and expenses to assets in a sample of forty-eight chapter 11 cases to be 2.2%); Stephen J. Lubben, *The Direct Costs of Corporate Reorganization: An Empirical Examination of Professional Fees in Large Chapter 11 Cases*, 74 AM. BANKR. L.J. 509, 540 (2000) (finding professional fees averaged 2.5% of assets when pre-packaged cases were excluded from sample); Lawrence A. Weiss, *Bankruptcy Resolution: Direct Costs and Violation of Priority of Claims*, 27 J. FIN. ECON. 285, 286 (1990) (reporting professional fees of 3% of assets based on sample of thirty-one publicly traded firms that filed for bankruptcy in early 1980s).

[3] *See generally* LYNN M. LOPUCKI, COURTING FAILURE: HOW COMPETITION FOR BIG CASES IS CORRUPTING THE BANKRUPTCY COURTS (Univ. Mich. Press 2005) (2005) (discussing how debtors' choice of counsel might unknowingly influence their reorganization as a result of specific state laws).

commenced in 2001 through early 2005. I thus provide the first portrait of the market for bankruptcy counsel.

In doing so I discover several import features of the market. For example, three large firms lead the market, but the market is largely fragmented and apparently subject to a good deal of competition. The two most common law firms in the sample together represent less than 25% of the debtors in the sample, and the ten most common law firms represent but a third of the debtors.

Predictably, large debtors tend to hire large law firms while small debtors tend to hire smaller law firms. But mid-sized debtors hire law firms of all sizes. And debtor size only explains a small part of the decision to hire one of the leading law firms as bankruptcy counsel. In short, the market defies easy, anecdotal explanation.

The remainder of the Article is comprised of three sections. Part I sets the stage by providing a brief overview of the law governing the retention of professionals in a chapter 11 case and the existing empirical studies of these professionals. Part II then presents data that shows that very large corporate debtors are much more likely to select one of three leading bankruptcy firms as their counsel, but otherwise the market for corporate bankruptcy counsel is much more competitive than might be expected. Part III closes out the Article by examining the implications of these findings and discusses avenues for further research.

I. THE BANKRUPTCY CODE AND PROFESSIONALS

The federal bankruptcy laws—today the Bankruptcy Code, and before that, the 1898 Bankruptcy Act—have long required court approval of the debtor's choice of professionals, including the debtor's choice of counsel to represent it in the bankruptcy case.[4] Under the present Bankruptcy Code, section 327(a), when read with section 1107(a)[5], allows a chapter 11 debtor to retain "one or more attorneys, accountants, appraisers, auctioneers, or other professional persons, that do not hold or represent an interest adverse to the estate, and that are disinterested persons."[6] Thus, a professional must satisfy a two-part test before retention: the professional

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[4] *See, e.g.*, *In re* Hydrocarbon Chem., Inc., 411 F.2d 203, 205–06 (3d Cir. 1969) ("It is well settled that unless counsel have been approved by the court, though their services were of value to the court in a [c]hapter X [reorganization] proceeding, they must be denied compensation."); *In re* Nat'l Tool & Mfg., 209 F.2d 256, 257 (3d Cir. 1954) (reversing lower court's decision to compensate attorney who rendered valuable services to trustee because attorney was not appointed in manner required); *see also* David Ferber et al., *Conflicts of Interest in Reorganization Proceedings Under the Public Utility Holding Company Act of 1935 and Chapter X of the Bankruptcy Act*, 28 GEO. WASH. L. REV. 319, 330–37 (1959) (explaining origin and purpose of requirement for court approval of debtor's choice of counsel).

[5] 11 U.S.C. § 1107(a) (2006) ("Subject to any limitations on a trustee serving in a case under this chapter . . . a debtor in possession shall have all the rights . . . and powers, and shall perform all the functions and duties . . . of a trustee serving in a case under this chapter . . . .").

[6] *Id.* § 327(a) ("Subject to any limitations on a trustee serving in a case under this chapter . . . a debtor in possession shall have all the rights . . . and shall perform all functions and duties . . . of a trustee serving in a case under this chapter.").

must be disinterested and hold no adverse interest.[7] This ex ante control over professionals is coupled with the bankruptcy court's power to alter professional compensation at the conclusion of a case. For example, section 328(c) gives the courts the power to deny compensation for services previously rendered by professionals, or to order disgorgement of fees already paid if a professional is found to have been not disinterested (i.e., found to have been "interested").[8]

Despite these strong controls over professionals, the Bankruptcy Code, which allowed attorneys to charge "market rates" (i.e., non-bankruptcy rates) for the first time in 1978, was often criticized for being unduly expensive, primarily as a result of excessive attorney's fees.[9] But several empirical studies soon tempered the claim that chapter 11 was "excessively" expensive.[10]

First, Lawrence Weiss studied a sample of thirty-seven publicly-traded firms that filed for bankruptcy between 1979 and 1986.[11] The study offered the first examination of direct costs under the 1978 Bankruptcy Code, finding costs to be an average of 3.1% of the book value of debt plus market value of equity at the end of the fiscal year preceding bankruptcy, which was substantially less than the 4% to 25% that prior studies had reported.[12]

In 1997, Brian Betker examined more up-to-date data with respect to direct costs of bankruptcy.[13] He asserted that "several related innovations," including the development of pre-packaged bankruptcies,[14] had changed the way firms restructured their debt and could alter firms' direct costs of bankruptcy.[15] He found that the direct costs of traditional chapter 11 cases averaged 3.93% of total pre-

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[7] *See In re* Martin, 817 F.2d 175, 180 (1st Cir. 1987) (applying "twin requirements of disinterestedness and lack of adversity").

[8] 11 U.S.C. § 328(c) (2006) ("[C]ourt may deny allowance of compensation for services and reimbursement of expenses of a professional person . . . if, at any time during such professional person's employment . . . such professional person is not a disinterested person . . . .").

[9] *See, e.g.*, SOL STEIN, A FEAST FOR LAWYERS: INSIDE CHAPTER 11—AN EXPOSE 123–132 (M. Evans and Co., Inc., 1989) (1989) (criticizing some bankruptcy lawyers for their methods of enriching themselves, including padding of time billed and dragging out case); Hon. Alexander L. Paskay & Frances Pilaro Wolstenholme, *Chapter 11: A Growing Cash Cow: Some Thoughts on How to Rein in the System*, 1 AM. BANKR. INST. L. REV. 331, 335 (1993) (identifying legal expenses associated with chapter 11 reorganization as ripe for reform).

[10] *See* Douglas G. Baird, *Bankruptcy's Uncontested Axioms*, 108 YALE L.J. 573, 573–574 n.3 (1998) (citing examples of empirical research affecting scholars' understanding of direct costs in bankruptcy).

[11] Lawrence A. Weiss, *Bankruptcy Resolution: Direct Costs and Violation of Priority of Claims*, 27 J. FIN. ECON. 285, 285–286 (1990) (presenting evidence on percentage of direct costs to total assets and violations of priority claims among New York Stock Exchange and American Stock Exchange firms in bankruptcy, and stating such factors affect firms' "cost of capital" and "capital structure").

[12] *Id.* at 286.

[13] Brian L. Betker, *The Administrative Costs of Debt Restructurings: Some Recent Evidence*, 26 FIN. MGMT. 56, 56 (1997) (comparing direct costs of 157 traditional chapter 11s, pre-packaged bankruptcies, and exchange offers between 1986 and 1993).

[14] *Id.* at 56 ("Several studies argue that [pre-packs] effectively combine the benefits of both [c]hapter 11 and workouts in a low-cost reorganization framework."). A pre-packaged chapter 11 case features a reorganization plan that was approved by one or more classes before the bankruptcy filing. *See* Lubben, *supra* note 2, at 516 ("A true [pre-pack] involves a [pre-petition] solicitation of votes on a plan.").

[15] Betker, *supra* note 13, at 56 ("Several studies argue that [pre-packs] effectively combine the benefits of both [c]hapter 11 and workouts in a low-cost reorganization framework.").

bankruptcy assets (median 3.37%), which was substantially larger than average direct costs for pre-packaged bankruptcies (mean 2.85%, median 2.38%), though direct costs for pre-packaged bankruptcies were not significantly larger than those for exchange offers (mean 2.51%, median 1.98%).[16]

And in 2000, this author asserted that many prior studies, including Betker's, overstated the direct costs associated with chapter 11 filings by including costs that were exogenous to chapter 11. Using a sample drawn from the Business Bankruptcy Project database,[17] I examined professional fees along three dimensions: "(a) fees as a percentage of the firm's overall debt load, (b) fees as a percentage of the debtor's reported assets, and (c) fees in relation to total firm size."[18] With respect to the entire sample, the direct costs of chapter 11 were found to average 0.87% of total firm size.[19] When pre-packaged bankruptcies were removed from the sample, the direct costs increased to 1.20% of total firm size.[20] When measured as a percentage of assets, direct costs were found to average 1.8% of total firm size for the entire sample and 2.5% of total firm size when pre-packs were excluded.[21]

More recently, Lynn LoPucki and Joseph Doherty reported on "one of the most extensive studies to date of the professional fees and expenses awarded by U.S. bankruptcy courts in the reorganization of large, public companies."[22] LoPucki and Doherty studied the professional fees and expenses awarded by U.S. bankruptcy courts in forty-eight chapter 11 cases involving large, public companies whose plans were confirmed between 1998 and 2002.[23]

LoPucki and Doherty considered and rejected a number of different methods of calculating firm size and ultimately decided to use the value of assets reported by the debtor on the bankruptcy petition.[24] The forty-eight firms in their sample reported assets ranging from $65 million to $7.5 billion and an average of $881

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[16] *Id.* at 57 ("[T]he direct costs of traditional [c]hapter 11 cases average 3.93% of pre-bankruptcy total assets. This figure is significantly larger than average direct costs for [pre-packs] (2.85%). Direct costs of [pre-packs] are not significantly larger than direct costs for exchange offers (2.51%).").

[17] This database was first created by Dr. Teresa Sullivan, Professor Elizabeth Warren, and Professor Jay Lawrence Westbrook and is comprised of cases drawn from twenty-three districts, two from each of the numbered circuits, with the exception of the Ninth Circuit, from which three districts were selected. *See generally* Elizabeth Warren & Jay Lawrence Westbrook, *Financial Characteristics of Businesses in Bankruptcy*, 73 AM. BANKR. L.J. 499 (1999).

[18] Lubben, *supra* note 2, at 512.

[19] *Id.* ("The direct costs of [c]hapter 11 are found to average 0.87% of total firm size with respect to the entire sample . . . .").

[20] *Id.* at 512–13 ("The direct costs of [c]hapter 11 are found to average . . . 1.20% of total firm size when pre-packaged bankruptcy cases are excluded from the sample.").

[21] *Id.* at 513 ("Even when measured as a percentage of assets, the direct costs of [c]hapter 11 are found to average a modest 1.8% of total firm size with respect to the entire sample, and 2.5% of total firm size when pre-packaged bankruptcy cases are excluded.").

[22] LoPucki, s*upra* note 2, at 111.

[23] *Id.* at 115 ("This article reports on a study of professional fees and expenses awarded by U.S. bankruptcy courts in the [c]hapter 11 cases of 48 large, public companies whose plans were confirmed in the period from 1998 through mid-2002.").

[24] *Id.* at 122–24 (discussing twelve methods for determining firm size and reasons for eliminating all methods other than use of debtor's reported value assets).

million.[25] Using that measure, they then found that professional fees increased with the size of the reorganizing firm, but at a declining rate, indicating economies of scale.[26] They reported that total fees and expenses were 1.4% of the total assets reported in the beginning of the bankruptcy proceedings, and that firms expended, on average, 2.2% of assets on professional fees.[27] Next, controlling for the size of the firm, LoPucki and Doherty found a positive correlation between the length of time chapter 11 cases remained pending and the amount of fees and expenses awarded.[28]

These studies thus compliment the present Article. The choice of lead bankruptcy counsel, the most important professional in a chapter 11, clearly will have an influence on the costs of the case. The next section looks at the factors that influence the selection of counsel.

II. AN EMPIRICAL STUDY OF COUNSEL SELECTION

In this part of the Article I present my empirical results. Section A describes the sample, Section B examines some simple statistical tests of the data, and Section C presents some regression models.[29]

A. The Sample

The sample is comprised of 275 corporations that filed bankruptcy petitions between 2001 and the first half of 2005. The cases were filed in districts throughout the country, although, not surprisingly, Delaware and the Southern District of New York are by far the most common districts in the sample, representing 31.6% and 20.6% of the sample cases, respectively.[30]

These cases were identified using Lynn LoPucki's Bankruptcy Research Database.[31] Thus all of the cases in the sample are large corporations, each with assets greater than $100 million (measured in 1980 dollars),[32] that were required to

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[25] *Id.* at 140 (studying "a group of 48 firms with assets ranging from about $65 million to $7.5 billion, and averaging $881 million").

[26] *Id.* at 124–26 ("Professional fees increase with the size of the reorganizing firm. This increase is generally assumed to be subject to economies of scale.").

[27] LoPucki, *supra* note 2, at 140 ("[W]e found that total fees and expenses were 1.4 percent of total assets reported in the court file at the beginning of the bankruptcy case, and that firms expended, on average, 2.2 percent of assets on professional fees . . . .").

[28] *Id.* at 128. ("We estimate that doubling the time a case remains pending results in a 57 percent increase in fees.").

[29] The SPSS output file associated with this Article is available upon request from the author.

[30] *Cf.* Lynn M. LoPucki & Sara D. Kalin, *The Failure of Public Company Bankruptcies in Delaware and New York: Evidence of a "Race to the Bottom,"* 54 VAND. L. REV. 231, 248 (2001) (reporting 16% of cases studied emerged from Delaware reorganizations and 19% from New York reorganizations).

[31] *See* Lynn M. LoPucki, Bankruptcy Research Database (BRD), Web BRD: A Window on the World of Big-Case Bankruptcy, http://lopucki.law.ucla.edu (last visited Sept. 11, 2006) (enabling user to "design and instantly execute an empirical study of large, public company bankruptcy cases in seconds—in the most complete, accurate data available anywhere.").

[32] Just over $231 million in 2004 dollars.

file reports with the United States Securities and Exchange Commission ("SEC").[33] The LoPucki database is also the source of basic financial information for the debtors in the sample.

I then hand coded information on the debtor's lead counsel and the number of attorneys in the lead counsel's firm.[34] Debtor's counsel information was initially obtained from the Bankruptcy DataSource files on Lexis, supplemented with internet searches. The data was then confirmed (and the number of cases with missing information reduced) by a series of searches on PACER. Counsel information was obtained for 269 of the debtors in the sample. The number of attorneys in each firm was obtained from Martindale-Hubbell's web page.[35] This information was available for 209 of the debtors in the sample.

As seen in Table 1, below, the debtors in the sample are quite large by any measure. The average debtor in the sample had assets of more than $2.5 billion and more than 6,500 employees before the bankruptcy.[36] On the latter point, according to U.S. Census data from 2002, only 0.30% of all domestic companies have more than 500 employees.[37] But there are also numerous indications that the sample is rather skewed—the result of a handful of exceedingly large cases—and the median or confidence intervals are arguably more useful than the means. Thus, Table 1 reports a variety of measures that allow the reader to understand the true shape of the distribution of the sample.

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[33] For more on the contents of the Bankruptcy Research Database, *see* Lynn M. LoPucki, Bankruptcy Research Database (BRD), Contents of the WebBRD, 2005, http://lopucki.law.ucla.edu/contents_of_the_webbrd.htm (last visited Oct. 6, 2006) (containing data on all large, public company bankruptcy cases filed in United States Bankruptcy Courts).

[34] "Lead counsel" means the firm retained to represent the debtor under section 327(a). If there was more than one firm so retained, the firm without an office in the district was deemed the lead counsel.

[35] LexisNexis Martindale-Hubbell, http://www.martindale.com/ (last visited Oct. 6, 2006) (providing data for attorneys and law firms nationwide).

[36] Throughout this Article, asset figures have been standardized into current dollars using the CPI to allow for inter-year comparison, and all asset figures are in millions of dollars. *See* U.S. DEPT. OF LABOR, BLS HANDBOOK OF METHODS, CH. 17: THE CONSUMER PRICE INDEX 1 (1997), http://stats.bls.gov/opub/hom/pdf/homch17.pdf (indicating Consumer Price Index (CPI) measures "change over time in the prices of consumer items").

[37] *See* U.S. CENSUS BUREAU, UNITED STATES: 2002 COUNTY BUSINESS PATTERNS (2002), http://censtats.census.gov/cgi-bin/cbpnaic/cbpsel.pl (select "2002") (last visited Oct. 9, 2006) (providing data on employee size and payroll organized by major industries).

TABLE 1: DESCRIPTIVE STATISTICS OF DEBTORS IN SAMPLE

			Statistic	Std. Error
Assets (in current dollars; millions)	Mean		2816.41	663.696
	95% Confidence Interval for Mean	Lower Bound	1508.08	
		Upper Bound	4124.73	
	5% Trimmed Mean		1273.14	
	Median		683.68	
	Std. Deviation		9663.554	
	Minimum		223	
	Maximum		102068	
	Interquartile Range		1370.79	
	Skewness		7.662	.167
	Kurtosis		66.318	.333
No. of employees before bankruptcy	Mean		6323.09	1269.103
	95% Confidence Interval for Mean	Lower Bound	3821.35	
		Upper Bound	8824.84	
	5% Trimmed Mean		4190.18	
	Median		2787.00	
	Std. Deviation		18478.413	
	Minimum		1	
	Maximum		252000	
	Interquartile Range		4355.50	
	Skewness		11.444	.167
	Kurtosis		149.827	.333

To further illuminate the extreme ends of the sample, Table 1A sets forth the five largest and five smallest cases based on asset size.

TABLE 1A: EXTREME CASES IN SAMPLE (BY ASSET SIZE)

		Debtor Name	Assets (in current dollars; millions)
Highest	1	WorldCom, Inc.	102,068
	2	Enron Corp.	65,577
	3	Conseco, Inc.	60,035
	4	Global Crossing Ltd.	30,151
	5	UAL Corporation (United Airlines)	24,640
Lowest	1	High Voltage Engineering Corporation (2004)	0
	2	IWO Holdings, Inc.	219
	3	Wherehouse Entertainment, Inc. (2003)	223
	4	JCC Holding Co.	223
	5	Talon Automotive Group, Inc.	224

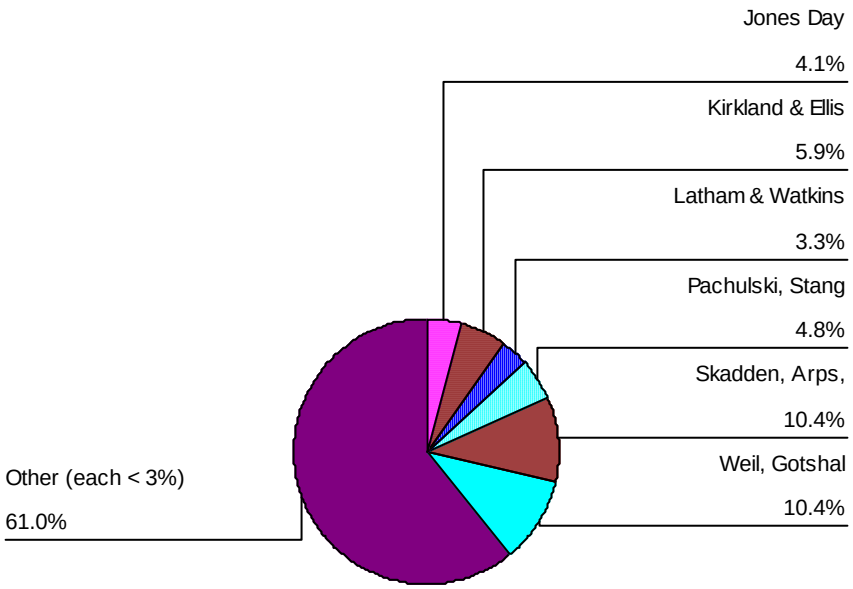
The debtors in the sample are spread over a wide range of industries, as shown in Table 2. When the debtors are subdivided by SIC Major Division Codes, only the "communications" group exceeds 10% of the sample.

TABLE 2: SIC DIVISION CODES OF DEBTORS IN SAMPLE

		Frequency	Percent	Cumulative Percent
Missing		12	4.4	4.4
	B: Mining	5	1.8	6.2
	C: Construction	4	1.5	7.6
	D: Manufacturing	89	32.4	40.0
	E: Transportation, Communications, Electric, Gas	81	29.5	69.5
	F: Wholesale Trade	15	5.5	74.9
	G: Retail Trade	16	5.8	80.7
	H: Finance, Insurance, And Real Estate	14	5.1	85.8
	I: Services	39	14.2	100.0
	Total	275	100.0	

The choice of lead debtor's counsel is also subject to a good deal of variation. For 269 debtors in the sample with counsel information, there are 103 unique law firms or attorneys. Figure 1 shows the law firms that appear most frequently in the sample.

Figure 1 -- Lead Debtor's Counsel (n=269)

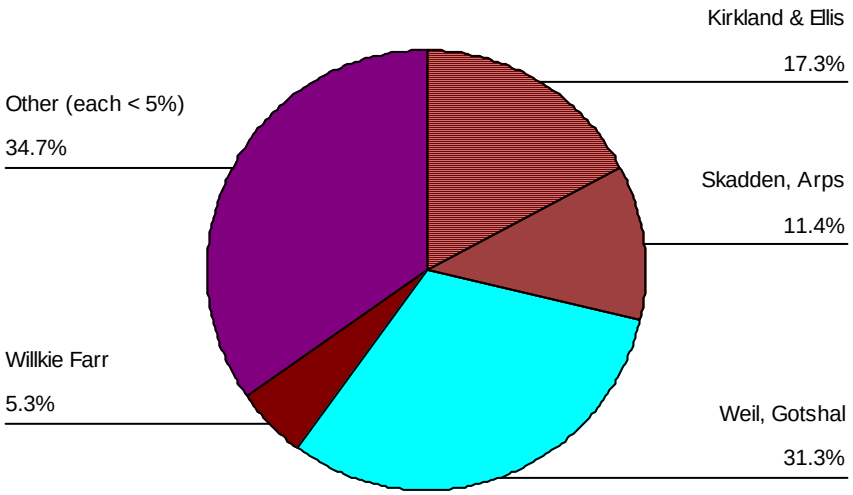


The law firms in the sample come in a wide range of sizes, with the smallest employing just twelve attorneys, while the largest quartile of law firms each employing more than 1,000 attorneys.

In short, the sample is compromised of large and very large debtor corporations, represented by law firms of a wide variety of sizes. But the foregoing chart is arguably incomplete, inasmuch as simply counting the number of representations is a crude measure of the role played by the leading law firms in the market for bankruptcy counsel. Arguably a truer picture would take into account the size of the various cases, and thus I close this section with a chart showing the frequency of each law firm in the sample weighted by the debtor's standardized assets. In this presentation, the role of law firms with one or two cases diminishes as the role of three leading firms expands tremendously.[38]

[38] Weil, Gotshal's share of Figure 2 drops to 11% when Enron and WorldCom are removed from the sample. An alternative version of Figure 2, reflecting the removal of these two cases, appears as Appendix A of this Article.

Figure 2 -- Debtor's Lead Counsel (n=268)



Cases weighted by debtor's assets

B. The Choice of Counsel

In this section I parse the data to look for factors that may influence the choice of counsel. The information developed in this part of the Article will inform the regression analysis in the next section.

The first question I examine is whether there are substantial differences among the debtors based on where they filed their bankruptcy cases or the law firms that represented them. To examine the first part of this question, I looked at the debtors that filed their cases in the Southern District of New York, Delaware, and all other districts. While the New York cases initially seem to involve larger debtors, based on standardized assets, this is a result of Enron and WorldCom. After removing those two cases from the sample, there are no significant differences between the three groups of cases based on number of employees, standardized asset size, and time spent in chapter 11 (for those cases with a confirmed plan).[39]

But the debtors that file their petitions in New York are substantially more likely to hire one of the "big three" law firms shown in Figure 2: more than half of

[39] Asset size is the only factor affected by the removal of the two large cases—the three groups are not significantly different with regard to number of employees or case length even with these cases in the sample.

the cases in the sample filed in New York involve one of these three firms.[40] By contrast, the probability that one of these firms will be retained by a debtor filing in Delaware is .21 and in all other districts as low as .18.

And as these results hint, when debtors are sorted by their choice of law firm, both the average number of employees and the average standardized assets size are significantly different.[41] This difference is significant at the .01 level when the sample is split between those debtors represented by the six law firms that appear most often in the sample (as shown in Figure 1) and becomes even more powerful when the sample is split between firms represented by Skadden, Weil, and Kirkland, the "big three" law firms, as opposed to those represented by all other firms.[42] The former effect is shown on Table 3 below.

TABLE 3: DIFFERENCE IN MEANS BY LAW FIRM

	Is Debtor's Counsel one of Top 6 Law Firms?	N	Mean	Std. Deviation	Std. Error Mean
Debtor's Assets	No	168	1533.23	3139.670	242.231
	Yes	105	4551.37	13462.098	1313.766
No. of Employees	No	169	4274.80	6048.422	465.263
	Yes	105	10410.91	26903.742	2625.536
Months to Confirmed Plan	No	125	10.89813	8.476969	.758203
	Yes	88	10.32424	7.426351	.791652

As seen, the debtors represented by the six most active law firms are substantially larger both in terms of asset size and employee numbers. Thus, there is some preliminary indication that debtors select firms based on their own size. Since these six law firms are among the largest—five of the six employ more than 1,000 attorneys—this might also be some evidence of large debtors hiring large law firms.

This leads to the question of whether, even in the select world of large, public company bankruptcy, there are multiple markets for legal counsel. To examine this question further, I partitioned the sample into quartiles and thirds, based on the debtors' standardized assets to look for significant differences in the samples.[43]

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[40] p^=.53. The difference in probabilities described in this paragraph significant at the .05 level. Note that the Levine test for homogeneity of variances indicated that significant differences in variances of the three groups (p< .001) exist. Therefore, to better ensure against Type I error, I used the Tamhane post-hoc test for all differences.

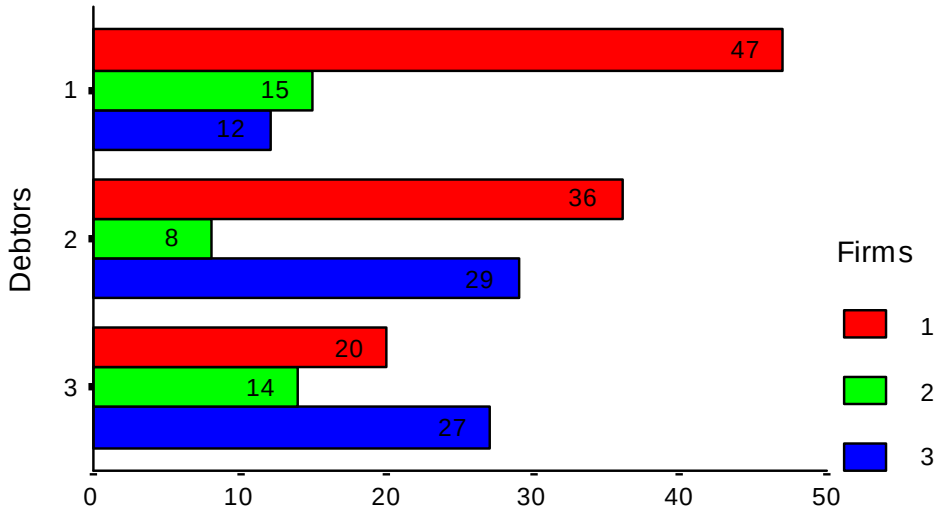
[41] Time spent in chapter 11 is not significantly different between the two parts of the sample. The results in Table 3 remain substantially the same when the logs of the three variables are used.

[42] These firms rank third, twelfth, and thirteenth, respectively, on the American Lawyer's 2005 ranking of global law firms by total revenues. *See* The American Lawyer, *The Am Law Global 100* (Nov. 2005), *available at* http://www.law.com/jsp/tal/PubArticleTAL.jsp?id=1130765711793 (last visited Oct. 6, 2006) (ranking world's largest international law firms by gross revenue). Skadden, Arps, the third largest firm worldwide, had estimated total revenues of just over $1.4 billion. *Id.*

[43] In both cases, I ranked the firms with "1" corresponding to the debtors with the largest assets.

As an initial matter, there is substantial positive correlation between the debtors ranked by asset size (whether divided into three or four groups) and the ranked size of the law firms in the sample.[44] This suggests a positive relationship between law firm size and debtor size—larger debtors hire the larger law firms. This intuition is confirmed by examining the two categorical values (debtor and law firm size quartile ranks) using a basic Pearson Chi-Square test, which shows a statistical relationship ($p<.01$) between the two variables.[45]

Figure 3 -- Ranked Debtors and Law Firms



Debtors ranked by asset size

Law firms ranked by number of attorneys

Figure 3 shows the debtors in the sample ranked in three groups by asset size with their counsel also ranked in three groups by the number of attorneys employed by the law firm. In this figure we can see most clearly that the largest firms tend to represent the larger debtors, while the smaller firms represent the smaller debtors. Interestingly, the table also shows a group of mid-range law firms that represent all types of debtors. This cautions against strong statements about this market's stratification.

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[44] Kendal's tau-b = .231 (four groups of debtors); .237 (three groups of debtors).

[45] H^2= 23.982, df=9, n=208.

C. Regression Analysis

To further explore the ideas raised in the prior section, I now turn to some regression models. To narrow the inquiry, I will focus on the factors that influence the selection of one of the "big three" corporate bankruptcy law firms.[46]

I thus examine the hypothesis that large debtors—with size measured by number of employees and level of standardized assets—are more likely to select one of these three law firms as their bankruptcy counsel. This is tested against the null hypothesis that debtor size has no bearing on this choice.

TABLE 4: LOGISTIC REGRESSION (Y=DEBTOR'S COUNSEL IS KIRKLAND, SKADDEN, OR WEIL (Y/N))

	B	S.E.	Wald	df	Sig.	Exp(B)	Model	
							H^2	Nagelkerke's R^2
Log of Assets in Current Dollars	.758	.330	5.281	1	.022	2.135	33.83 (p<.001)	.177
Log of Number of Employees	.997	.319	9.760	1	.002	2.711		
Constant	-6.839	1.141	35.898	1	.000	.001		

As seen from Table 4, increases in both the number of employees and the size of the debtor's assets positively increase the probability that the debtor will select one of the three leading law firms as its bankruptcy counsel. To be sure, the model only partially explains the decision to choose these large law firms. Factors outside of the model, such as the extent of the preexisting relationship between debtor and law firm, plainly influence the choice of counsel. Also potentially important are the Bankruptcy Code's own retention rules,[47] which may reduce the number of law firms eligible to represent a debtor.

Another potential factor, also exceedingly difficult to measure, is the prestige that debtor's management may experience from such a choice. However paradoxical it may seem that choosing bankruptcy counsel might be associated with "prestige," this is just another variant of the classic Berle and Means problem resulting from the separation of ownership and control.[48] Management receives private benefits from telling their peers that they have hired a "big New York firm"

[46] As shown in Figures 1 and 2, Skadden, Kirkland, and Weil are the apparent market leaders.

[47] *See supra* Part I.

[48] *See generally* ADOLPH A. BERLE & GARDINER C. MEANS, THE MODERN CORPORATION AND PRIVATE PROPERTY (Adolph A. Berle & Gardiner C. Means eds., Harcourt, Brace & World 4th ed. 1968) (1932) ("As the ownership of corporate wealth has become more widely dispersed, ownership of that wealth and control over it have become to lie less and less in the same hands.").

to handle their reorganization.[49] In addition, risk adverse managers, who may fear that bankruptcy may end their employment by the debtor,[50] have every incentive to hire lawyers that may exceed the debtor's needs.[51] With their jobs at stake, and the shareholders' or the junior creditors' money to spend, why not "hire the best"?

There is a very real, but rarely discussed, policy question lurking here: Should bankruptcy courts play a more active role in telling debtors what law firms to hire? In particular, is it appropriate for bankruptcy courts to tell debtors that they are just "too small" to hire a particular law firm? Or that the debtor's case is "too mundane" to justify the services of an elite law firm?

Additionally, while the foregoing model captures debtor size, it does little to capture the potential complexity of a case, beyond complexity directly associated with the debtor's size. Thus, I now expand the model to consider indicators of case complexity. I first include a dummy variable that indicates whether the case was "pre-packaged," a type of case that is arguably more complex, given the accelerated timetable of the proceedings and the need to integrate bankruptcy and securities law in a single transaction.[52] I then use other proxies of case complexity that are potentially more controversial.

First, I use two dummy variables that indicate whether a case was filed in the Southern District of New York or Delaware, on the theory that debtors seek out these districts when their cases are complex and will benefit from the experienced bankruptcy judges in these jurisdictions. Given the heated debates about the real value added by these two bankruptcy courts, this interpretation of the variable is plainly subject to the reader's own analysis.[53] I also use time to confirmation, again using case length as proxy for case complexity. Of course, while both of these factors increase the predictive power of the model, neither is likely to be available except in hindsight, limiting the ex ante predictive power of the model. Nevertheless, the model still offers important insights into the choice of bankruptcy counsel.

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[49] *See* Lucian Arye Bebchuk, Jesse M. Fried, & David I. Walker, *Managerial Power and Rent Extraction in the Design of Executive Compensation*, 69 U. CHI. L. REV. 751, 835–37 (2002) (describing managerial private benefits in exchange for cooperation with board allow acquisition to go forward); Rene M. Stulz, *The Limits of Financial Globalization*, 60 J. FIN. 1595, 1597 (2005) ("Corporate insiders appropriate private benefits, and thereby expropriate investors because they maximize their own welfare.").

[50] *See* Stuart C. Gilson, *Bankruptcy, Boards, Banks, and Blockholders: Evidence on Changes in Corporate Ownership and Control When Firms Default*, 27 J. FIN. ECON. 355, 369–72 (1990) (discussing significant changes for incumbent directors when bankruptcy or debt restructuring ends).

[51] *Cf.* Bruce MacEwen, Nobody Ever Got Fired for Hiring Skadden (Apr. 21, 2004), www.bmacewen.com/blog/archives/2004/04/nobody_ever_got_fired_for_hiring_skadden.html ("[W]hen the deal on the table . . . is a $1.8 billion acquisition, with complex antitrust, securities, tax, and financing issues built-in, go with the one-stop-shop that provides that array of expertise.").

[52] *See supra* note 14 and accompanying text (noting in pre-packaged chapter 11 cases, reorganization plans are approved by at least one class before bankruptcy filing).

[53] *See* David A. Skeel, Jr., *Bankruptcy Judges and Bankruptcy Venue: Some Thoughts on Delaware*, 1 DEL. L. REV. 1, 1 (1998) (stating Delaware and New York are rivals as venue of choice for large debtors); s*ee also supra* note 3.

TABLE 5: LOGISTIC REGRESSION (Y=DEBTOR'S COUNSEL IS KIRKLAND, SKADDEN, OR WEIL (Y/N))

	B	S.E.	Wald	df	Sig.	Exp(B)	Model H^2	Nagelkerke's R^2
Log of Assets in Current Dollars	.959	.406	5.568	1	.018	2.609	56.257 (p<.001)	.336
Log of Number of Employees	1.184	.396	8.921	1	.003	3.266		
SDNY Dummy	1.496	.457	10.694	1	.001	4.462		
Months in chapter 11	-.025	.026	.942	1	.332	.975		
Prepackaged Case Dummy	1.931	.755	6.532	1	.011	6.893		
Delaware Dummy	.083	.432	.037	1	.847	1.087		
Constant	-8.277	1.520	29.634	1	.000	.000		

In particular, the model shown in Table 5 indicates that large firms with complex chapter 11 cases are especially likely to hire one of the three largest bankruptcy law firms, which corresponds with common intuition. But what the model also shows in that size and complexity are but partial explanations for the selection of these top-tier law firms. If we make the reasonable assumption that these elite law firms charge more for their services, a bankruptcy court faced with an application to retain one of these firms, in a case that is neither large nor manifestly complex, should consider what other reasons might justify this additional expense.[54] Some reasons may be acceptable on policy grounds, but others, like managerial prestige, are unlikely to be warmly received by creditors.

III. CONCLUSION

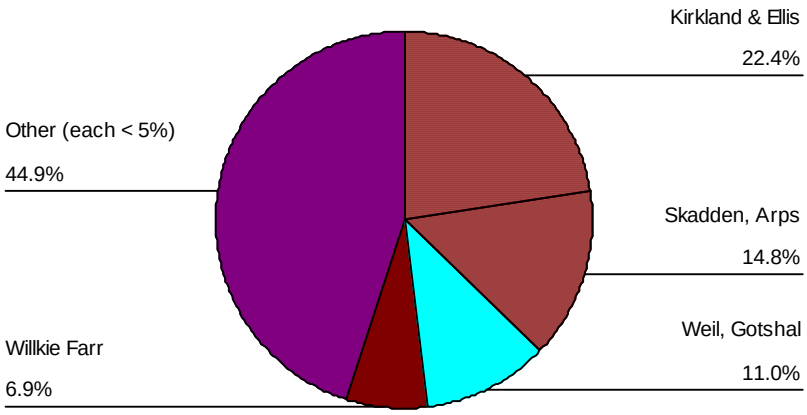
In this short Article, several important new insights on the market for corporate bankruptcy counsel have been revealed. Most importantly, the market was shown to have many more participants than might have been expected. In part, this shows the danger of extrapolating from anecdotal evidence about the six or seven "mega cases" filed each year. While it is easy to assume that the same firms that handle these cases are active throughout the range of public company bankruptcies, in fact firms of all sizes compete for these cases. As seen in Figure 1, even the top ten bankruptcy firms only represent about a third of the large corporate debtors in the sample, and the market is extremely fragmented with respect to the remaining cases.

The rapid failure of several well known corporations, combined with the eye-popping dollar figures these firms have paid to their bankruptcy attorneys, have reawakened the press, and thus the public, to the world of chapter 11 that had been

[54] Further, it is essential to underscore that "large" in this context means large relative to a sample of cases where all debtors have assets in excess of $225 million. *See supra* Part II.A (discussing "large" in terms of size of assets and amount of employees debtor retains).

forgotten since the days of Pan Am and Eastern Airlines. This Article takes a first step in studying some of the factors that drive the choice of bankruptcy counsel. In doing so, the Article provides a basis for future research on larger, more developed samples.

Appendix A -- Alternative Figure 2



Cases weighted by debtor's assets

Enron and Worldcom removed from sample