Has Chapter 11 Become More Expensive?

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Many market participants believe that Chapter 11 has increasingly become more expensive. Using a new dataset detailing the fees paid to the debtor's lead law firm in large bankruptcy cases filed between 2004 and 2022, I find evidence that this is true. On average, Chapter 11 fees consumed four times as much of a debtor's pre-bankruptcy assets in 2022 than was the case in the 2010s. The daily cost of bankruptcy also appears to be much higher, with the median case reaching $84,000 in 2022, compared to $32,000 in 2010. Moreover, the pre-bankruptcy restructuring process may also be more expensive, as pre-bankruptcy legal expenses—including workouts, out-of-court restructuring, and bankruptcy preparation—increased by 89% from the 2000s to the late 2010s. In sum, the evidence is consistent with the view that debtors and creditors now pay more for Chapter 11, although the trend is still young, and it remains to be seen how durable it will be.

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Introduction

Among his many contributions, Professor Alan Schwartz has significantly advanced our understanding of the role of bankruptcy costs, which he notes "drain substantial resources from large [Chapter 11 firms]."[1] Building on Professor Schwartz's pioneering work in this space, I use my short contribution to this special volume of the *Yale Journal on Regulation* to examine a claim that has become very influential in bankruptcy practice over the past few years: the belief that Chapter 11 is much more expensive today than it was in the past. Or, as Professor Schwartz might put it, that the asset drain of formal bankruptcy is higher today than it used to be. To the extent this is true, it is puzzling for at least two reasons. The first is that bankruptcy proceedings are far faster now, and what once took years now is finished in months.[2] The second is that restructuring practice has become very contract-focused[3] and many firms now first respond to financial distress with so-called "liability management transactions."[4] In a liability management transaction, a borrower usually exploits contractual slack to borrow new money or to bargain for a forbearance. These transactions have become central to debtor-creditor practice. As a result, one might

1. *See* Arturo Bris, Alan Schwartz & Ivo Welch, *Who Should Pay for Bankruptcy Costs?*, 43 J. LEG. STUD. 295 (2005). Professor Schwartz was also concerned with the ex ante incentives created by Congress' decision to pay for the representation of junior creditors but not senior creditors. In modern bankruptcy practice, this problem looks different, as senior creditors' bargaining power as DIP lenders allows them to nearly always get paid out of the DIP Loan Agreement or a cash collateral order. *See* Kenneth Ayotte & Jared A. Ellias, *Bankruptcy Process for Sale*, 39 YALE J. ON REGUL. 1 (2022). At the time of Professor Schwartz's article, this practice appears to have been less common. *See id.* at 299 ("A bankruptcy court may use its inherent powers, and some courts do, to reimburse other senior expert expenses that are incurred during the course of a Chapter 11, but the extent and scale of this practice are unknown."). Professor Schwartz encouraged a policy reform where the debtor would be given discretion to reimburse professionals. To the extent it had been adopted, the result would likely have been that all DIP loan agreements would eliminate the reimbursement of junior creditors as a condition of bankruptcy financing *See id.*; George G. Triantis, *A Theory of the Regulation of Debtor-in-Possession Financing*, 46 VAND. L. REV. 901 (1993); B. Espen Eckbo, Kai Li & Wei Wang, *Loans to Chapter 11 Firms: Contract Design, Repayment Risk and Pricing,* 66 J.L. ECON. 465 (2023); David A. Skeel, *The Past, Present, and Future of Debtor-in-Possession Financing*, 25 CARDOZO L. REV. 1905 (2004).

2. A recent study found that the median large firm exited Chapter 11 in 103 days in 2020 as compared to 363 days in 2005—a dramatic change in bankruptcy practice. *See* Edith Hotchkiss, Karin Thornburn & Wei Wang, *The Changing Face of Chapter 11 Bankruptcy: Insights from Recent Trends and Research*, 15 ANN. REV. FIN. ECON. 351, 354 (2023).

3. Presumably, this is not the type of contractarianism that Professor Schwartz urged the profession to consider in a series of important articles urging courts to enforce pre-bankruptcy contracting and to not impose a mandatory "one size fits all" bankruptcy process on sophisticated parties who can contract for better. *See* Alan Schwartz, *A Normative Theory of Business Bankruptcy*, 91 VA. L. REV. 1199 (2005).

4. A liability management transaction is a transaction in which a borrower identifies provisions in its existing loan documents that will allow it to borrow additional money to relieve financial distress long enough for a business turnaround to take effect. *See* Vincent S.J. Buccola & Gregory Nini, *The Loan Market Response to Dropdown and Uptier Transactions*, 53 J. LEGAL STUD. 489 (2024); Diane Lourdes Dick, *Hostile Restructurings*, 96 WASH. L. REV. 1333 (2021); Jared A. Ellias & Robert J. Stark, *Bankruptcy Hardball*, 108 CALIF. L. REV. 745 (2020); Katie Kelleher, *Same Game, New Name: Exploring the Parallels Between Liability Management Transactions and DIP Lending* (2024) (unpublished manuscript, on file with author).

suspect that more legal spending by distressed firms would take place outside the bankruptcy courtroom and that the bankruptcy process might be less involved today than it was in the recent past.

Given these considerations, I examine changes in bankruptcy fees using two new datasets of the fees of the 267 firms with at least $1 billion in assets or liabilities that filed for bankruptcy between 2004 and 2023, for which information is available:[5] (1) a hand-collected dataset of the fees paid to the debtor's lead bankruptcy counsel, including pre-bankruptcy fees disclosed on the mandatory retention application filed with the bankruptcy court; and (2) a dataset of all of the costs of the debtor's retained professionals, as collected by New Generation Research. By including the pre-bankruptcy fees of the debtor's counsel in the analysis, I partially address the bias that may exist if the path to Chapter 11 has changed significantly over the past few years such that today's in-court legal work differs from 2010 or 2005.[6]

I begin by investigating whether the costs of bankruptcy have in fact increased, and I find initial reason to be skeptical of the prevailing view. The average cost of bankruptcy—measured either by the debtor's lead lawyer's fees or the aggregate fees of all professionals in the New Generation Research dataset—does not appear to be higher today than it was 20 years ago, in either nominal dollars or after adjusting for inflation.

However, three closer analyses of the data provide significant support for the view that bankruptcy has become more expensive. First, I compute a measure representing the percentage of the debtor's pre-bankruptcy assets paid to Chapter 11 professionals, calculated as the ratio of final bankruptcy costs to the debtor's asset value at the petition date. Using this measure, I observe a sharp increase in bankruptcy costs, with an uptick beginning in 2020. From 2008 to 2020, the debtor's lead counsel's fees were equivalent to 0.5% to 0.8% of pre-bankruptcy assets on average. This jumped to 1% in 2021 and nearly 2% in 2022, a roughly four-fold increase from its prior trend. Thus, it is fair to say that the bankruptcies of the early 2020s have been more expensive than slightly older cases, at least as adjusted for the petition value of assets.[7]

5. A key challenge to any empirical study of bankruptcy costs is that we can only observe the direct costs of bankruptcy of the firms that choose to file for Chapter 11. For all we know, the firms that choose to file are different from the firms that choose to (or whose creditors allow them to) restructure outside of a formal court proceeding. As such, a study like this one can only describe the observed costs of the firms that choose to file for Chapter 11.

6. This paper is the second to look at pre-bankruptcy fees—Professor Stephen Lubben examined these numbers, but from a different source (the debtor's Statements of Financial Affairs). *See* Stephen J. Lubben, *What We "Know" About Chapter 11 Cost Is Wrong*, 17 FORDHAM J. CORP. & FIN. L. 141 (2012).

7. This result is similar to an analysis using New Generation Research data only from Creditor's Corner. *See The Data Download*, CREDITOR RIGHTS COALTION, https://creditorcoalition.org/data [https://perma.cc/S72Q-BV7Y].

Second, I show that when constant nominal fees combine with faster bankruptcies—an average of 18 months between the petition date and plan confirmation for the sample firms that filed between 2004 and 2010 and an average of 9 months for the firms that filed for bankruptcy between 2016 and 2020—the result is that the "daily bleed" of bankruptcy is much higher. In constant dollars, the median day of bankruptcy in 2022 cost more than $84,000 in debtor's counsel fees, more than double the $32,000 median in 2010. Including the fees of other professionals such as financial advisors, the average day in 2010 cost about $46,000 compared to about $253,000 in 2022. Thus, it appears that while the aggregate observed direct costs of bankruptcy may not have increased over the past twenty years, the *intensity* of the costs is now significantly higher and the increase in the speed of Chapter 11 has not resulted in cost savings for creditors. To the extent market participants perceive each additional day of Chapter 11 as much more expensive than at an earlier period, the evidence supports their view.

Third, I investigate the possibility that the observed change in the cost of bankruptcy may understate the overall shift because the pre-bankruptcy distress period may now be longer and more important. Large companies may now have more tools to delay bankruptcy filings, due to pro-borrower corporate debt markets over the past decade and the development of liability management tools, which extend shareholder runway without the need for a bankruptcy process. As a result, companies may arrive in bankruptcy sicker and after already failing multiple rounds of restructuring, which might increase pre-bankruptcy fees and make the direct costs of the formal bankruptcy process an unreliable measure of changes in overall restructuring expenses. To see if this is true, I examine the total cost of the debtor's lead counsel, including both the pre-bankruptcy costs and the final bankruptcy costs. These data show an unambiguous upward trend in pre-bankruptcy expenses that is evident throughout the sample period and especially sharp starting in 2017. In 2010, the mean Chapter 11 debtor's lead counsel fees, including the pre-bankruptcy costs, were about 1% of total assets—this doubled to around 2% in 2022.

In sum, while the constant dollar direct costs of Chapter 11 do not appear to be higher today than 20 years ago, the belief that bankruptcy is now more expensive finds some support in the data. The average day of the now-shorter bankruptcy process appears significantly more expensive than the average day was in the past. Moreover, the limited evidence on pre-bankruptcy costs suggests that when using a broader measure of direct financial distress costs, including pre-bankruptcy expenses, there is a strong upward trend. Including pre-bankruptcy period costs only magnifies the trend, and pre-bankruptcy costs have increased at a faster rate than in-bankruptcy costs.

These results require two important qualifications. First, it is too early to know whether or not the apparent uptick in fees is a permanent feature of bankruptcy practice, or whether it is a product of unusual circumstances.

For example, many of the bankruptcies of the past few years involved pandemic or crypto-related issues that may have been harder to settle or bargain around in the absence of clear guidance from precedent.[8] Future research is needed to track changes in bankruptcy costs. Second, the data in this paper only represent a portion of the direct costs of financial distress, let alone the indirect costs. Recent research has made significant progress on the indirect costs of bankruptcy,[9] and the findings in this paper point to the need for additional research on the indirect costs of the pre-bankruptcy period.

This Essay proceeds as follows. In Section I, I present data on changes in bankruptcy costs over the past 20 years, showing that, on average, costs today do not appear higher than in the recent past. In Section II, I assess whether the data in Section II is misleading due to higher expense per asset, shorter bankruptcy cases, and the omission of pre-bankruptcy costs, and I find that it is. The final section concludes.

I. Reviewing New Evidence of the Direct Costs of Bankruptcy

In this Section, I look at new data to test the hypothesis that the cost of bankruptcy has increased dramatically in recent years. The question of bankruptcy costs is the topic of a large literature, where Professor Schwartz is one of several important writers.[10] Many authors have begun from the perspective that bankruptcy is too expensive,[11] while others have reasoned, as Professor Stephen Lubben did, that the professional fees of Chapter 11 lawyers are high because the value they provide to distressed firms is also high.[12] Some work has pointed to potential explanations of costlier

8. *See generally* Jared A. Ellias, *What Drives Bankruptcy Forum Shopping? Evidence from Market Data*, 47 J. LEGAL STUD. 119 (2018) (discussing the benefit of legal precedent for decision making).

9. *See* Michael Ohlrogge, *Down the Tubes: Financial Distress, Bankruptcy and Industrial Water Pollution* (unpublished manuscript), https://ssrn.com/abstract=4477457 [https://perma.cc/GC6K-C6JG] (2023); Jared A. Ellias, *Employee Bankruptcy Trauma* (unpublished manuscript), https://ssrn.com/abstract=4540838 [https://perma.cc/5RHQ-93TN]; Antill, Samuel & Megan Hunter, *Consumer Choice and Corporate Bankruptcy* (unpublished manuscript), https://ssrn.com/abstract=3879775 [https://perma.cc/Q4EB-M9TP].

10. The literature is far too large to cite all of the important articles. *See generally* Arturo Bris, Alan Schwartz & Ivo Welch, *Who Should Pay for Bankruptcy Costs?*, 34 J. LEGAL STUD. 295 (2005); LYNN M. LOPUCKI, COURTING FAILURE: HOW COMPETITION FOR BIG CASES IS CORRUPTING THE BANKRUPTCY COURTS (2005); Arturo Bris, Ivo Welch & Ning Zhu, *The Costs of Bankruptcy: Chapter 7 Liquidation Versus Chapter 11 Reorganization*, 61 J. FIN. 1253 (2006); Lubben, *supra* note 6; Samuel Antill, *Are Bankruptcy Professional Fees Excessively High?*, 37 REV. FIN. STUD. 3595 (2024); Edward I. Altman, *A Further Empirical Investigation of the Bankruptcy Cost Question*, 39 J. FIN. 1067 (1984); Jay Lawrence Westbrook, *Fees and Inherent Conflicts of Interest*, 1 AM. BANKR. INST. L. REV. 287, 288-89 (1993).

11. This literature is too large to fully summarize. For some important contributions, *see Cynthia A. Baker, Other People's Money: The Problem of Professional Fees in Bankruptcy, 38* ARIZ. L. REV. 35 (1996).

12. *See* Lubben, *supra* note 6.

bankruptcy, such as capital structure fragmentation, creditor conflict[13] or forum shopping.[14] Other work suggests that avoiding the costly bankruptcy system, or minimizing it, reduces fees, such as through restructuring debts with a quick pre-packaged bankruptcy or an out-of-court restructuring.[15]

In recent years, a narrative has taken hold among practitioners that the bankruptcy process has become simply too expensive to be a good option for most distressed firms. To be sure, fear of the costs of bankruptcy are nothing new.[16] However, there appears to be a broad sense in the marketplace that something has changed to make Chapter 11 just too expensive to be of much practical use to many investors seeking to salvage a distressed investment. Indeed, important developments in the credit markets can be thought of as providing debtors a pathway towards restructuring without the need for Chapter 11.[17] To the extent that the bankruptcy system is too expensive to use, it will change the set of options that distressed companies have when they run into trouble and thwart the congressional goal of providing distressed firms with a helpful framework for reorganization.

To the best of my knowledge, this is the first study to examine whether bankruptcy costs have increased in recent years.[18] The main reason to suspect there might be an increase in bankruptcy costs, beyond the conventional wisdom, is the well-documented increase in legal billing rates, which could obviously filter to firms reorganizing in Chapter 11, as they pay market rates for legal services.[19] While it is hard to break out the profitability

13. *See* Douglas G. Baird & Robert K. Rasmussen, *Antibankruptcy*, 119 YALE L.J. 648, 692-93 (2010); Wei Jiang, Kai Li & Wei Wang, *Hedge Funds and Chapter 11*, 67 J. FIN. 513 (2012).

14. *See, e.g.,* LoPucki, *supra* note 10, 141-42 (2005); Lynn M. LoPucki & Joseph W. Doherty, *Professional Overcharging in Large Bankruptcy Reorganization Cases*, 5 J. EMP. L. STUD. 983 (2008).

15. *See, e.g.*, Barry E. Adler, *A Theory of Corporate Insolvency*, 72 N.Y.U. L. REV. 343, 353 (1997) ("[Out of court restructuring through ex ante contracting] would accomplish a reorganization of an insolvent firm without the expensive imbroglio that is often a consequence of the current bankruptcy reorganization process."); Lucian Bebchuk*, A New Approach to Corporate Reorganizations*, 101 HARV. L. REV. 775, 785-89, 804 (1988); Elizabeth Tashjian, Ronald C. Lease & John J. McConnell, *Prepacks: An Empirical Analysis of Prepackaged Bankruptcies*, 40 J. FIN. ECON. 135, 155 (1996) (assessing the cost savings of prepackaged filings); Stuart C. Gilson, Kose John, & Larry H.P. Lang, *Troubled Debt Restructurings: An Empirical Study of Private Reorganization of Firms in Default*, 27 J. FIN. ECON. 315 (1990) (finding that out of court restructurings are cheaper than Chapter 11 cases).

16. *See* Bankruptcy, 18 BULL. COM. L. LEAGUE AM., Nov. 1913, at 25 ("These attorneys . . . seek large fees which come out of the pockets of the creditors for this representation."); Ellias, *supra* note 9.

17. *See* Jared A. Ellias & Elisabeth de Fontenay, *The Credit Markets Go Dark*, 134 YALE L.J. 696 (2024).

18. Sam Antil recently examined Chapter 7 trustee fees, which is a separate setting from the Chapter 11 fees studied herein. Antill, *supra* note 10; Altman, *supra* note 10.

19. See, *Are Law Firm Rates Getting Ridiculous?,* LEGAL.IO, (June, 13, 2024), https://www.legal.io/articles/5507637/Are-Law-Firm-Rates-Getting-Ridiculous [https://perma.cc/6GJN-ATMC]; Evan Ochsner, *Big Law Bankruptcy Fees Reach $2,500 an Hour for Top Lawyers (1),* BLOOMBERG L., (Feb. 5, 2024, 5:00 AM), https://news.bloomberglaw.com/bankruptcy-law/big-law-bankruptcy-fees-reach-2-500-an-hour-for-top-lawyers [https://perma.cc/8NG4-A8WN].

of bankruptcy groups from the publicly reported information on law firm profits, if bankruptcy lawyers are making more money than ever, it stands to reason that the additional profits for law firms may be transfers from creditors.[20]

To learn more about changes in fees over time, I first explain the dataset and I then share results which call into question the prevailing narrative that bankruptcy cases have become more expensive.

A. Data

To examine how bankruptcy cases change over time, I assembled a new dataset of the fees of Chapter 11 debtors. I began with the list of Chapter 11 debtors maintained by New Generation Research and limited it to the debtors who filed for Chapter 11 with assets or liabilities of at least $1 billion from 2004 to 2022.[21] The initial dataset consists of 350 firms. I start the dataset in 2004 because that is as far back as PACER goes, and I end the dataset in 2022 because as of this writing, the 2023 and 2024 bankruptcy cases have not all concluded yet, which biases the numbers for those years downwards. That is because, presumably, the cases that continue for years are more expensive and firms only enter the sample after their lead counsel files a final fee application. I omit the 77 pre-packaged bankruptcies from the final sample as pre-packaged bankruptcies are generally not litigious, although the results are qualitatively similar if I include them.

For each Chapter 11 debtor, I asked a research assistant to examine the court docket and to record the total costs and expenses of the debtor's lead counsel by examining two key court documents. Lawyers advising a Chapter 11 debtor are required to first file a retention application, where they typically disclose the amount of money they were paid by the debtor pre-bankruptcy.[22] There is some amount of measurement error in this number, as law firms sometimes disclose only the amounts billed in the three months prior to bankruptcy and sometimes the law firm does other

20. *See* Andrew Maloney, *Elite Law Firms Pushed Industry Gains in First Half of 2024,* THE AM. LAW. (Aug. 26, 2024, 3:55 PM), https://www.law.com/americanlawyer/2024/08/26/elite-law-firms-pushed-industry-gains-in-first-half-of-2024/?slreturn=2024101594705 [https://perma.cc/5DVU-QKGH].

21. I omit 22 bankruptcy cases that are simply the resolution of failed banks, as those cases do not involve the reorganization of an operating asset.

22. *See* 11 USC § 327 (providing for the retention of counsel to a debtor in possession). FED. R. BANKR. P. 2014 requires the debtor to disclose "all of the person's connections with the debtor, creditors, any other party in interest, their respective attorneys and accountants, the United States trustee, or any person employed in the office of the United States trustee. The application shall be accompanied by a verified statement of the person to be employed setting forth the person's connections with the debtor, creditors, any other party in interest, their respective attorneys and accountants, the United States trustee, or any person employed in the office of the United States trustee." To comply with this, large firms have developed a practice of providing an affidavit attached to the retention application that details all financial transactions between the debtor and the law firm that might pose a conflict of interest. For example, money received during the applicable preference period. That affidavit was the primary source of data for this paper.

work for the company so the bill encompasses more than restructuring services.[23] In some cases, the disclosure is not easy to understand, providing information on a retainer without a final amount of fees billed against it.[24] The debtor's lead bankruptcy counsel is also retained at different times relative to the firm's bankruptcy filing. As a result, caution is advised in interpreting this data, but the dataset is large enough that it does provide an indication of how pre-bankruptcy direct distress costs may have changed over the sample period. To display a constant sample throughout the paper, I also omit 6 cases where I am unable to obtain pre-bankruptcy attorney's fees.[25] Including these firms in the graphs below that only examine total bankruptcy costs does not change the results.

The second document that we examined is the debtor's final fee application, where the debtor provides a request for the final payment of the fees and expenses incurred in Chapter 11.[26] These fees are a reasonable proxy for the direct costs of bankruptcy, as the debtor's lead counsel is usually the largest estate professional.[27]

The nominal total amount of fees across the 267 final sample firms is approximately $5.9 billion dollars. For some analyses, I adjust this number for inflation, and in 2004 dollars the aggregate amount is $4.7 billion dollars.[28] To contextualize those numbers, the accounting value of the aggregate assets that the Chapter 11 firms brought in bankruptcy court jurisdiction on the petition date is $1.9 trillion dollars.

My focus on the debtor's lead counsel's fees introduces a potential source of bias, in that I am missing other estate professionals, most importantly the financial advisor.[29] Upon information and belief, these also

23. To my knowledge, this is the first study examining pre-bankruptcy direct costs using this type of evidence.

24. For example, Latham & Watkins LLP disclosed in the 2019 bankruptcy case of Hexion Holdings, as part of its retention application, that: "During the 90-day period prior to the Debtors' bankruptcy filing, the Debtors paid L&W a total of $4,626,525.49." *See* In re Hexion Holdings, Case No. 19-10684, Docket No. 149 (Bankr. D. Del. April 10, 2019). A source of measurement error is that some firms provided 90-day numbers (which is a reference to the applicable preference period) while others provided fuller disclosure. In some cases, firms disclosed both a 90-day number and a longer period—in those cases, nearly all the work usually took place within the 90-day period.

25. Frustratingly, many older bankruptcy cases have had their dockets removed from PACER, making it much harder to retrieve older documents.

26. In some cases, some of these fees may have been revised before approved by the bankruptcy judge, although that generally does not happen. This happens seldom enough that I elected not to track down a third document, the final order approving the debtor's lead counsel's fees.

27. Professors Lynn LoPucki and Joseph Doherty find that 92% of the total fees charged to the debtor while they are in Chapter 11 are the fees of the lead bankruptcy counsel. *See* Lynn M. LoPucki and Joseph W. Doherty, *Why are Delaware and New York Bankruptcy Reorganizations Failing?, 55* VANDERBILT L. REV. 1933, 1985 (2002).

28. I use the Python CPI package to adjust the amounts to 2004 numbers. *See CPI*, PALWIRE, https://palewi.re/docs/cpi [https://perma.cc/U2UU-L2VS].

29. *See* Stephen J. Lubben, *The Chapter 11 Financial Advisors*, 28 EMORY BANKR. DEV. J. 11 (2011).

may have increased in recent years. To address this problem, I obtain from New Generation Research the data they have begun tracking on professional fees in Chapter 11. They provided records of fees filed by 3,235 number of professionals that correspond to 228 of the sample of 267 firms.[30] The aggregate nominal amount of those fees are $16.9 billion, which suggests that the debtor's main counsel fees represent about a third of the direct costs of bankruptcy.[31]

B. The Aggregate Amount of Debtor's Lead Counsel Fees Does Not Appear to Have Changed.

In this Section, I examine the aggregate amount of debtor lead counsel fees and find that the total amount of fees per case do not appear to have changed much over the sample period. I analyze the data to look to see if the direct costs of bankruptcy appear to be increasing over time, in raw amount and after adjusting for inflation. I first focus on the debtor's main counsel's fees as a proxy for the overall costs of restructuring and I then confirm the analysis using the broader data on aggregate fees which include all of the debtor's lawyers and financial advisors.[32]

30. For ease of exposition, I do not include all of the data from the New Generation Research dataset that correspond to firms that did not have a public filing disclosing pre-bankruptcy debtor counsel fees.

31. In unreported results, I find that this proportion is pretty similar throughout the sample period, although the comparison is not perfect because the two samples were assembled with different methodologies, as mine was hand-gathered versus New Generation Research's which was the product of machine reading.

32. The literature on direct bankruptcy costs has focused on the fees of the debtor's lead law firm, so it is also a logical starting point for a research study. *See e.g.*, Jared A. Ellias, *Do Activist Investors Constrain Managerial Moral Hazard in Chapter 11? Evidence from Junior Activist Investing*, 8 J. L. ANALYSIS 493, 526 (2014). As Professor Schwartz mentioned, higher bankruptcy costs reduce creditor recoveries, all else being equal, which would also impact *ex ante* costs of capital. *See, e.g.*, Alan Schwartz, *A Normative Theory of Business Bankruptcy*, 91 VA. L. REV. 1199, 1204 (2005).

Figure 1. Average Chapter 11 Debtor Lead Counsel Fees, in Nominal Dollars

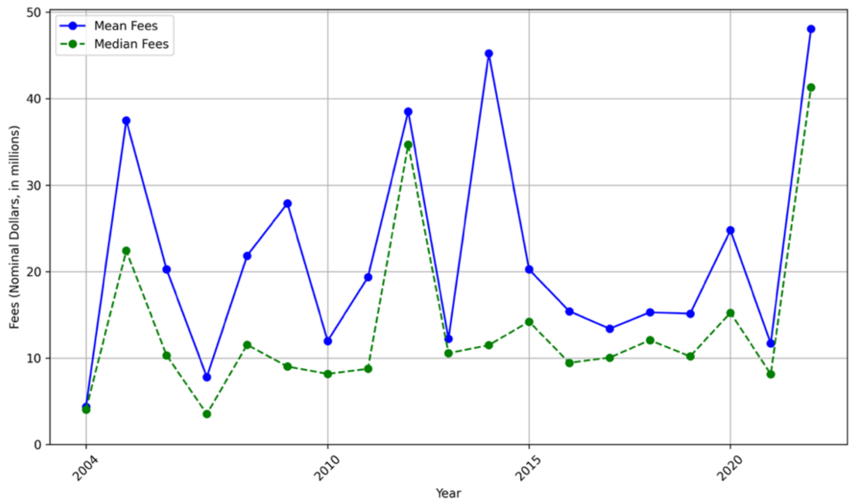
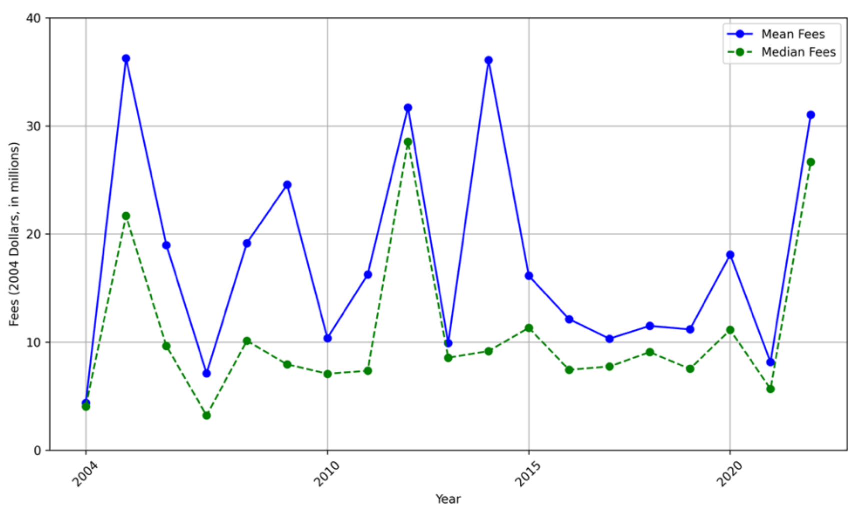


Figure 1 shows that the nominal fees paid to the Chapter 11 Debtor's lead counsel has trended upwards as measured by nominal dollars, but the trend line is very slight. 2022 appears to be a local maximum, but it is not all that much higher than prior peaks. To be sure, we would expect an upward trend in nominal dollars through a twenty year sample period without any underlying change other than inflation.

Figure 2. Average Chapter 11 Debtor Lead Counsel Fees, in Constant Dollars



To address the inflation over the sample period, I adjust the raw fees amounts to 2004 dollars using the consumer price index. Figure 2 above shows the same data as the mean and median amount of aggregate fees and expenses paid to the debtor's lead bankruptcy counsel over the sample period. In inflation-adjusted terms, the aggregate fees paid to the debtor's counsel appear to stay steady, or perhaps even *fall* over the sample period, although there appears to be an uptick in 2022. Given the lagged nature of the data, it is possible that what the market is noticed is only present in the 2022 data, and market participants who "live" bankruptcy cases on a daily basis have observed a new and higher level of fees. However, it is worth noting that in constant dollars the 2022 peak is an increase over the late 2010s but not very different than the level of bankruptcy costs observed during the financial crisis period and again in the early 2010s.

An important omitted variable bias that could reduce the explanatory power of the results thus far is that I am only measuring the debtor's main counsel's fees. To gain further insight, I use the data from New Generation Research described *supra*.[33] The advantage of this data is that it has information on all estate professionals, such as the official creditor's committees, additional bankruptcy counsel, financial advisors and claims agents. As such, it is a more accurate measure of direct bankruptcy costs.

Figure 3. All Aggregate Professional Fees, in Constant Dollars

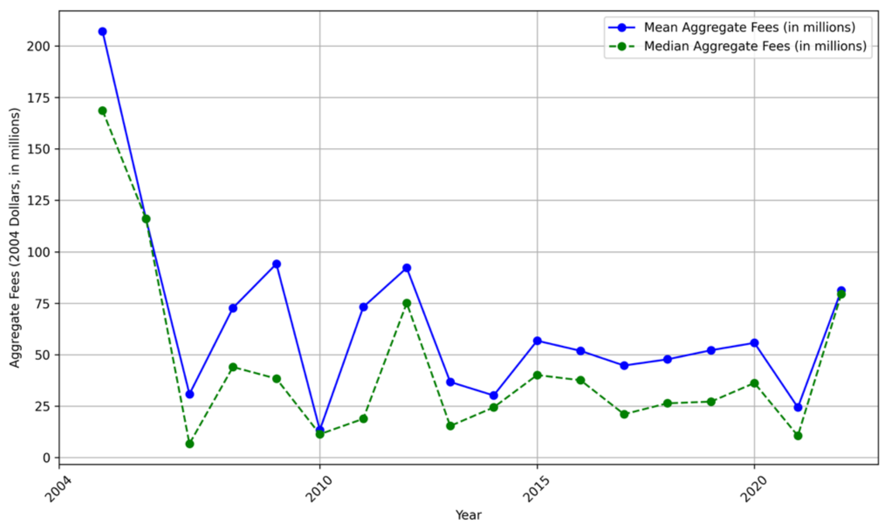


Figure 3 shows the aggregate fees graphed over the sample period. As it turns out, this also fails to reveal an unambiguous upwards trend over the sample period. We do appear to observe the same uptick during the

33. *See supra* notes 21-31 and accompanying text. In quality audits, I found some discrepancies between the New Generation Research data and my data gathering. However, they would not bias the broader trends in the data, suggesting these data are reliable enough to reveal the contours of big trends in Chapter 11 data.

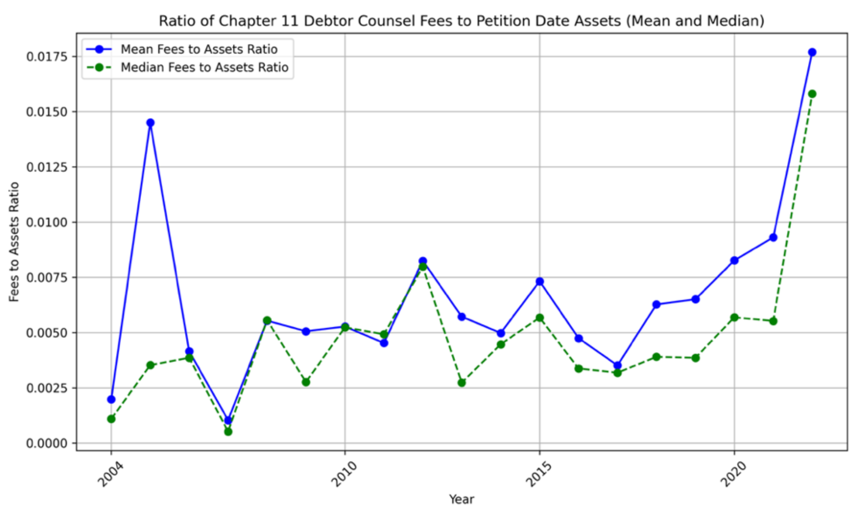
late 2010s, but the trend is within the same general range of the past fifteen years.

II. A Closer Analysis of the Data Reveals Cost Increases

The results in Section II are not consistent with the prevailing narrative that the inflation adjusted direct costs of bankruptcy have increased significantly in recent years. In this Section, I will use the data to provide three potential explanations for why market participants may, nonetheless, believe that bankruptcy is now more expensive. First, I show that the cost of restructuring assets in Chapter 11 has, in fact, increased significantly. This is likely a more accurate measure than the headline dollar figure studied in Section II. Second, I show that the length of bankruptcy cases has fallen over the sample period but the costs of bankruptcy did not. As a result, each day of bankruptcy is much more expensive than used to be the case. Third, anecdotal evidence suggests that the companies now engage in more intense, hardball negotiations with creditors than used to be the case. When I include pre-bankruptcy costs in the analysis, the data show that the costs of bankruptcy have, in fact, been increasing over the past twenty years.

A. The Costs of Restructuring Assets

Figure 4. The Ratio of the Debtor's Lead Bankruptcy Counsel's Fees to Firm Assets



The results in Section II are naïve and do not take into account essential firm characteristics like size. Prior work suggests that larger firms are more costly to reorganize,[34] although other studies suggest that is not true.[35] To examine the potential uptick in costs further, I compute a test statistic which is the ratio of the debtor's counsel fees and expenses to assets—in effect, computing something resembling the cost of restructuring assets. In Figure 4 above, I graph that number over the sample period.

The results here complement Figure 1, and a trend appears to be visible: the costs of bankruptcy do appear to have ticked upwards over the past decade, with the largest increase coming in the early 2020s. During the 2010s, Chapter 11 costs appear to average about 0.5% of firm assets—this number grows to 1% in 2021 and to nearly 2% in 2022. To the extent the 2022 numbers illustrate a trend it is, at least on a per asset basis, a very large increase over 2015—nearly two and a half times as much. Thus, while the average total direct costs of bankruptcy do not appear to have increased in recent years, the cost of restructuring a dollar of assets in Chapter 11 does appear to be higher in the 2020s than it was in the 2010s or the 2000s.

B. The Costs Per Day of Bankruptcy

One way that market participants may understand bankruptcy is as "the burn rate." For example, the unsecured creditors of FTX cried foul at what appeared to be the "remarkable" rate of spending, noting that "[t]hey've now moved to a pace of almost $50 million a month in fees, with literally hundreds of lawyers, financial advisors and bankers working on them practically full time . . . every dollar spent in the case is essentially a dollar that creditors don't receive."[36]

In recent years, bankruptcy has become much faster, but Figure 1 did not reveal that the costs of bankruptcy have fallen with the increase in speed.[37] Professors Robert K. Rasmussen and Randall Thomas predicted that "fees may be correlated roughly with the length of the bankruptcy

34. *See* Julian R. Franks and Walter N. Torous, *An Empirical Investigation of U.S. Firms in Reorganization*, 44 J. OF FIN. 747, 750-51 (1989) (noting that "the length of time [of bankruptcy] may depend on the size of the company" and that "legal fees rise with the period spent in Chapter 11"). Other work has examined how some parties may strategically seek to increase the duration of Chapter 11 to try to extract rents. *See* Douglas G. Baird & David A. Bernstein, *Absolute Priority, Valuation Uncertainty, and the Reorganization Bargain*, 115 YALE L.J. 1930 (2006); Jared A. Ellias, *Do Activist Investors Constrain Managerial Moral Hazard in Chapter 11?*, 8 J. L. ANALYSIS 493 (2016).

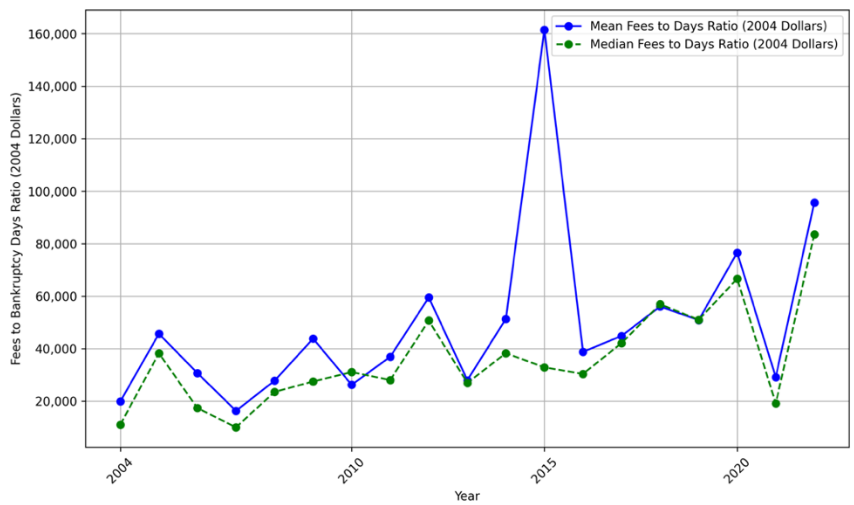
35. Stephen J. Lubben, *What We "Know" About Chapter 11 Cost Is Wrong*, 17 FORDHAM J. CORP. & FIN. L. 141 (2012).

36. *See* Jesse Hamilton, *FTX Bankruptcy Burning Through $1.5M in Legal Costs Every Day,* COINDESK (Aug. 23, 2023, 4:19 PM), https://www.coindesk.com/policy/2023/08/23/ftx-bankruptcy-burning-through-15m-in-legal-costs-every-day [https://perma.cc/JG3E-3JCT].

37. Melissa B. Jacoby & Edward J. Janger, *Ice Cube Bonds: Allocating the Price of Process in Chapter 11 Bankruptcy*, 123 YALE L.J. 862, 862-947 (2014); Lynn M. Lopucki, *Chapter 11's Descent into Lawlessness*, 96 AM. BANKR. L.J. 247 (2022).

proceeding. The longer the proceeding, the greater the fees."[38] Professors Lynn LoPucki and Joseph Doherty found that longer bankruptcy cases are more expensive.[39] It stands to reason, then, that the costs of bankruptcy should have been *falling* over the past twenty years. But, as Table 1 shows, they have not. Figure 5 below shows the ratio of the debtor's lead counsel fees to the days of bankruptcy.

Figure 5. The Bankruptcy Burn Rate



As the graph shows, although the trend is not unambiguous it does appear that the costs per day for large Chapter 11 debtors have increased significantly over time. In 2010, the median cost per day was about $32,000; that number climbed to $67,000 in 2020 and $84,000 in 2022. While it remains to be seen whether the relatively high year of 2022 is an aberration, the level of fees does appear to be higher in the 2020s than it was in the 2000s.

C. Pre-Bankruptcy Fees

In recent years, anecdotal reports suggest that pre-bankruptcy bargaining has become more important and that large firms have new tools to avoid having to file for bankruptcy.[40] Apart from the most obvious tool—

38. *See* Robert K. Rasmussen & Randall S. Thomas, *Whither the Race? A Comment on the Effects of the Delawarization of Corporate Reorganizations*, 54 VAND. L. REV. 283, 295 (2001).

39. *See* Lynn M. LoPucki & Joseph W. Doherty, *The Determinants of Professional Fees in Large Bankruptcy Reorganization Cases*, 1 J. EMP. L. STUD. 111 (2004).

40. *See* William W. Bratton & Adam J. Levitin, *The New Bond Workouts*, 166 U. PA. L. REV. 1597 (2018); Jason Roderick Donaldson, Edward R. Morrison, Giorgia Piacentino & Xiaobo Yu, *Restructuring vs. Bankruptcy* (Colum. L. & Econ. Working Paper No. 630, 2020); Diane Lourdes Dick, *Hostile Restructurings*, 96 WASH. L. REV. 1333 (2021); Ellias & Stark, *supra* note 4; Elisabeth de Fontenay, *The $900 Million Mistake: In re Citibank August 11, 2020 Wire Transfers*, 16 CAP. MKTS. L.J. 307 (2021); Elisabeth de Fontenay, *The Deregulation of Private Capital and the*

the amend-and-extend forbearance, which is purportedly now more common[41]—a great deal of the room to maneuver in distress is now a function of the debtor's loan contracts.[42]

In many ways, we have arrived at something that resembles a Frankenstein's monster of Professor Schwartz's contractarian goals for the bankruptcy system.[43] In a series of important papers, Professor Schwartz urged the enforcement of pre-bankruptcy contracts between sophisticated investors. He did worry, however, that "some creditors may collude with the firm to block efficient procedures if they are better off under inefficient procedures."[44] It is safe to say that we have entered a world with extensive creditor collusion with debtors, although the ultimate efficiency consequences remain an open question.[45]

To provide an example of what this looks like in practice, when Serta, a mattress manufacturer, ran into financial distress it first analyzed the amount of slack available under its loan contract.[46] The firm found that it had the ability to essentially "liberate" collateral from the claims of its secured lenders (through a dropdown transaction)[47] or to re-engineer the company's existing priority schedule (through an uptier transaction).[48] The availability of contractual slack that would allow these types of transaction led to a type of bidding war, as creditors fought to be the one to benefit

Decline of the Public Company, 68 HASTINGS L.J. 445 (2020); Mitchell Mengden, *The Development of Collateral Stripping by Distressed Borrowers*, 16 CAP. MKTS. L.J. 56 (2021); Kenneth Ayotte & Christina Scully, *J. Crew, Nine West, and the Complexities of Financial Distress*, 131 YALE L.J.F. 363 (2021).

41. *Leveraged Loan Amendments Hit Record Pace While Refinancing Yields Hit 23-Year High*, PITCHBOOK (Oct. 6, 2023), https://pitchbook.com/news/articles/leveraged-loan-amendments-hit-record-pace-while-refinancing-yields-hit-23-year-high [https://perma.cc/LNP6-K39Q].

42. Bo Becker & Victoria Ivashina, *Covenant-Light Contracts and Creditor Coordination*, 70 Swedish House of Finance Research Paper (2016); Greg Nini, David C. Smith & Amir Sufi, *Creditor Control Rights, Corporate Governance, and Firm Value*, 25 REV. FIN. STUD. 1713 (2012); Greg Nini, David C. Smith & Amir Sufi, *Creditor Control Rights and Firm Investment Policy*, 92 J. FIN. ECON. 400 (2009).

43. *See* Alan Schwartz, *A Contract Theory Approach to Business Bankruptcy*. 101 YALE L.J. 1807 (1998); Alan Schwartz, *Bankruptcy Contracting Reviewed*, 109 YALE L.J. 343 (1999).

44. *See* Alan Schwartz, *Contracting About Bankruptcy*, 13 J.L. ECON. & ORG. 127, 133 n.13 (1997).

45. A recent paper suggests that the trend may have both positive and negative effects on firms ex ante. *See* Samuel Antill, Neng Wang & Zhaoli Jiang, *Creditor-on-Creditor Violence and Secured Debt Dynamics*, (Harv. Bus. Sch., Working Paper, 2024), https://ssrn.com/abstract=4821620 [https://perma.cc/H9SH-QFTK].

46. *See* Max Frumes, *Special Situations*: *Serta Simmons considering IP transfer opposed by first-lien lenders*, COVENANT REV. (June 5, 2020).

47. *See* Max Frumes, *Special Situations*: *Serta Simmons considering IP transfer opposed by first-lien lenders*, COVENANT REV. (June 5, 2020) ("According to credit investors familiar with the credit, the credit agreement had numerous opportunities for leakage that would allow the company to move IP from Serta into an unrestricted subsidiary and/or contribute IP to an intermediate holdco where the company could issue debt that would be structurally senior to the first-lien term loan."). *See also* Buccola and Nini, *supra* note 4. The transaction is similar to the PetSmart deal discussed in Ellias & Stark, *supra* note 4.

48. *See generally* North Star Debt Holdings, L.P. v. Serta Simmons Bedding, LLC, No. 652243/2020 (N.Y. Sup. Ct. June 11, 2020).

from the opportunity.[49] At first, a group of its first and second lien lenders sent a proposal for a refinancing transaction that would provide all of the firm's existing first and second lien lenders an equal opportunity to provide new financing. A second lender group of first lien lenders then sent their own proposal, for a transaction that would surgically alter the debtors' capital structure to give the second group priority over the first group. At this point, a member of the first group broke off and proposed a third re-financing transaction, one that would benefit the dissident member at the expense of all the other lenders. The remaining members of the first group then proposed their own "unequal" transaction, which Serta accepted. In emails mourning the defeat, members of the second group bemoaned that "[the private equity sponsor] has played our two groups off of each other and continues to do so . . . we concede that [the second group] has outmaneuvered our group." In effect, Serta was able to obtain the type of relief formerly only possible in bankruptcy—a priming distressed financing of $200 million in new money—while the creditors who did not share in the deal found their first lien claims demoted to third (or potentially fourth) lien claims and second lien claims became fourth (or even) fifth lien claims.[50]

Given the increasing prominence of these types of transactions, it stands to reason that the work of bankruptcy may be different today than it was even a decade ago. The types of firms that file for bankruptcy may be firms that exhausted their options to engage in liability management transactions, or whose creditors insist on a bankruptcy because they are so deeply troubled. At the very least, it is possible that the pre-bankruptcy costs of financial distress are much higher than they tend to be if the period of bargaining while financially distressed is longer or more contentious than it used to be on average.

To learn more about pre-bankruptcy fees, Figure 6 below shows the raw average amount of pre-bankruptcy fees that the debtor's lead counsel discloses to the bankruptcy court.

49. *See* In re Serta Simmons Bedding, LLC, No. 23-90020, 2023 WL 3855820, at *4 (Bankr. S.D. Tex. June 6, 2023).

50. In many cases, these transactions give rise to fraudulent transfer type claims, but those are so difficult to prevail on that the remedy is challenging. *See* Ellias & Stark, *supra* note 4. In any event, Professor Schwartz was always skeptical of litigation that merely redistributed value from one creditor to another. *See e.g.* Alan Schwartz, *A Normative Theory of Business Bankruptcy*, 91 VA. L. REV. 1199, 1204 (2005) ("For example, if a trustee successfully uses an avoiding power to demote a creditor from secured to unsecured status, the firm's assets will be reduced by the trustee's litigation costs, but the total value available for distribution to creditors will not otherwise increase"). He also expressed skepticism of the then "recent [practice of] courts using consider[ing] whether to use fraudulent conveyance law to require disgorgement from creditors of firms that failed after engaging in leveraged buyouts . . . [t]his effort seems misguided." *Id.*

Figure 6. Pre-Bankruptcy Fees of the Debtor's Lead Counsel, in Nominal Dollars

As the Figure shows, the trend here is mostly upwards over the sample period—the median number dips a bit in the early 2020s, while the mean does not—which is suggestive evidence that the financial distress period may be more expensive in ways that the primary research design in this paper would not be calibrated to detect.

Figure 7 below shows the same graph as Figure 4—the ratio of fees to the debtor's assets—but includes the pre-bankruptcy fees.

Figure 7. The Ratio of the Debtor's Lead Counsel's Pre- and In-Bankruptcy Fees to Firm Assets

The Figure shows a fairly unambiguous upwards trend, with measured fees consuming more of the debtor's assets when pre-bankruptcy fees are included. The white area between the dotted and solid line also appears to grow over the course of the sample period, pointing to the increasing magnitude of pre-bankruptcy fees relative to the fees charged in bankruptcy cases. Table 1 below shows the percentage of the debtor's total fees that are pre-bankruptcy fees.

Table 1. Pre-Bankruptcy Fees as a Percentage of All Chapter 11 Debtor's Counsel Fees

Five-Year Period	Mean Pre-bankruptcy Fee Percentage	Median Pre-bankruptcy Fee Percentage
2004-2010	18.16%	15.61%
2011-2015	23.18%	21.55%
2016-2020	34.27%	33.97%
2021-2022	22.09%	15.26%

As the Table shows, the proportion of all fees (pre-bankruptcy and in-bankruptcy) that are pre-bankruptcy fees increased throughout the sample period, hitting a level in 2016-2020 that is approximately 89% higher than 2004-2010. The 2021 to 2022 period appears to be relatively lower, but we are still relatively early on to know for sure whether this trend has been interrupted or whether the relatively smaller pre-bankruptcy fees represent noise in a trend line.

Conclusion

A powerful belief shaping debtor creditor practice is that Chapter 11 has become more expensive. This is a contributing factor to many trends in restructuring. For example, many creditors may choose to opt into an unsatisfying liability management transaction because they think Chapter 11—the primary body of law protecting their interests—is too expensive to be of help.

In this paper, I have used new data to investigate whether Chapter 11 really has become more expensive. I find that the total inflation-adjusted fees of the debtor's lead counsel and the aggregate fees of all estate professionals look fairly similar over the past twenty years. However, on closer inspection it is clear that while the headline numbers may look similar, Chapter 11 has, in fact, become more expensive in several different analyses. Chapter 11 fees consumed, on average, four times as many of a debtor's pre-prepetition assets in 2022 than was the case in the 2010s. The cost per day of bankruptcy also appears to be much higher, with the median case reaching $84,000 in 2022 (from $32,000 in 2010). The pre-bankruptcy costs of restructuring advice also appears to be much higher (89% higher in the five year period from 2016 to 2020 as compared to 2004-2010), with firms either doing more planning for bankruptcy cases or engaging in prolonged workout talks and perhaps liability management transactions.

To be sure, there is much we do not know about the observed increase in bankruptcy fees and future research is needed to understand their drivers in greater detail than was possible in this short paper. For example, is it possible that the issues of the late 2010s and early 2020s—crypto and the pandemic—involved many undecided questions of law or so much economic uncertainty that restructuring was inherently harder and thus more expensive? How much of the observed uptick in pre-bankruptcy fees can we really attribute to liability management transactions? How much of the increase in fees is just due to law firm billing rates that grew faster than inflation? Will the trend line revert to a prior mean and will this all turn out to be just a blip?