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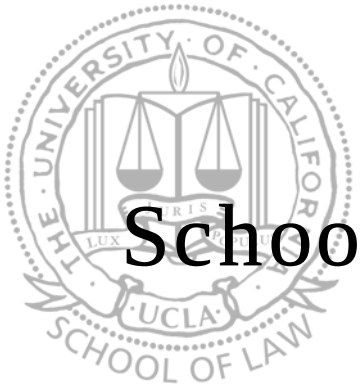
ONE SIZE FITS SOME: SINGLE ASSET REAL ESTATE BANKRUPTCY CASES

Kenneth N. Klee

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By
Kenneth N. Klee*

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* Acting Professor of Law, UCLA School of Law. © 2001 Kenneth N. Klee, All Rights Reserved. The author gratefully appreciates and acknowledges comments of Professors Daniel J. Bussel, Caroline Gentile, Robert Goldstein, Lynn M. LoPucki, Richard Sander, Kirk Stark, and Elizabeth Warren, on previous drafts of this article. The author gratefully appreciates and acknowledges valuable technical assistance by Joseph Doherty, Associate Director for Research, Empirical Research Group, UCLA School of Law, and research assistance by Jacob Simon of the UCLA School of Law Class of 1998, Steven Cademartori of the UCLA School of Law Class of 2000, and Arusi Loprinzi of the UCLA School of Law Class of 2003. The Author is also grateful for generous funding from the National Conference of Bankruptcy Judges Endowment for Education and the Faculty Grants Program awarded by the Council on Research of the Academic Senate at UCLA.

INTRODUCTION

Congressional shortcuts can cut short the rights of chapter 11[1]real property owners and investors.[2] Shortcuts rely on generalizations that sacrifice accuracy and precision for the sake of expedience.[3] In fashioning a shortcut, the guide is usually inductive logic: If a shortcut works for a few cases, surely it will work in many, if not all, cases. Reliance on inductive logic often is supported by assumptions based on limited observations, but, by its very nature, a shortcut rarely relies on systematic, detailed, empirical research. Of course such research is often tedious, time-consuming, and expensive.

Absent an emergency, legislators can afford to engage in empirical research before adopting legislation, but, not surprisingly, they seldom do so.[4] Using inductive logic to incorporate generalizations into legislation can lead to irresponsible laws that are not in the public interest. Even when a legislator responds to lobbying pressures, taking extra time to develop the data can support fine-tuning that provides the foundation for superior legislative results. This article focuses on a striking example of federal legislation where even a small amount of empirical research would have produced data supporting a more efficient statutory amendment.

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[1] *See* 11 U.S.C. §§ 1101-1174 (West 2000).

[2] *See, e.g., infra* Part IV, arguing that the congressional shortcut in removing the $4 million cap on single asset real estate ("SARE") cases will harm property owners and investors. In this article, the term "shortcut" refers to a broad general solution to a problem that is not as thorough as a more specialized solution.

[3] Commentators have analyzed and criticized the use of shortcuts by courts in resolving securities law cases. *See* Stephen M. Bainbridge & Mitu Gulati, *How Do Judges Maximize? (The Same Way Everybody Else Does—Boundedly): Rules of Thumb in Securities Fraud Opinions* 3 (2001) (concluding that judges are using substantive heuristics to dispose of securities law cases at the motion to dismiss stage) (unpublished manuscript on file with author); Hillary A. Sale, *Judging Hueristics* (2000) (unpublished manuscript on file with author).

[4] It is a matter of conjecture whether legislators are too busy to cause their staffs, the General Accounting Office, or the Congressional Research Service to engage in empirical research or whether legislators prefer to respond to lobbying pressures without being burdened by hard data that might undercut the lobbyists' legislative objectives. On some occasions, Congress has commissioned studies before legislating a solution to a perceived problem, and did so with respect to other aspects of the Bankruptcy Reform Act of 2001. *See* U.S. General Accounting Office, Personal Bankruptcy: Analysis of Four Reports on Chapter 7 Debtors' Ability to Pay (Aug. 29, 2000) available at http://www.gao.gov/ (last visited September 26, 2001). As a norm, however, policymakers typically have a full legislative agenda that covers a wide range of topics and little taste for delving into the kinds of minutiae necessary to produce high quality empirical research. Moreover, to the extent that legislation is proposed in response to interest-group lobbying, a friendly legislator sees little to gain from developing data that would suggest that her supporters are pushing for something unwise.

In the Bankruptcy Reform Act of 2001,[5] Congress enacted a so-called "technical" amendment[6] ("2001 Amendment") repealing the $4 million cap in the definition of "single asset real estate" ("SARE").[7] Before the 2001 Amendment, because of the dollar limitation in the definition, SARE essentially covered most apartment houses, very small office buildings, and small strip shopping centers.[8] After the 2001 Amendment, SARE covers large office buildings, it probably covers office/shopping complexes like Rockefeller Plaza, and it possibly covers hotels and casinos.[9] The consequence of this so-called technical amendment is to subject large real estate projects with complex capital structures and operating problems to the same reorganization process as a 5-unit apartment house. Most importantly, in a SARE case the Bankruptcy Code[10] permits a mortgage holder to obtain relief from the automatic stay to commence foreclosure a mere 90 days[11] after the order for relief, unless the debtor has filed a plan of

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[5] Pub. L. No. 107-xxx, xxx Stat. xxx, enacted xxx, 2001.

[6] *Id.* § 1201(5)(B) (amending the definition of "single asset real estate" in § 101(51B) of title 11, United States Code (the "Bankruptcy Code")). Congress enacted section 1201 in Title XII--Technical Amendments (available on line as H.R. 333 at http://thomas.loc.gov, search for "Bankruptcy Reform Act of 2001").

[7] Before it was amended by the Bankruptcy Reform Act of 2001, section 101(51B) of the Bankruptcy Code read as follows:

> In this title — (51B) "single asset real estate" means real property constituting a single property or project, other than residential real property with fewer than 4 residential units, which generates substantially all of the gross income of a debtor and on which no substantial business is being conducted by a debtor other than the business of operating the real property and activities incidental thereto having aggregate noncontingent, liquidated secured debts in an amount no more than $4,000,000;

[8] *See, e.g., In re* Syed, 238 B.R. 133, 140 (Bankr. N.D. Ill. 1999) (noting that "[t]he phrase 'single asset real estate' was intended in the statute to encompass an apartment building, office building, or strip mall shopping center . . . ."). "We commonly think of a single asset case as one of a debtor with a single apartment house or condo complex or a single piece of real estate." 138 CONG. REC. S 8241 (daily ed. June 16, 1992) (statement of Sen. Reid).

[9] Whether shopping complexes, office towers, hotels and casinos are covered depends on whether courts find those properties to have substantial businesses other than operating the real property and activities incidental thereto. *See supra* notes 7 and 8; Centofante v. CBJ Dev., Inc. (*In re* CBJ Dev., Inc.), 202 B.R. 467 (Bankr. 9th Cir. 1996) (full service hotel is not SARE, but apartment building would be even if it were called a hotel). Some courts will not interpret the SARE definition to include a golf course or a golf and ski facility. *See In re* Larry Goodwin Golf, Inc., 219 B.R. 391, 393 (Bankr. M.D.N.C. 1997) (golf club is a "business" rather than SARE); *In re* Prairie Hills Golf & Ski Club, Inc., 255 B.R. 228, 230 (Bankr. D. Neb. 2000) (golf and ski facility is not SARE because it involves significant income producing activities other than income producing buildings and land).

[10] *See* 11 U.S.C. §§ 101-1330 (West 2000).

[11] The court can extend the 90-day period for "cause" by an order entered within the 90-day period. *See* 11 U.S.C. § 362(d)(3) (West 2000). Forcing the debtor to seek an extension is costly. Moreover, based on their different attitudes toward SARE cases generally, the application of judicial discretion in this context is likely to lead to disparate results in similar cases before different judges. *See infra* note 91.

reorganization that has a reasonable possibility of being confirmed within a reasonable time[12] or the debtor in possession[13] has commenced monthly payments equivalent to interest[14] to each secured creditor.[15]

As a result of the 2001 Amendment, mortgage holders have the leverage to flush out of the bankruptcy system prematurely some large real estate developers or owners that have liquidity problems before they have a reasonable chance to reorganize.[16] By threatening to use this leverage, mortgage holders can control the chapter 11 process to their benefit. They can decide whether to seize control of the property for potential upside gain or leave it in chapter 11 to serve their other purposes. That is why they financed the lobbying effort to press for this amendment.[17] Their benefit often will come at the expense of property owners, general unsecured creditors, and the public that subsidizes the cost of operating the bankruptcy system to achieve a public good.

After testifying before Congress about the forerunner of the 2001 Amendment, I recognized the desirability of gathering empirical data to shed light on whether large SARE debtors differed from small SARE debtors in their chapter 11 experiences. I examined the case law and gathered information in unreported cases to determine whether SARE debtors confirmed chapter 11 plans. By analyzing plan confirmation rates over the past 20 years, this article tests the wisdom

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[12] *Id.* § 362(d)(3)(A) (West 2000).

[13] The statute says "debtor" but means "debtor in possession" acting as the legal representative of the bankruptcy estate. *See* 11 U.S.C. §§ 323(a) & 1107(a) (West 2000).

[14] Some courts and commentators mistakenly characterize the statute as requiring the payment of interest. Rather, the payments are "in an amount equal to interest." *See* 11 U.S.C. § 362(d)(3)(B) (West 2000). Unless the creditor is oversecured or the debtor is solvent, the payment of postpetition interest is forbidden. *See* 11 U.S.C. §§ 502(b)(2), 506(b), 726(a)(5) (West 2000). In fact, if the creditor is oversecured, although postpetition interest will accrue under section 506(b), the payment of postpetition interest prior to the conclusion of the case might be forbidden as well. *See* Orix Credit Alliance, Inc. v. Delta Resources, Inc. (*In re* Delta Resources, Inc.), 54 F.3d 722 (11th Cir. 1995).

[15] *See* 11 U.S.C. § 362(d)(3)(B) (West 2000).

[16] *See* David B. Young, *Automatic Stay Issues: Selected Recent Developments*, 820 PLI/COMM. L. & Pract. 9, 71 (April 2001) (section "362(d)(3), seeks to place the debtor on a fast track and to permit the mortgage lender to foreclose unless the debtor acts swiftly."). *Accord In re* Khemko, Inc., 181 B.R. 47, 49 (Bankr. S.D. Ohio 1995) (noting that the purpose of section 362(d)(3) is to "impose an expedited time frame for filing a confirmable plan" in SARE cases).

[17] *See generally,* http://www.opensecrets.org/news/bankruptcy/index.htm (last visited Sept. 17, 2001) indicating that during the 1999-2000 lobbying cycle, finance and credit card companies contributed $9 million. During the same cycle, commercial banks contributed $29 million, and credit unions contributed $2.1 million, more than 2.5 times the amount spent by this industry during the 1996 presidential campaign.

of treating large and small SARE debtors alike in a manner different from all other chapter 11 debtors.

Before turning to the main focus of this article whether small and large SARE debtors should be governed by the same or different reorganization procedures and rules, Part I of this article examines the history and policy behind SARE reorganization and asks a threshold question: why should SARE debtors be granted the opportunity to reorganize at all? It makes the claim that compelling policy reasons favor reorganization of SARE debtors, even though theories of allocative efficiency might indicate otherwise. Part II reviews the 2001 Amendment that adopts a single procedure for all SARE reorganizations by changing the definition of SARE to eliminate the $4 million cap and the policies that the amendment implicates. Part III reports on original data analyzing pre-amendment real estate cases to see how they fared in bankruptcy and finds that larger SARE debtors above the $4 million cap have higher chapter 11 confirmation rates. Part IV uses these findings to conclude that Congress was not justified in repealing the SARE $4 million cap because chapter 11 works for larger SARE debtors. Congress acted on the basis of a hunch instead of doing its homework.

I. WHY REORGANIZE SARE CASES AT ALL?

In order to answer the question whether or under what conditions single asset real estate cases should be able to reorganize under the Bankruptcy Code, we need to evaluate the costs and benefits of reorganization compared to foreclosure under state law. To place the evaluation in context, this part begins with a brief history of real property reorganizations followed by a description of how chapter 11 reorganization cases work. It continues by examining the arguments for and against allowing SARE cases access to chapter 11 at all and concludes by focusing on political motivations that led to enactment of the 2001 Amendment rather than exclusion of SARE debtors from chapter 11.

A. The History of Real Property Reorganization Cases.

During the 1930's, the deteriorating economic climate in the United States led to massive defaults in the repayment of real

property mortgages.[18] Economic disaster threatened not only the debtors who owed mortgage obligations, but the financial institutions, particularly savings banks, that held the mortgages.[19] As debtors defaulted, mortgage holders commenced foreclosure proceedings and financial institutions began to hold record title to enormous amounts of real property.[20] Many of these financial institutions faced the Hobson's choice of holding real estate that generated little income but carried tax, maintenance, and insurance liabilities or selling the real estate into a thin market with few buyers and distressed prices.[21] Yet in many states, financial institutions could not intervene to protect their interests by foreclosing on mortgaged properties, because the states had imposed moratorium laws to suspend foreclosures.[22] As a result, the United States faced the prospect of numerous financial institution insolvencies.[23] In addition, Congress saw a risk of undermining our economic system by allowing real property defaults to cause the pervasive dispossession of private ownership. To

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[18] See Homer F. Carey, *Real Property: Post Depression and Future*, 1 J. LEGAL & POL. SOC. 101, 101 (1943) ("Foreclosures reached staggering proportions [from 1921 to 1930] and bankruptcies were occurring at an ever accelerating rate.").

[19] See Current Legislation, *Emergency Mortgage Legislation*, 8 ST. JOHNS L. REV. 204, 206 (1933) ("Savings banks and insurance companies with their millions in mortgages . . . were caught in the deluge of foreclosure and in this time of chaos, President Roosevelt declared the Banking Holiday."); Milton Esbitt, *Bank Portfolios and Bank Failures During the Great Depression: Chicago*, 46 J. OF ECONOMIC HISTORY 455, 457 (1986) ("fully 95% of the bank troubles in Chicago were predicated on real estate") (footnote omitted); ELMUS WICKER, THE BANKING PANICS OF THE GREAT DEPRESSION 16 (Cambridge Univ. Press 1996) ("Real estate lending, primarily nonfarm, . . . was an important source of unsettled banking markets during the Great Depression."); Thomas S. Stone, *Mortgage Moratoria*, 11 WIS. L. REV. 203, 206 (1936) ("The wave of foreclosures . . . was of little benefit to creditors.").

[20] See Carey, *supra* note 18, at 104 ("[P]roperty passed in great volume to the creditor class during the interval from 1930 to 1937."). Contemporary literature contains the following hyperbole: "When one realizes that approximately 50 per cent of the farm lands in Central and Northern California are controlled by one institution—the Bank of America—the irony of these 'embattled' farmers defending their 'homes' against shysters becomes apparent." CAREY MCWILLIAMS, FACTORIES IN THE FIELD: THE STORY OF MIGRATORY FARM LABOR IN CALIFORNIA 233 (Boston: Little Brown 1944).

[21] *See, e.g.,* Stone, *supra* note 19, at 206 ("the past few years have found banks and other lending institutions loaded down with physical properties which they cannot operate."); Arthur E. Sutherland, Jr., *Foreclosure and Sale, Some Suggested Changes in the New York Procedure*, 22 CORNELL L.Q. 216, 217 (1937) ("The great lending institutions are reluctant to load themselves with foreclosed real estate . . . .").

[22] *See, e.g.,* Robert H. Skilton, *Mortgage Moratoria Since 1933*, 92 U. PA. L. REV. 53, 88 (1943) ("The chief criticism that may be made of the New York moratorium is that it was too inclusive. Commercial properties . . . were protected against the consequences of default in principal."). *See generally Emergency Mortgage Legislation*, *supra* note 18, at 206; Stone, *supra* note 19, at 206; William L. Prosser, *The Minnesota Mortgage Moratorium*, 7 SO. CAL. L. REV. 353 (1934).

[23] *See, e.g.,* Raymond J. Mischler, *After the Mortgage Moratorium—What?*, 19 IA. L. REV. 560, 561 (1934) ("Foreclosures and forced sales were reaching proportions that threatened state and national stability.").

ameliorate this situation, among other goals, Congress enacted Chapter XII of the Bankruptcy Act to permit individual and partnership debtors who owned real property the opportunity to reorganize.[24] By enacting Chapter XII, Congress created a beneficial legal mechanism to prevent financial institutions from either conducting massive resales of foreclosed real estate into depressed markets or retaining concentrated ownership of real property on their balance sheets. Before the enactment of Chapter XII, SARE debtors either renegotiated consensually with their mortgage holders or liquidated the property under the Bankruptcy Act of 1898 or state mortgage foreclosure laws.

When Congress enacted the Bankruptcy Code in 1978, it continued to permit SARE debtors to reorganize under the same laws and rules as other kinds of chapter 11 debtors. A property owner was eligible to file for relief under chapter 11 whether the owner was an individual, partnership, or corporation.[25] The 1978 Bankruptcy Code gave all kinds of SARE debtors a breathing spell to permit them to restructure their property and their mortgage.

In 1994, however, the law changed fundamentally for some SARE property owners when Congress adopted special rules for SARE debtors with secured debts of less than $4 million ("small" SARE debtors). In those cases, Congress restricted small SARE debtors to an expedited chapter 11 procedure designed to confirm a plan quickly

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[24] *See* Morris W. Macey & M. William Macey, Jr., *The Chapter XII Chrysalis*, 52 AM. BANKR. L.J. 121, 123 (1978) ("Chapter XII was . . . developed principally to meet an emergency situation prevalent in Illinois and, to some extent, Massachusetts.") (citations omitted). Chapter XII was enacted as part of the Chandler Act of 1938, Pub. L. No. 75-696, 52 Stat. 840, 916-930 (repealed by Bankruptcy Reform Act of 1978, Pub. L. No. 95-598, 92 Stat. 2549, 2682). At the same time it passed Chapter XII, Congress passed Chapter X of the Bankruptcy Act to facilitate corporate reorganization of different kinds of businesses, including those that owned real property. See Pub. L. No. 75-696, 52 Stat. 840, 883-905 (repealed by Bankruptcy Reform Act of 1978, Pub. L. No. 95-598, 92 Stat. 2549, 2682); *In re* Colonial Realty, 516 F.2d 154, 158 (1st Cir. 1975) ("The purpose of Chapters X and XII is to restore, not to dismantle the economically distressed debtor. The power to prevent secured parties from availing of their contractual remedies upon default, and to compel those creditors who have acted with sufficient celerity to be in possession at the time of filing to return the debtor's property is essential to preserve the possibility of a successful rearrangement of the debtor's affairs. Little hope of resuscitation would remain for the debtor disemboweled just prior to filing.").

[25] An individual (human being), partnership, or corporation is eligible to be a chapter 11 debtor. *See* 11 U.S.C. §§ 101(41), 109(b), (d) (West 2000); Toibb v. Radloff, 501 U.S. 157 (1991) (individual debtor not in business was eligible to file under chapter 11). Individual debtors with regular income and noncontingent, liquidated secured debts less than $871,550 and noncontingent, liquidated unsecured debts less than $290,525 may file chapter 13 cases instead of chapter 11 cases. *See id.* § 109(e) (as amended effective April 1, 2001). Generally, chapter 13 is less expensive and more effective than chapter 11. Thus an individual SARE debtor who is eligible might choose to file a chapter 13 case instead of a chapter 11 case. This article assumes that the debtor files for relief under chapter 11.

or force the debtor to pay the mortgage holder. Debtors who could do neither faced losing their property to foreclosure. Specifically, to protect mortgage lenders in SARE cases having secured debts not greater than $4 million,[26] the 1994 amendments added an additional procedure by which a real property mortgage holder could obtain relief from section 362's automatic stay against lien foreclosure.[27] Section 362(d)(3) permits a SARE mortgage holder to get relief from the automatic stay to foreclose, unless, within 90 days after the order for relief, the debtor files a confirmable plan or begins making monthly payments to the mortgage holder.[28] Thus the amendments minimize the mortgage holder's out-of-pocket loss by shortening the chapter 11 process or forcing the debtor to "pay to play" by making cash payments to the lender. This provision shifts the risk of delay from the secured lender to the debtor. It also creates a barrier to entry that discourages small real estate owners from filing for chapter 11 relief.[29] Mortgage

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[26] *See* 11 U.S.C. § 101(51B) (West 2000) which defines "single asset real estate" as follows:

> real property consisting of a single property or project, other than residential real property with fewer than 4 residential units, which generates substantially all of the gross income of a debtor and on which no substantial business is being conducted by a debtor other than the business of operating the real property and activities incidental thereto having aggregate noncontingent, fixed, liquidated secured debts in an amount no more than $4 million;

[27] *See* Pub. L. No. 103-394, § 218(b), 108 Stat. 4106, 4128 adding paragraph (3) to section 362(d) of title 11 of the United States Code. *See infra* note 28. Lenders with secured loans of at least $4 million did not receive the benefits of these protections, although they could seek relief from the automatic stay under section 362(d)(1) or (2). *See* 11 U.S.C. § 362(d)(1)-(2) (West 2000). Presumably Congress adopted the $4 million cap in 1994 because it thought that different policy concerns governed larger cases.

[28] Paragraph (3) of section 362(d) of title 11 of the United States Code provides as follows:

> [The court shall grant relief from the automatic stay of section 362(a)] (3) with respect to an act against single asset real estate under subsection (a), by a creditor whose claim is secured by an interest in such real estate, unless, not later than the date that is 90 days after the entry of the order for relief (or such later date as the court may determine for cause by order entered within that 90 day period)—
>
> > (A) the debtor has filed a plan of reorganization that has a reasonable possibility of being confirmed within a reasonable time; or
> >
> > (B) the debtor has commenced monthly payments to each creditor whose claim is secured by such real estate (other than a claim secured by a judgment lien or by an unmatured statutory lien), which payments are in an amount equal to interest at a current fair market rate on the value of the creditor's interest in the real estate.

[29] One commentator has speculated that the 1994 amendment would discourage small real estate debtors from filing for chapter 11 relief, thereby resulting in earlier foreclosures under state law. *See generally*, John C. Murray, *The Lender's Guide to Single Asset Real Estate Bankruptcies*, 31 REAL PROP. PROB. & TRUST J. 393 (1996). Another believed that the 1994 amendments would cause the bankruptcy courts to "experience increased efficiency due to the reduction of filings

holders and their lobbyists justified the provision based on an alleged "shared experience" that most real estate cases are filed solely to delay foreclosure;[30] and they convinced Congress that these cases seldom result in confirmed plans but instead use the resources of the federal courts for improper dilatory purposes.[31]

In 2001, once again bowing to pressure from mortgage holders and their lobbyists, Congress repealed the $4 million cap and subjected all SARE debtors to the expedited procedures that had applied since 1994 to small SARE debtors.

B. How Chapter 11 Works for SARE Debtors.

Before analyzing the 2001 Amendment, it is useful to understand how chapter 11 works for SARE debtors and to consider whether SARE cases should reorganize at all. Continuing the pattern of federal reorganization relief that started during the Great Depression, the Bankruptcy Code allows almost any kind of SARE debtor to initiate a chapter 11 reorganization case, whether the debtor is an individual, partnership, or corporation.[32] After filing a chapter

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which don't have any reasonable chance of confirmation." Testimony of Mary Jane Flaherty, *Hearing 102-620 Before the Subcomm. on Courts and Admin. Practice of the Senate Comm. on the Judiciary*, 102d Cong., 1st Sess. 89 (July 30, 1991). Although it is obvious that a debtor would prefer a 90 day delay to immediate foreclosure, as a matter of cost/benefit analysis the foregoing speculations appear to be sound. Debtors that own small real estate projects will be less inclined to pay a bankruptcy attorney's retainer, a chapter 11 filing fee, the quarterly United States trustee's fees, and the other substantial incremental costs of filing for chapter 11 when the limitations of section 362(d)(3) operate to compress and restrict their opportunity to reorganize. *See* 28 U.S.C. § 1930(a)(3), (6) (West 2000). At the margin, they will walk away and allow the lender to foreclose or give the lender a deed to the property in lieu of foreclosure.

[30] *See, e.g.,* Testimony of Mary Jane Flaherty, *Hearing 102-620 Before the Subcomm. on Courts and Admin. Practice of the Senate Comm. on the Judiciary*, 102d Cong., 1st Sess. 88-89 (July 30, 1991) ("The problem with single asset cases is there is usually no reasonable prospect of reorganization . . . the filing is simply used as a legal method to delay foreclosure. Lenders typically receive relief from the stay, but only after substantial delay and expenses.").

[31] *See id.*; Testimony of Warren Lasko, *Hearings on Bankruptcy Reform Legislation Before the Subcomm. on Economic and Commercial Law of the House Comm. on the Judiciary*, 103d Cong., 2d Sess. 532 (Ser. No. 62 Aug. 17, 1994) ("The survey also confirms that Chapter 11 is being used by developers and owners of single asset real estate property for delay, not for legitimate reorganization of a business."). The subcommittee manager of the bill in the House of Representatives described the 1994 amendments as "designed to curtail bankruptcy fraud and abuse and reduce the unnecessary costs and delays of the bankruptcy process . . . ." *See* 140 CONG. REC. H 10771 (daily ed. Oct. 4, 1994) (statement of Rep. Synar).

[32] The Bankruptcy Code uses the term "individual" to mean a particular human being. *See In re* Hooton Co., 43 B.R. 389, 391 (Bankr. N.D. Ala. 1984) ("The term 'individual' is not included in the definition found in 11 U.S.C. § 101; however, it may be said to mean generally a single human being as distinguished from a social group or institution."); David Swarthout, Note, *When is an Individual a Corporation?—When the Court Misinterprets a Statute, That's When!*, 8 AM. BANKR. INST. L. REV. 151, 152 n.9 (2000) (citing Toibb v. Radloff, 501 U.S. 157, 160-61 (1991); stating that the Court's use of the term "individual" excludes "corporate debtors and only refer[s] to human beings."). The Bankruptcy Code's definition of "corporation" probably includes limited

11 petition, the debtor ordinarily remains as a debtor in possession[33] with the power to operate its business,[34] sell assets,[35] obtain credit,[36] and propose a plan of reorganization.[37]

For at least the last 60 years, most SARE debtors in bankruptcy have had over-leveraged capital structures where a decline in rents (or inability to rent) produces a cash flow insufficient to service their secured debts. Some debtors have obtained junior mortgages to create additional short-term cash flow, but often this strategy adds more debt without solving the debtor's long-term liquidity crisis. Ultimately, the liquidity crisis escalates to the point where the mortgage holder threatens to foreclose and the debtor walks away from the property, renegotiates with the mortgage holder out of court, or files a chapter 11 petition. In these chapter 11 cases, the plan of reorganization almost always proposes debt relief. Debt relief takes many forms, ranging from a simple extension of maturity date or an adjustment of the interest rate or of the debt amortization period, to forgiveness of indebtedness or the conversion of debt to either equity or a participating mortgage. Indeed a principal purpose of bankruptcy is to give the debtor an opportunity to solve her liquidity problems.[38]

In some SARE cases, the borrower needs to restructure both the secured debt and the business operations. For example, the building might require construction for completion, expansion, retrofitting, repair, or renovation. In this kind of SARE case, the debtor first must obtain additional capital to finance the needed

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liability companies, limited liability partnerships, and business trusts, but not true trusts. *See* 11 U.S.C. § 101(9) (West 2000) (defining "corporation"); Sally S. Neely, *Partnerships and Partners and Limited Liability Companies and Members in Bankruptcy: Proposals for Reform*, 71 AM. BANKR. L.J. 271, 286 (1997) (stating that a LLC "appears to be a corporation" under the Bankruptcy Code's definition of "corporation"); Thomas F. Blakemore, Feature, *Limited Liability Companies and the Bankruptcy Code: A Technical Review*, AM. BANKR. INST. J., June 1994, at 12 (stating that "a LLC would appear to qualify as a 'corporation' under Code § 101(9)").

[33] *See* 11 U.S.C. § 1101(1) (West 2000) (defining "debtor in possession" to mean the debtor except when a trustee is serving in the case). It is rare for chapter 11 trustees to be appointed or elected. *See* 11 U.S.C. § 1104(a) (West 2000) (specifying grounds for the appointment of a chapter 11 trustee).

[34] *See* 11 U.S.C. §§ 1107(a), 1108 (West 2000).

[35] *See* 11 U.S.C. § 363 (West 2000).

[36] *See* 11 U.S.C. § 364 (West 2000).

[37] *See* 11 U.S.C. § 1121(a) (West 2000) giving the debtor the right to file a plan.

[38] *See, e.g.,* Elizabeth Warren, *Bankruptcy Policymaking in an Imperfect World*, 92 MICH. L. REV. 336, 372 (1993) (characterizing chapter 11 as "creating an opportunity for a business to survive its immediate financial crisis"); H.R. Rep. No. 595, 95th Cong., 1st Sess. 221 (1977) ("[t]he purpose of a reorganization . . . case is to formulate and have confirmed a plan of reorganization . . . for the debtor."). *But see* Kevin A. Kordana & Eric A. Posner, *A Positive Theory of Chapter 11*, 74 N.Y.U. L. REV. 161, 164 (1999) ("We assume that the purpose of Chapter 11 is to minimize the cost of credit.").

construction in order to prove that its reorganization plan is feasible. If the value of the property is less than the mortgage debt, the debtor probably will not obtain additional financing on an unsecured basis or even with a junior lien for security. Sometimes, however, new capital is acquired through debtor-in-possession financing secured by a senior lien on the property.[39] Most lenders, however, will not provide postpetition debtor-in-possession financing unless the new credit is secured by a so-called priming lien with priority ahead of the prepetition mortgages.[40] The law permits this to be done only if the prepetition mortgage holder's interest in the real property is adequately protected.[41] Although a value cushion is a common form of adequate protection,[42] where the amount of prepetition mortgage debt exceeds the value of the property, this method of protection is unavailable. In some SARE cases, however, the value added by new construction will provide a sufficient cushion to cover new postpetition financing and adequately protect the prepetition mortgage holder's interest in property.[43] Even if the debtor in possession cannot obtain debtor-in-possession financing, it may be possible for existing or new equity owners to infuse equity capital under a reorganization plan. Unless the prepetition mortgage holder votes to accept the plan, however, the infusion of equity may be done, if at all, only if a market process is used to determine the value of the new equity.[44]

While the debtor in possession attempts to obtain debtor-in-possession financing or new equity, the secured lender is automatically stayed from pursuing its foreclosure rights.[45] Although it is possible for the debtor to make periodic cash payments to the lender as a form of adequate protection,[46] not all courts require current payment of postpetition interest on prepetition mortgages.[47]

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[39] *See* 11 U.S.C. § 364 (West 2000) giving the debtor in possession the ability to obtain postpetition financing.

[40] *See id.* § 364(d) (West 2000).

[41] *See id.* §§ 361, 364(d)(1)(B) (West 2000).

[42] *See, e.g.,* Pistole v. Mellor (*In re* Mellor), 734 F.2d 1396, 1400 (9th Cir. 1984); McCombs Properties VI , Ltd. v. First Texas Sav. Ass'n (*In re* McCombs Properties VI, Ltd.), 88 B.R. 261 (Bankr. C.D. Cal. 1988).

[43] *See, e.g., In re* Ledgemere Land Corp., 125 B.R. 58, 63 (Bankr. D. Mass. 1991).

[44] *See* Bank of America NT&SA v. 203 N. LaSalle St. Ltd. Partnership (*In re* 203 N. LaSalle St. Ltd. Partnership), 526 U.S. 434, 458, 119 S. Ct. 1411, 1424 (1999) (if new value principle exists under the bankruptcy Code, it requires the equity to be exposed to a market value such as through an auction or the termination of the debtor's plan exclusivity.).

[45] *See* 11 U.S.C. § 362(a) (West 2000) (the filing of the bankruptcy petition automatically stays the mortgage holder from commencing or continuing foreclosure).

[46] *See id.* § 361(1) (West 2000).

[47] If the mortgage holder is oversecured, some courts permit postpetition interest to accrue but do not permit its payment until the conclusion of the case. *See, e.g.,* Orix Credit Alliance v. Delta

Under the reorganization plan, unless the debtor is solvent, the undersecured lender's claim will include principal and prepetition interest, but not postpetition interest.[48] For example, assume that a debtor owes a mortgage holder $1 million under a note bearing annual interest at 10 percent and secured by real property worth $800,000. If the reorganization plan is confirmed and effective one year after bankruptcy filing, the mortgage holder will receive consideration worth $800,000 on the effective date of the plan but will forego $100,000 in postpetition interest. Thus bankruptcy may reduce the undersecured mortgage lender's recovery on a present value basis compared to what it would have received by pursuing its state law rights.

C. Arguments For and Against Reorganization.

We now discuss the fundamental question: "Why should SARE cases be permitted to reorganize under chapter 11?"[49] Some commentators have contended, or have adopted theoretical positions that should lead them to contend, that the chapter 11 process in SARE cases is inefficient compared to the alternative of mandatory prompt auctions.[50] Allocative efficiency, they argue, requires swift and inexpensive foreclosure in accordance with state law.[51] These commentators contend that permitting the borrower to file a chapter 11 petition inefficiently delays foreclosure, thereby imposing increased

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Resources, Inc. (*In re* Delta Resources, Inc.), 54 F.3d 722 (11th Cir. 1995). If the mortgage holder is undersecured, it might not be entitled to payment of postpetition interest as long as the value of the real property is not declining. *See, e.g.,* United Sav. Ass'n v. Timbers of Inwood Forest, Ltd. (*In re* Timbers of Inwood Forest, Ltd.), 484 U.S. 365 (1988) (undersecured creditor is not entitled to adequate protection for the delay in its foreclosure rights attributable to the automatic stay).

[48] *See* 11 U.S.C. §§ 502(b)(2), 726(a)(5) (West 2000).

[49] *See, e.g.,* David B. Young, *Automatic Stay Issues: Selected Recent Developments*, 820 PLI/COMM. L. & Pract. 9, 59 (April 2001) ("It is at least arguable that single asset real estate debtors do not belong in a reorganization proceeding at all.").

[50] *See, e.g.*, Douglas G. Baird & Edward R. Morrison, *Bankruptcy Decision Making,* JOURNAL OF LAW, ECONOMICS, AND ORGANIZATION, Vol. 17, No. 2, Fall 2001. Also available at http://www.law.uchicago.edu/Lawecon/index.html (working paper no. 126 last visited August 28, 2001).

[51] *See* Alex M. Johnson, Jr., *Critiquing the Foreclosure Process: An Economic Approach Based on the Paradigmatic Norms of Bankruptcy*, 79 U. VA. L. REV. 959, 989 (1993) ("The ability of a lender to foreclose on a mortgage in an inexpensive and expeditious manner is a key element of the ex ante bargain struck between creditor and debtor, a bargain that allows the debtor to obtain a loan at a very attractive interest rate, at least compared with other forms of debt such as personal loans.") (citation omitted).

costs on secured creditors.[52] Secured creditors in turn pass these losses on to all borrowers in the form of higher interest rates.

Other commentators argue that bankruptcy law should be permitted to interfere with state law only if it solves a "common pool problem."[53] In their view, bankruptcy is necessary to prevent one creditor from acting in its own self interest to the detriment of creditors as a whole. For example, it properly prevents a creditor with a security interest in valuable machinery of an insolvent manufacturing company from foreclosing on its security interest and causing the liquidation of the debtor to the detriment of all other creditors. They argue that almost all SARE cases are two party disputes that involve only a debtor and mortgage holder; therefore, there is no common pool problem, and there should be no bankruptcy case.[54] Permitting a SARE debtor to file for bankruptcy confers no benefits on a pool of other claimants, there being none, they argue, and only imposes unjustified costs and delay on mortgage holders, resulting in higher interest rates, fewer mortgage loans approved,[55] and "withholding from the marketplace property capable of producing value."[56] "The time spent in the Bankruptcy Court is wasteful and without any public benefit."[57] Therefore, so the argument runs, the

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[52] Taken to its extreme, this argument supports prompt, strict foreclosure with no right of redemption as the most efficient system. *See, e.g.,* James Geoffrey Durham, *In Defense of Strict Foreclosure: A Legal and Economic Analysis of Mortgage Foreclosure*, 36 S.C. L. REV. 461, 462 (1985) (concluding that "strict foreclosure . . . is the most efficient method of foreclosure, and is equitable and fair in almost every situation.").

[53] *See, e.g.,* Thomas H. Jackson, The Logic and Limits of Bankruptcy Law 19, 194-95 (Harv. Univ. Press 1986).

[54] *See, e.g.*, Daniel Draper, *Stays of Mortgage Foreclosure—A Proposal for Reform*, 93 BANKING L.J. 133, 135-36 (1976) ("Although, in many cases, the insolvent debtor can adjust its financial situation and eventually satisfy creditors, in our experience that is rarely, if ever, the case for a single-project real estate corporation. The presumption that 'time will heal' is simply not valid where the debtor has virtually nothing to reorganize except a single mortgaged project . . . . Stays against secured creditors of single-project corporations rarely increase the probability of reorganization and consequently cannot further any policy aimed at enhancing all opportunities for success by the debtor.") (citations omitted); Testimony of Michael F. Brown, *Hearings on Com. & Pub. Sector Issues in Bankruptcy Before the Subcomm. on Economic and Commercial Law of the House Comm. on the Judiciary*, 102d Cong., 2d Sess. 250-51 (Aug. 5, 1992) ("When financial problems arise . . . virtually the only creditor is the mortgage holder. Generally there is little or no trade debt or other associated debt.").

[55] *See* Testimony of James W. Nelson, *Hearing 102-620 Before the Subcomm. on Courts and Admin. Practice of the Senate Comm. on the Judiciary*, 102d Cong., 1st Sess. 183 (July 30, 1991) ("The results of lenders' potential losses from single-asset foreclosure delays are higher mortgage interest rates to compensate for the loss [and] a disincentive for institutional lenders to continue to invest in commercial mortgages . . . . ").

[56] *See* Draper, *supra* note 54, at 138.

[57] *See id.* at 142.

Bankruptcy Code should be amended to bar SARE cases from reorganizing under chapter 11.[58]

Contrary to the claim that the common pool problem is the sole or primary basis to evaluate the desirability of allowing SARE debtors access to chapter 11, three principal arguments, developed below, powerfully favor access to chapter 11 to allow SARE debtors an opportunity to reorganize: First, chapter 11 smoothes out market inefficiencies, particularly during massive real estate downturns. Second, federal public policy supports giving property owners a chance to save their investments. Third, macro-economic and social policies favor reorganization of SARE debtors.

First, during broad-based financial crises, allowing debtors to restructure debts in chapter 11 smoothes economic turbulence and precludes the downward spiral in real estate prices that can result when massive amounts of foreclosed properties are dumped on the market simultaneously. Chapter 11 functions in SARE cases to smooth out market inefficiencies caused by state foreclosure systems.[59] Specifically, some state law foreclosure systems are flawed because they permit lenders to seize property and conduct foreclosure sales without sufficient notice, resulting in artificially depressed prices.[60] Although the Depression is long gone, "the modern mortgage market is subject to deficiencies that create similar market

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[58] *See, e.g.,* NATIONAL BANKRUPTCY REVIEW COMMISSION, BANKRUPTCY: THE NEXT TWENTY YEARS 661 n.1678 (1997) ("Some even question whether SARE debtors should be excluded from Chapter 11. *See, e.g.,* Robert M. Zinman, *No Chapter 11 For Single Asset Real Estate, No "New Value" for Single Asset Real Estate*, AM. BANKR. INST. WINTER LEADERSHIP CONF. (Dec. 5-7, 1996) (unpublished article on file with the American Bankruptcy Institute and the National Bankruptcy Review Commission); Alan Robin & James Lipscomb, *Real Estate Bankruptcies and the Bankruptcy Process*, REAL PROP. PROB. & TR. J. (Spring 1997)."). The report is available from the United States Government Printing Office or on the Internet at http://govinfo.library.unt.edu/nbrc/reporttitlepg.html (last visited Oct. 1, 2001).

[59] *See, e.g.,* Lynn M. LoPucki, *Strange Visions in a Strange World: A Reply to Professors Bradley and Rosensweig*, 91 MICH. L. REV. 79, 100 (1992).

[60] *See* Arthur J. Hughes, *Reorganization Under the Amended Bankruptcy Act*, 13 NOTRE DAME LAW. 112, 114 (1938) ("Market values did not properly approximate the real values of the properties. The scarcity of purchasers generally enabled a few buyers to acquire properties at their own figure, far below the cost of the properties a few years before. To be forced to sell in such a market, was certain to result in a complete loss to the debtor and a substantial loss to the creditors."). *See* also, LYNN M. LOPUCKI & ELIZABETH WARREN, SECURED CREDIT: A SYSTEMS APPROACH 71 (Aspen Law & Business 3d ed. 2000) ("When property subject to a mortgage or other lien is sold in foreclosure proceedings, the buyer is usually the mortgagee or other lien creditor and the price for which the property is 'bought in' is sometimes significantly less than the property's fair market value." quoting Armstrong v. Csurilla, 112 N.M. 579, 581, 817 P.2d 1221, 1223 (N.M. 1991)). Cf. BFP v. Resolution Trust Corp., 511 U.S. 531, 531, 114 S. Ct. 1757, 1758 (1994) (The Court, in an opinion authored by Justice Scalia, notes that property that must be sold under the strictures of foreclosure is simply worth less than fair market value).

conditions."[61] These evils exist "not . . . only in time of emergency."[62] Thus many foreclosures result in a nonconsensual "sale" at a below market price. By contrast, chapter 11 gives the property owner the opportunity to sell the property over a reasonable time; when debtors sell properties with lenders' cooperation, the resulting orderly sales can increase value for the lenders and other creditors. Alternatively, chapter 11 permits the property owner to restructure the mortgage through a consensual valuation under a plan supported by the mortgage holder or through a "market tested" valuation in a contested plan confirmation.[63]

These arguments are reinforced by the views of commentators. For example, based on his previous law review article,[64] Judge Bufford testified before the National Bankruptcy Review Commission that real estate reorganization had its roots in the Depression and was enacted to prevent the banks from owning most of the real estate in the nation.[65] In addition, then FDIC Chairman William Seidman testified during the 101st Congress that when bank regulators force quick sales of real estate owned after foreclosure, property values decline precipitously.[66] Thus when it considered the Bankruptcy Reform Act of 2001, Congress was well aware that society is much better off if real property values are smoothed by orderly liquidations.

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[61] *See* Robert M. Washburn, *The Judicial and Legislative Response to Price Inadequacy in Mortgage Foreclosure Sales*, 53 SO. CAL. L. REV. 843, 851-52 & n.48 (1980) (citing National Bank v. Equity Investors, 81 Wash. 2d 886, 924-27, 506 P.2d 20, 43-44 (1973) (en banc)). *See also* Arthur E. Wilmarth, Jr., *The Expansion of State Bank Powers, The Federal Response, and the Case for Preserving the Dual Banking System*, 58 FORD. L. REV. 1133, 1244 (1990) ("[During the late 1980's,] bank failures in Texas have been caused primarily by an excessive concentration of bank assets in commercial loans related to real estate and energy ventures.").

[62] *See* D.J. Farage, *Mortgage Deficiency Judgment Acts and Their Constitutionality*, 41 DICK. L. REV. 67, 67 (1937) ("[E]mergencies do expose to the spotlight certain economic malpractices, which, in more prosperous times, flourish unheeded.").

[63] *See* Bank of America National Trust and Savings Ass'n. v. 203 North LaSalle Street Limited Partnership, 526 U.S. 434, 119 S. Ct. 1411, 143 L. Ed. 2d 607 (1999).

[64] *See* Hon. Samuel L. Bufford, *What is Right About Bankruptcy Law and Wrong About Its Critics*, 72 WASH. U.L.Q. 829, 836-38 (1994) (bankruptcy law "prevents secured creditors from starting a downward spiral of foreclosures and bank failures that could result in the failure of the entire economy.").

[65] *See* NATIONAL BANKRUPTCY REVIEW COMMISSION, BANKRUPTCY: THE NEXT TWENTY YEARS 680 (1997).

[66] *See* Stuart D. Root, *Bank Capital, Asset Liquidation, and the Credit Crunch*, 1993 COLUM. BUS. L. REV. 169, 182-183, 183 n.66 (FDIC chairman, William Seidman testified before the House Comm. On Banking, Finance, and Urban Affairs, 101st Cong., 2d Sess. 28 (1990), but Congress "seemingly ignored . . . estimate[s] that assets lose up to twenty percent of value when they are taken over by the government for disposition. A liquidation program involving hundreds of billions of dollars in assets is thus bound to have an adverse impact on the values of assets held by institutions.") (footnotes omitted).

Second, chapter 11 also serves to implement important federal policies protecting ownership investments in real estate. Contrary to the assertion that SARE cases are two party disputes, many cases involve the interests of numerous owners who have invested in the real estate project.[67] As a normative matter, chapter 11 protects general partners or guarantors who might be liable for foreclosure deficiencies from the risk of an unfair[68] or inefficient state foreclosure process. As a consequence, partners and guarantors can make efficient decisions ex ante whether to invest in real estate projects.[69] Moreover, minimizing foreclosure deficiencies has a beneficial second order effect. The tax recapture liability of partners in a debtor real estate partnership is reduced by the efficiencies of chapter 11. Thus governments do not reap a windfall based on artificially low foreclosure prices.[70]

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[67] Some cases also involve unsecured creditors, such as vendors, property managers, and tenants.

[68] Although law and economics scholarship generally has steered clear of distributional issues, recently economic analysis in the literature has attacked the propriety of making fairness-based assessments. *See, e.g.,* Louis Kaplow & Steven Shavell, *Fairness Versus Welfare*, 114 HARV. L. REV. 961, 1011 (2001) ("Our argument for basing the evaluation of legal rules entirely on welfare economics, giving no weight to notions of fairness, derives from the fundamental characteristic of fairness-based assessment: such assessment does not depend exclusively on the effects of legal rules on individuals' well-being. As a consequence, satisfying notions of fairness can make individuals worse off, that is, reduce social welfare. "). In this article, by unfair, I refer to a state foreclosure statute that provides insufficient notice or auction procedures to produce a fair market price. *See supra* note 60 and accompanying text. Some commentators might argue that the state foreclosure system is part of the property owner's bargain when it obtains the mortgage. Others might reply that the property owner's right to file for chapter 11 relief was a risk the mortgage holder took when it made the loan.

[69] Congress changed the risk/reward ratio for real estate investments in 1986 when it withdrew tax incentives to invest in real estate and enacted passive activity loss rules. *See* Daniel S. Goldberg, *Tax Subsidies: One-Time Vs. Periodic, An Economic Analysis of the Tax Policy Alternatives*, TAX L. REV. 305, 340 (Winter 1994). But chapter 11 remains an important part of the risk/reward ratio by protecting owners from immediate loss of their investments in the event their business faces a liquidity crisis. *See, e.g.,* Elizabeth Warren, *Bankruptcy Policymaking in an Imperfect World*, 92 MICH. L. REV. 336, 357-58 (1993) (describing the policies of chapter 11 to encourage risk taking); Lynn M. LoPucki, *Strange Visions in a Strange World: A Reply to Professors Bradley and Rosensweig*, 91 MICH. L. REV. 79, 100 (1992) (Chapter 11 offers "the owners, and more importantly the creditors, an alternative to putting the debtor's assets on the auction block" when the debtor faces a liquidity crisis.).

[70] Federal and state governments impose taxes on depreciation recapture and capital gains arising from loan foreclosures whether or not the loan is recourse. *See, e.g.,* 26 U.S.C. §§ 1231, 1245, 1250 (West 2000). The concept of a nonrecourse loan in bankruptcy is described by the Supreme Court in Johnson v. Home State Bank, 501 U.S. 78, 86 (1991) (defining nonrecourse loans as "agreements where the creditor's only rights are against property of the debtor, and not against the debtor personally") (citing H.R. Rep. No. 95-595, at 312, U.S. Code Cong. & Admin. News 1978). Taxpayers who dispose of property subject to nonrecourse debt in excess of basis typically must pay tax on an amount of gain equal to the excess. *See* Commissioner of Internal Revenue v. Tufts, 461 U.S. 300, 361, 103 S. Ct. 1826, 1836 (1983). For a thorough description of how real property foreclosures create taxable gains, *see* Interhotel Co. v. C.I.R., 2001 WL 705960 (U.S. Tax Ct. June 22, 2001) ("In a nonrecourse debt financing situation, the lender agrees that it

Third, macro-economic and social policies also favor reorganization of SARE debtors. Granting SARE debtors meaningful access to chapter 11 not only makes good economic sense, it is good social policy. Since most lenders are the successful bidders at foreclosure sales,[71] by facilitating reorganization and retention of ownership, chapter 11 prevents an undue concentration of real estate ownership by large financial institutions during economic downturns.[72] Moreover, some commentators have contended that chapter 11 allows the bankruptcy court to consider equitable, community, and other factors in ruling on a mortgage holder's relief from stay motion.[73] For example, a court might consider that "[m]any

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will not maintain a collection action directly against the debtor. Rather, should the debtor default, the lender's only recourse is the institution of foreclosure proceedings with respect to the property securing the debt. Accordingly, if the value of the property securing the debt falls below the amount of the debt, it is the lender, not the debtor, who bears the risk of loss. Nevertheless, it is well settled that for tax purposes, nonrecourse debt incurred to acquire property constitutes a part of the debtor's cost basis in the property it has purchased. Accordingly, the amount of debt (even nonrecourse debt) increases the amount the debtor/taxpayer may claim for depreciation with respect to encumbered property. However, when the debtor disposes of the property, the debtor must include in the amount realized from the disposition of the property the amount of any remaining nonrecourse debt to which the property is subject. Thus, if the debtor has taken deductions (such as depreciation deductions) that have reduced its basis in the property to an amount less than the amount of the nonrecourse debt, the debtor must recognize gain at least to the extent that its basis is exceeded by the amount of debt secured by the property."). Gregory M. Stein, *The Scope of the Borrower's Liability in a Nonrecourse Real Estate Loan*, 55 WASH. & LEE L. REV. 1207 (1998) ("[U]ntil 1986, limited partners received significant tax advantages when their partnerships borrowed on a nonrecourse basis rather than on a recourse basis. A partner can deduct allocable partnership losses up to the amount of that partner's basis in the partnership, and a limited partner's basis is increased to account for nonrecourse debt but generally not for recourse debt. This advantage caused passive investors to favor limited partnerships with nonrecourse debt. Partnerships that wished to attract capital almost had to borrow on a nonrecourse basis, a fact which lenders understood fully.") (footnotes omitted).

[71] Basil H. Mattingly, *The Shift From Power to Process: A Functional Approach to Foreclosure Law*, 80 MARQ. L. REV. 77, 101 (1996) (stating that lenders rely on foreclosure "to control their collateral, to cut the borrower out of the title picture" because they "generally anticipate being the purchaser at foreclosure sales") citing Maury B. Poscover, *A Commercially Reasonable Sale Under Article 9: Commercial, Reasonable, and Fair to All Involved*, 28 LOY. L.A. L. REV. 235, 246 (1994) ("Typically, lenders are the successful bidders at foreclosure sales. After buying the property the lenders take the property into their portfolio . . . [and] hire real estate agents to locate prospective purchasers.").

[72] The Savings and Loan debacle in the United States during the 1980's provides an example. Government regulators seized several savings and loan associations and forced most of them to simultaneously market and sell real estate owned. As a result, the market was flooded with real estate inventory and prices plummeted. *See* Daniel S. Goldberg, *Tax Subsidies: One-Time vs. Periodic - An Economic Analysis of the Tax Policy Alternatives*, 49 TAX L. REV. 305, 341 (1994) ("[P]rices declined further and the market became flooded with available real estate.").

[73] *See, e.g.,* Raymond T. Nimmer, *Real Estate Creditors and the Automatic Stay: A Study in Behavioral Economics*, 1983 ARIZ. ST. L.J. 281 (1983) ("A secured creditor who can remove the stay may gain a substantial economic benefit. Depending on the relationship between the secured collateral and the debtor's overall estate, denial or delay of foreclosure may be vital to ultimate completion of a plan for relief . . . . [Economic and financial] factors are not the only considerations that courts apply . . . . The result is a general balancing of equitable factors . . . that is significantly more complex than the pure economic evaluation often suggested in the

foreclosures occur in inner-city neighborhoods occupied by low-income groups . . . fac[ing] unemployment in an economic downturn . . . [and] are thus more likely to default on their mortgage loans and less able to avoid foreclosure."[74]

It appears that these three arguments held sway against law and economics arguments to the contrary. For reasons that were not articulated in Congressional debates concerning the 2001 Amendment, neither Congress nor the mortgage holders embraced arguments to exclude SARE debtors from chapter 11.[75] Perhaps they were aware that within the realm of economics, in opposition to the efficiency arguments identified at the beginning of this part C, some commentators believe that chapter 11 reorganization promotes allocative efficiency by comparison with foreclosure under state law.[76] Or perhaps they reasoned in accordance with the three arguments discussed above in response to the efficiency and common pool problems: even if state law foreclosure is more efficient than chapter 11 under most market conditions, when real estate markets are turbulent, our experience with the Depression teaches that state law foreclosure imperils both borrowers and lenders. Moreover, we should not forget that our laws are passed by politicians, many of whom consider issues of fairness and equity that generally are outside the realm of allocative efficiency.[77] As identified above, these concerns

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literature."). *See generally* Karen Gross, *Taking Community Interests Into Account In Bankruptcy: An Essay*, 72 WASH. U.L.Q. 1031, 1031 (1994) (arguing that community interests must be taken into account in bankruptcy).

[74] *See* Washburn, *supra* note 61, at 853.

[75] Some witnesses argued policies based on efficiency to urge repeal of the $4 million cap, but not to support an outright ban on SARE debtors' access to chapter 11. *See* Testimony of Donald R. Ennis, *Hearings on H.R. 764 and H.R. 120 before the Subcomm. on Commercial and Admin. Law of the House Comm. on the Judiciary*, 105th Cong., 1st Sess. 106, 106, 109 (April 30, 1997) available at 1997 WL 225308 [F.D.C.H.] and on line at http://commdocs.house.gov/committees/judiciary/hju41948.000/hju41948_0f.htm and http://www.house.gov/judiciary/557.htm (last visited Sept. 11, 2001) (Repeal of the $4 million cap is necessary "to permit the efficient operation of the single asset provisions and the fulfillment of their purpose.").

[76] Contrary to the argument that allocative efficiency requires strict foreclosure without redemption, some commentators who analyze actual economic data have found that mortgagor protection laws "may indeed promote economic efficiency." *See, e.g.,* Michael H. Schill, *An Economic Analysis of Mortgagor Protection Laws*, VA. L. REV. 489, 491 (1991) (empirical study). "[V]iewed from an ex ante perspective, mortgagor protections may promote, rather than impede, economic efficiency by functioning as a form of insurance against the adverse effects of default and foreclosure." *See id.* at 538. This article does not attempt to resolve which commentators are correct, whether state law foreclosure systems are preferable to chapter 11, or which group has the burden of proof in evaluating comparative economic efficiencies. Rather, this article proceeds on the basis that that Congress has adopted chapter 11 as a federal alternative to state law foreclosure.

[77] *See* Shavell & Kaplow, *supra* note 68, arguing that economic analysis should give no weight to notions of fairness.

could well support a political decision to allow SARE debtors access to chapter 11. As discussed below, that is what the politicians did.

D. The Politics.

Those interest groups that pushed for special treatment of SARE debtors could have instead called for their exclusion. Since arguments for the complete exclusion of two party disputes existed at the time of both the 1994 and 2001 Amendments, why didn't the lending industry push for an outright exclusion of SARE cases from bankruptcy? Perhaps their lobbyists counseled against trying to overturn a federal policy that is over 60 years old. Alternatively, it is possible that mortgage holders wanted their borrowers, in some cases, to have access to chapter 11.

In cases in which title to the property is clouded or the property is laced with toxic waste, for example, mortgage holders prefer to use the bankruptcy court to their own advantage.[78] When the property owner uses chapter 11, the owner is fully constrained in its activities and the property may be cleaned up, either figuratively or literally, while the mortgage holder avoids any liability that might be imposed on it by virtue of ownership that would result from foreclosure. By permitting property owners to reorganize in chapter 11, mortgage holders get the best of both worlds.

But their attraction to chapter 11 is limited: The lenders want all of the benefits of bankruptcy and also want to control the process. For example, they don't want the debtor to be able to restructure secured debt without the lender's consent.

Moreover, they are not content to receive these benefits in small SARE cases; they want them in all SARE cases.[79] Thus, they

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[78] Lenders may realize another subtle benefit of chapter 11. Mortgage holders who do not want to foreclose on defaulted real properties may use the automatic stay of borrowers' chapter 11 filings to accomplish that objective, even if the mortgage holders' government regulators would prefer immediate foreclosure. During a borrower's chapter 11 case, the automatic stay legally prevents foreclosure unless the lender obtains relief from the stay. Lenders who do not want real estate assets on their books can fail to seek relief from the automatic stay or delay the process. *See* Sutherland, *supra* note 21, at 217 ("The mortgagee has ordinarily used every resource to encourage the debtor to keep up his interest and taxes, and comes to foreclosure only when the case is hopeless. The great lending institutions are reluctant to load themselves with foreclosed real estate . . . .").

[79] *E.g.* Testimony of Jill M. Sturtevant, *Hearings on H.R. 764 and H.R. 120 before the Subcomm. on Commercial and Admin. Law of the House Comm. on the Judiciary*, 105th Cong., 1st Sess. 131, 137-38 (April 30, 1997) available on line at http://commdocs.house.gov/committees/judiciary/hju41948.000/hju41948_0f.htm and http://www.house.gov/judiciary/560.htm (last visited June 13, 2001) ("ABA [American Bankers' Association] strongly supports enactment of H.R. 764's provision striking the $4 million debt cap

influenced the Bankruptcy Commission to make a recommendation to Congress to amend the law,[80] and they financed lobbyists to shepherd that amendment into law.[81]

Taking these considerations into account, it is not surprising that in passing the 2001 Amendment, Congress nominally retained access to chapter 11 for SARE debtors while sharply reducing the meaningfulness of that access. The result is a law that permits debtors access to chapter 11, but under such tight time restrictions that, after 90 days, the debtor's functional ability to remain in chapter 11 usually is at the complete discretion of the mortgage holder. Moreover, unlike current law, the restrictive procedures of the 2001 Amendment now apply to single asset real property projects of all sizes without regard to the amount of the mortgage. With this background, we are prepared to examine the 2001 Amendment in detail as a prelude to determining whether Congress made the right choice.

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applicable to single asset realty cases."); Testimony of John A Gose, *Hearings on the Bankruptcy Commission's Report before the Subcomm. on Administrative oversight and the Courts of the Senate Comm. on the Judiciary*, 105th Cong., 1st Sess. (Oct. 21, 1997) (available at 1997 WL 659242 [F.D.C.H.]) ("No rational correlation exists between the size of a single asset real estate bankruptcy and the complexity of that transaction. A cap, which presently exists in the Bankruptcy Code, is purely arbitrary.").

[80] At the instigation of the author, a majority of the Bankruptcy Commissioners also supported an alternative recommendation that would have raised the cap but not eliminated it. NATIONAL BANKRUPTCY REVIEW COMMISSION, BANKRUPTCY: THE NEXT TWENTY YEARS § 2.6.1A, at 684 (1997).

[81] *See, e.g.,* Testimony of George J. Wallace on behalf of the Consumer Bankruptcy Reform Coalition, *Hearings on H.R. 833 before the Subcomm. on Commercial and Admin. Law of the House Comm. on the Judiciary*, 106th Cong., 1st Sess. 19-40, 345, 365-66 (March 17, 1999) available on line at
http://commdocs.house.gov/committees/judiciary/hju63593.000/hju63593_0f.htm and
http://www.house.gov/judiciary/106-wall.htm (last visited June 13, 2001); Testimony of George J. Wallace on behalf of the American Financial Services Association, *Hearings on H.R. 3150, H.R. 2500 and H.R. 3146 before the Subcomm. on Commercial and Admin. Law of the House Comm. on the Judiciary*, 105th Cong., 2d Sess. 95-113, 171, 174, 185, 187-89, 193-200, 202 (March 12, 1998) available on line at
http://commdocs.house.gov/committees/judiciary/hju54594.000/hju54594_0f.htm and
http://www.house.gov/judiciary/5347.htm (last visited June 13, 2001);
Testimony of Lloyd N. Cutler on behalf of the Bankruptcy Issues Council, *Hearings on H.R. 3150, H.R. 2500 and H.R. 3146 before the Subcomm. on Commercial and Admin. Law of the House Comm. on the Judiciary*, 105th Cong., 2d Sess. 53-57, 70, 81-86 (March 10, 1998) available on line at
http://commdocs.house.gov/committees/judiciary/hju52831.000/hju52831_0f.htm and
http://www.house.gov/judiciary/5167.htm (last visited June 13, 2001).

II. THE 2001 AMENDMENT EXPLODES THE CAP

A. The Rationale for Congressional Action.

The Bankruptcy Reform Act of 2001 abolished the $4 million cap on the definition of SARE based on arguments made at congressional hearings that essentially one size reorganization procedure could fit all.[82] Congress was told and convinced that a real estate case is a real estate case is a real estate case, whether it is an apartment house or the Waldorf Astoria Hotel.[83] Some witnesses told Congress that the $4 million cap should be repealed because large properties have the same maintenance and tax problems and the same recapitalization problems as small properties.[84] Repeal of the $4 million cap is necessary "to permit the efficient operation of the single asset provisions and the fulfillment of their purpose."[85] Other witnesses and commentators took the position that some cap was appropriate but had no hard data to support their claims.[86] Although a few witnesses suggested banning SARE cases from chapter 11

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[82] *See supra* note 79. One Congressman characterized the repeal of the $4 million cap as necessary to cure an "injustice" stemming "from a last-minute decision that was made in the 103rd Congress, which placed an arbitrary $4 million ceiling on the single asset provisions of the bankruptcy reform bill. The effect has been to render investors helpless in foreclosure on single assets valued at over $4 million. " *See* 145 CONG. REC. H 2713 (May 5, 1999) (statement of Rep. Kollenberg). Inexplicably, Congress adopted exactly the opposite rationale in expanding the debt threshold from $2 million to $3 million in the definition of small business debtors for the purpose of segregating small businesses from larger businesses. *See* § 432 of the Bankruptcy Reform Act, amending the definition of "small business debtor" in section 101(51)(D) of the Bankruptcy Code to cover businesses that have "aggregate noncontingent, liquidated secured and unsecured debts . . . in an amount not more than $3,000,000 . . . . "

[83] *See In re* Penn Central Transp. Co., 354 F. Supp. 717 (E.D. Pa. 1972) (Penn Central held the ground lease on the Waldorf Astoria). After the 2001 Amendment, if the ground lease were real property held by an SARE debtor, section 362(d)(3) would apply to it.

[84] *See supra* note 79.

[85] *See supra* note 75.

[86] *E.g.* Testimony of Kenneth N. Klee, *Hearings on H.R. 764 and H.R. 120 before the Subcomm. on Commercial and Admin. Law of the House Comm. on the Judiciary*, 105th Cong., 1st Sess. 20, 22, 25-26, 37 (April 30, 1997) available on line at http://commdocs.house.gov/committees/judiciary/hju41948.000/hju41948_0f.htm and http://www.house.gov/judiciary/553.htm (last visited June 12, 2001) ("I would have to think a $10 million limit would bring in the lion's share of the projects . . . ."). *See* Lawrence Ponoroff, *The Dubious Role of Precedent in the Quest for First Principles in the Reform of the Bankruptcy Code: Some Lessons From the Civil Law and Realist Traditions*, 74 AM. BANKR. L.J. 173, 195 (2000) ("Wisely, until now, the definition of "single asset real estate" has been limited to debtors with below a certain maximum level of secured debt . . . ."). After the Congressional hearings, Professors Warren and Westbrook analyzed hard data and concluded that 72 percent of the SARE cases are already covered by the $4 million cap and raising the cap to $15 million would capture 94 percent of the cases. *See* Elizabeth Warren & Jay L. Westbrook, *Financial Characteristics of Business in Bankruptcy*, 73 AM. BANKR. L.J. 499, 543 (1999).

altogether, others said chapter 11 played an important role for SARE cases.

One policy argument was made, to no avail, in support of retaining the $4 million cap and treating large SARE debtors the same as other chapter 11 debtors. It was argued that separate treatment of all SARE debtors from other debtors would induce lenders to force borrowers to incur transaction costs to form new single asset entities to finance each property, even if the properties are owned by the same real party in interest. That is, if a manufacturer seeks financing for construction of a $50 million plant, a rational lender will require the manufacturer to form a single asset company to hold title to the real estate and become the borrower. The lender may force the manufacturer to guarantee the debt. As a result, the manufacturer will not avoid liability on the loan, and will incur the transaction costs of forming the single asset company and maintaining separate tax, accounting, and legal records. Moreover, in the event of insolvency of several related projects, instead of the manufacturer filing bankruptcy for one company that owns several properties, the manufacturer will file a separate bankruptcy petition for each company that holds a troubled project, resulting in payment of multiple filing fees and the costs of multiple bankruptcy administrations.[87]

In this light, it is reasonable to question why Congress abandoned the line it drew in 1994. Was the change occasioned by lobbying pressure from secured lenders, did circumstances change after 1994, was Congress wrong in enacting the cap in the first in 1994? Certainly the shared experience that led Congress to adopt the $4 million cap in 1994 suggested that the group of larger SARE cases had more complex debt structures, greater capacity to service chapter 11 administrative expenses, and a greater likelihood of confirming a plan.[88] That is why Congress enacted special rules only for smaller

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[87] This strategic behavior certainly is one downside of the Bankruptcy Reform Act of 2001, which lets lenders opt out of the normal chapter 11 rules by requiring borrowers to compartmentalize real property assets. Another theoretical byproduct of the recent Act is that it should reduce monitoring by unsecured creditors. Why should unsecured creditors pay attention to SARE cases since secured lenders will dominate and quickly foreclose or receive assets as interest payments? In the author's experience, however, even before the Act was passed, because they have little at stake individually, unsecured creditors seldom monitored SARE cases.

[88] *See, e.g.,* Lynn M. LoPucki & William C. Whitford, *Patterns in the Bankruptcy Reorganization of Large, Publicly Held Companies*, 78 CORNELL L. REV. 597, 600 (1993) (reporting a 96 percent confirmation rate for large, public companies). Lynn M. LoPucki & Sara Kalin, *The Failure of Public Company Bankruptcies in Delaware and New York: Empirical Evidence of a Race to the Bottom*, 54 VAND. L. REV. 231, 256 (2001) (table showing extremely high confirmation rate for large, public companies through 1997).

SARE debtors. Anecdotal testimony led Congress to believe that as a group smaller debtors, for the most part, had simple debt structures, little capacity to service chapter 11 administrative expenses, and no reasonable likelihood of confirming a plan. For the small SARE debtors, it made sense for Congress to pretermit the chapter 11 process. But the same was not true for larger SARE debtors in 1994 and it remains untrue in 2001. If there is a reasonable likelihood that, as a group, large SARE debtors will be able to confirm chapter 11 plans, what rationale justifies subjecting these debtors to the strictures of section 362(d)(3)? Indeed, if the data show that most large SARE cases have a reasonable possibility of confirming a chapter 11 plan, it makes more sense as a matter of policy for Congress to raise the $4 million cap to a dollar sum certain than to abandon it all together. Perhaps Congress believed that if the cap worked well for small SARE debtors, it should be extended to all SARE debtors.

B. Predicted Effects of Blowing Up the Cap.

Whether or not Congress justifiably exploded the $4 million cap, it changed the law, and parties in SARE cases will have to adapt to those changes.[89] The new reality for large SARE debtors is that they will be subject to lenders' threats to bring, and actual filing of, motions for relief from the automatic stay under section 362(d)(3). How will this change in leverage affect the way chapter 11 works for large SARE debtors? Certainly it will be unreasonable for many large SARE debtors to file a plan within 90 days after the order for relief. To be sure, the court can extend this time for "cause,"[90] but why should the large SARE debtor have to bear the cost, burden, and uncertainty of bringing such a motion? The cost of bringing a motion is inevitable and not recoupable. The burden of proving the "cause" for extension is on the large SARE debtor, unlike all other large debtors who have a minimum 120-day plan exclusivity period within which to file a plan and do not face automatic foreclosure if they fail to file a plan within that period. The uncertainty whether the judge will grant the extension motion is obvious; in fact many judges have displayed open hostility toward SARE debtors.[91]

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[89] *See id.* and accompanying text.

[90] *See supra* note 11.

[91] Generally judicial hostility is manifested through a judge's characterization of the SARE debtor as having filed its bankruptcy petition "in bad faith." *See, e.g., In re* Boulders on the River, Inc., 164 B.R. 99, 103 (BAP 9th Cir. 1994) ("Bad faith exists if there is no realistic

Of course the debtor has the theoretical option of commencing payments to the mortgage holder. But many SARE debtors are illiquid.[92] The SARE debtor might be cash poor because the real estate project is not completed, because money is needed for repairs, maintenance, or renovation, or because a down market has created large vacancy rates. Moreover, in most SARE cases, the mortgage holder has a lien on the rents.[93] Before enactment of the Act, mortgage holders persuaded some courts that rents are additional collateral that must be protected separately and are unavailable to protect a mortgage holder's lien on the real property project.[94] One

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possibility of reorganization and the debtor seeks merely to delay or frustrate efforts of secured creditors.") (citing *In re* Albany Partners, Ltd., 749 F.2d 670, 674 (11th Cir. 1984); *In re* Timbers of Inwood Forest Assocs., Ltd., 808 F.2d 363, 384 (5th Cir. 1987) ("To the extent that the debtor in bankruptcy can prevent the secured creditor from enforcing its rights against collateral while the debtor benefits from the creditor's money, the debtor and his unsecured creditors receive a windfall at the expense of the secured creditors."). Courts often dismiss debtor's chapter 11 petition for filing in "bad faith." *See, e.g.,* Singer Furniture Acquisition Corp. v. SSMC, Inc. N.V., 254 B.R. 46, 60 (M.D. Fla. 2000); *In re* Albany Partners, Ltd., 749 F.2d 670, 675 (11th Cir. 1984); *See also In re* Pacific Rim Investments, LLP, 243 B.R. 768, 773 (D. Colo. 2000) (rejecting "the argument that the ability to reorganize precludes dismissal for bad faith").

[92] *See supra* note 38 and Lynn M. LoPucki, *Strange Visions in a Strange World: A Reply to Professors Bradley and Rosensweig*, 91 MICH. L. REV. 79, 100 (1992) (Chapter 11 offers "the owners, and more importantly the creditors, an alternative to putting the debtor's assets on the auction block" when the debtor faces a liquidity crisis.).

[93] In some SARE cases the mortgage holder has an "absolute assignment" of the rents whereby the mortgage holder owns the rents until the mortgage is paid. *See, e.g., In re* Ventura-Louise Properties, 490 F.2d 1141, 1143 (1974) ("Provisions granting to the mortgagee the right to collect rents in event of default may be attached to a mortgage or trust deed. Such an agreement can provide for an absolute assignment of rents upon default. 'It has been held that such a provision, rather than pledging the rents as additional security, operates to transfer to the mortgagee, the mortgagor's right to the rentals upon the happening of a specified condition.'") (citation omitted). Although beyond the scope of this article, discussion of rents has created a large body of literature. Not less than 64 law review articles have "rents" in the title. Of these, not less than 17 also mention *Ventura-Louise*. *See, e.g.*, Joanne N. Davies, *FNMA v. Bugna: California Assignment of Rents Provision and the Impact of the Bankruptcy Reform Act of 1994*, 31 LOY. L.A. L. REV. 1453 (1994); David Gray Carlson, *Rents in Bankruptcy*, 46 S.C. L. REV. 1075 (1995); John C. Siemers, *The Mortgagee's Lien Against Rents*, 25 TEX. TECH. L. REV. 873 (1994); Julia Patterson Forrester, *A Uniform and More Rational Approach to Rents as Security for the Mortgage Loan*, 46 RUTGERS L. REV. 349 (1993); Patrick A. Randolph, Jr., *When Should Bankruptcy Courts Recognize Lenders' Rents Interests?*, 23 U.C. DAVIS L. REV. 833 (1990); Sandra Elzerman, *Interests in Collaterally Assigned Rents and Profits Under the Bankruptcy Code*, 22 HOUS. L. REV. 1251 (1985).

[94] *See, e.g., In re* 499 W. Warren St. Assocs., Ltd. P'ship, 142 B.R. 53, 56 (Bankr. N.D.N.Y. 1992) ("A secured creditor holding both a mortgage securing a debt on a parcel of real property, and a perfected security interest in rents derived therefrom, holds two distinct interests. *See In re Landing Associates, Ltd.*, 122 B.R. 288, 296 (Bankr. W.D. Tex. 1990); *In re Apple Tree Partners, L.P.*, 131 B.R. 380, 400 (Bankr. W.D. Tenn. 1991). The value of each of these interests must be separately considered and, if necessary, adequately protected."); *In re* Landing Assocs., Ltd., 122 B.R. 288, 296 (Bankr. W.D. Tex. 1990) (claiming "adequate protection to the secured creditor with an assignment of rents" with "an assignment of rents confer[ring] rights which have discrete value apart from the underlying deed of trust interest in the real property generating those rents."); *In re* Apple Tree Partners, L.P., 131 B.R. 380, 400 (Bankr. W.D. Tenn. 1991) (citing *In re* Landing Assocs., Ltd., 122 B.R. 288, 296 (Bankr. W.D. Tex. 1990), "[A]n assignment of rents

beneficial provision in the Act makes rents available to satisfy the debtor's payment obligation under section 362(d)(3).[95] But in many cases, the net rents will be insufficient to service the debtor's payment obligation in full. Thus in many SARE cases, the debtor's option to commence making payments will be unrealistic.

If the debtor cannot file a confirmable plan within the fast track of section 362(d)(3), commence making payments to the mortgager holder, or persuade the court to grant an extension of time, then the mortgage holder is effectively in complete control of the chapter 11 process. If the property has a feature, such as environmental waste, where the mortgage holder might benefit by leaving the property in chapter 11, the mortgage holder grants an extension of time or fails to foreclose following relief from the stay. Alternatively, if the borrower faces tax problems in the event of foreclosure, the lender can threaten foreclosure to extract a contribution of new equity into the project to reinstate the loan and restore it to a performing asset on the lender's books. On the other hand, if the property has potential upside and the mortgage holder desires to capture this upside for its own benefit, then the mortgage holder gets relief from the automatic stay and the right to foreclose on the property. In essence, the chapter 11 case is over. Although this might be good news for the mortgage holder, it is bad news for the property owner who loses the opportunity to reorganize.

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confers rights which have discrete value apart from the underlying deed of trust interest in the real property generating those rents."); *In re* Madera Farms P'ship, 66 B.R. 100, 103 (9th Cir. 1986) ("It is clear that the rents are additional collateral."); Mortgage Guarantee Co. v. Sampsell, 124 P.2d 353, 356 (Cal. App. 1942) ("There can be no question but that the assignment of rentals in the deed of trust constituted additional primary security with the real property described in the deed of trust and the personal property described in the chattel of mortgage. Title Guaranty & Trust Co. v. Monson, 11 Cal.2d 621, 81 P.2d 944.").

[95] Pub. L. No. 107-xxx, *supra* note 5, at § 444(2) amended section 362(d)(3)(B) to preclude relief from the stay under section 362(d)(3) if:

> (B) the debtor has commenced monthly payments that—
>
> > (i) may, in the debtor's sole discretion, notwithstanding section 363(c)(2), be made from rents or other income generated before or after the commencement of the case by or from the property to each creditor who whose claim is secured by such real estate (other than a claim secured by a judgment lien or by an unmatured statutory lien); and
> >
> > (ii) are in an amount equal to interest at the then applicable nondefault contract rate of interest on the value of the creditor's interest in the real estate; . . .

III. DATA FROM SARE CHAPTER 11 CASES

A. Methodology.

Talk is cheap. It is easy to criticize Congress for failing to develop data about the operation of SARE cases before it passed significant changes, but it is much harder to develop those data. This is especially so for scholars and others who work with limited access to the underlying data and limited means to fund the needed research. Given the importance of bankruptcy law and the constitutional requirement that any federal bankruptcy law be uniform, however, it is astounding that Congress has not developed better bankruptcy data on which to base its legislative decisions. There is no national database of bankruptcy court records; bankruptcy courts compile and store their records locally. No separately recorded data on SARE cases are collected by the Administrative Office of the United States Courts. This means that the resources necessary to draw a national sample of SARE cases would be beyond the reach of a single researcher.

Faced with the prospect of cursing the darkness or lighting a very small candle, however, I decided to study what I could. I drew two samples. The first was a national sample of all reported SARE decisions augmented by data on unreported SARE cases sent to me by lawyers in response to a questionnaire. The second extracted SARE data from files of all chapter 11 cases administered by a single judge in Los Angeles. I refer to the first sample as the "National" dataset and the second sample as the "LA" dataset. I also combined the National and LA datasets into a "Combined" dataset.

I began this research by collecting every published bankruptcy court opinion dealing with a SARE chapter 11 case, despite the shortcomings of such a database. Published opinions may be grist for law school classes, but they are not random samples of all the cases decided. Indeed, the fact that an opinion is published is a fair indication that something is aberrational in the case. This defect afflicts any study of published opinions, although in the bankruptcy area it is ameliorated by the fact that trial courts—not just appellate courts—publish their decisions. That difference makes a database drawn from bankruptcy court opinions somewhat closer to a representative sample and the underlying reality, although the cases in which there was a sufficient dispute to prompt a published opinion are obviously somewhat different from a perfect cross-section of all the underlying cases. The cases that result in a written opinion may

involve more money or more contentious creditors or more aggressive lawyers. Thus despite these limitations, a database consisting of all published SARE cases, dominated by cases from the bankruptcy trial courts themselves, can shed some light on the operation of real estate chapter 11 cases.

Therefore, in order to test the reasonableness of abolishing the $4 million cap, I studied every reported SARE chapter 11 case from October 1, 1979 through December 31, 1997 to extract the following data, among others:[96]

- type of property;
- valuation range of the property;
- whether there was an out of court settlement, cram down, or consensual plan;
- whether maintenance and taxes were current pre-workout or prepetition;
- the terms of the senior and any junior indebtedness pre- and post-restructuring or plan confirmation; and
- any treatment of the old equity under the plan.

In total, the database contains 16 categories of information pertaining to various factual aspects of the cases.

To gather some information about a cross-section of SARE cases that did not result in a published opinion, I developed and circulated a questionnaire to 302 bankruptcy lawyers, 90 selected from my own experience as bankruptcy specialists and 212 from a bar association's membership list.[97] The questionnaire asked each lawyer

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[96] Because I am not recommending a specific debt limit for Congress to adopt, I was not trying to develop a specific dollar value and so I did not adjust debts and property values for the dataset to constant dollars for a specific base year. My hypothesis is that adjusting the data over time is an appropriate fine tuning of my methodology, but unnecessary to support the trends identified in this article. To make certain, however, that the data are not distorted by inflationary differences, the debts and property values were recomputed using an inflation adjustment based on the year of the bankruptcy filing. It is possible, of course, that the mortgage debt or property valuation was made a year or two after filing, but this adjustment helps to eliminate most of the inflationary effects. Of the 45 cases in the National dataset, only 32 have information on the year in which the chapter 11 petition is filed. It appears, however, that most of the remaining 13 cases were filed between 1987 and 1993. I used 1990 as a proxy-valuation year for these data and used actual filing years for the 32 cases in which I had filing data. I adjusted the values using the Consumer Price Index, and re-ran the regression. The Nagelkerke Pseudo-R^2 (*see infra* note 150) is very similar (.44), the coefficients are almost identical, and the significance levels improve. The p-value for property value is .0043, and for value-to-loan ratio is .0184. In sum, inflation does not appear to have a measurable effect on my results.

[97] Specifically, I sent 89 letters on February 5, 1998, 53 letters on April 9,1998, 64 letters on April 16, 1998, and 95 letters on April 28, 1998 to bankruptcy specialists known to me and to members of the American Bar Association Business Bankruptcy Committee. I also sent one email transmitting the questionnaire. In response, I received questionnaires describing 16 SARE

to provide the same kinds of information on all SARE cases in which they were involved since October 1, 1979.[98] As described below, this effort permitted expansion of the initial 30 usable case[99] data base by another 15 cases.[100]

Many of the reported decisions and a few of the questionnaires did not contain complete data in every category. To fill gaps in the data, I asked attorneys involved in the cases to provide additional information so that I could improve the database.[101] The database included 152 cases with sufficiently complete information for an extended analysis. Those 152 cases included 120 bankruptcy court decisions, 13 appellate court decisions, and 19 cases generated from the questionnaires, representing unpublished cases. Many of the 152 entries in the database, however, involved the same SARE reorganization case due to multiple reported decisions on the same property by the bankruptcy and appellate courts. Duplicate entries were deleted from the database, although data on a particular SARE project were derived from all related reports.[102]

The resulting dataset involved 45 usable cases comprising the National data set. Because of the relatively small number of observations in the dataset and the lack of randomness in the sample selection, I decided to try to develop another database to test the robustness of my findings.

While I was collecting my initial database on SARE cases, a unique opportunity to examine detailed court records came my way.

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cases. The response rate is low probably due to the time and expense required of respondents to assemble the requested information.

[98] I extracted the data from the case law and questionnaires and entered it into a Microsoft Excel spreadsheet. A sample questionnaire is reproduced *infra* in the Appendix.

[99] I define the term "usable case" to mean a case with sufficiently complete information for an extended statistical analysis.

[100] It is possible that the low response rate producing these 15 cases could lead to sample bias. Confirmation rates for these cases are significantly higher than the reported decisions. This disparity may reflect a judicial bias to write and publish opinions denying confirmation or it may reflect a bias on the part of attorneys in submitting data on confirmed cases in response to my questionnaire. Additional research would be necessary to resolve these issues.

[101] I used printouts of each published case listed in the database. It was necessary to read the case, first highlighting the pertinent information and then transferred it to the database. I retained for the file printouts that contained data included in the study.

[102] None of the cases included in the database involved repeat filings where the same debtor or project was in chapter 11 on more than one occasion. Some commentators view continuation of the business or the lack of a repeat filing as an essential measure of success. *See* Lynn M. LoPucki, *The Debtor in Full Control – Systems Failure Under Chapter 11 of the Bankruptcy Code*, 57 AM. BANKR. L.J. 99, 106-08 (1983). For purposes of this article, however, I measured initial confirmation of a chapter 11 plan without regard to repeat filings. This is the goal Congress has established for chapter 11 cases. The Bankruptcy Code permits a chapter 11 plan to be confirmed based on a reasonable likelihood (rather than certainty or a strong probability) that confirmation will not be followed by liquidation or further financial reorganization of the debtor. *See* 11 U.S.C. § 1129(a)(11) (West 2000).

When Judge Lisa Hill Fenning decided to leave the bench in February 2000, she offered to give me nine boxes of court documents she had collected on her bankruptcy cases in the Central District of California. Judge Fenning had compiled files on each business bankruptcy case over which she presided from 1987 through 1995 during her tenure on the bench. She collected case files on all kinds of chapter 11 cases she heard, not just on the handful about which she wrote published opinions. A few words about her cases are in order. First, chapter 11 case assignment in the Central District of California is random; SARE cases were not singled out for assignment to a single judge. Presumably, all judges had an equal likelihood of hearing a SARE case. Although it is one of ninety-four judicial districts around the country and its territories, the Central District is the largest in terms of number of chapter 11 business bankruptcy cases filed.[103] From 1987 through 1995, its 12,088 filed chapter 11 business cases constituted over 8 percent of all business bankruptcy cases filed nationally.[104] Although it is not possible to say whether Judge Fenning's cases were a cross-section of cases filed across the country, her cases represent a sample of one of the most active bankruptcy courts in the country. Even though these cases reflect the administration of only one judge in only one district, they provided a crosscheck against which I tested my findings from my initial broader-based dataset.

I examined the contents of the Fenning nine boxes to extract every SARE chapter 11 case. In some instances, the case file documents were incomplete or merely face-page filings with no supporting data, but there were records of far more SARE cases than appeared in reported opinions. Fortunately, many of the SARE cases had detailed records. The documents typically included bankruptcy petitions, schedules, and statements of financial affairs. If the case resulted in a confirmed plan, the plan also was included.

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[103] *See, e.g.,* 3 THE BANKRUPTCY YEARBOOK & ALMANAC 14-16 (1993) (Chapter 11 business case filings in the Central District of California constituted about 9 percent of all chapter 11 business cases filed nationally). Based on data compiled by the Administrative Office of United States Courts, during 1987-1995, the Central District of California was the venue for 12,088 chapter 11 business bankruptcy cases, representing 8.18 percent of the 147,849 business bankruptcy chapter 11 cases filed nationwide during those years. The next largest district was the Southern District of New York which hosted 7,471 or 5.05 percent of the business bankruptcy chapter 11 cases. *See* Administrative Office of United States Courts, Table F-2, U.S. Bankruptcy Courts Business and Nonbusiness Bankruptcy Cases Commenced by Chapter of the Bankruptcy Code, During the Twelve Month Period Ended Dec. 31, 1987 (and comparable tables for succeeding years) (on file with author).

[104] *See id.*

I reviewed each file and extracted only those cases that involved single asset real estate cases with sufficient information to identify and research the matter further. Where the data were incomplete, in order to expand the usefulness of these data, I reviewed each complete case file at the National Archives and recorded additional information pertinent to the study. The values in my "LA" database were based on the debtor's bankruptcy petition, schedules, and statement of financial affairs filed under penalty of perjury. If the debtor amended the schedules, the amended values were used. When there was a better and undisputed source of information in the case file than the data provided on the schedules, I included that source in the LA database. Examples of better sources included undisputed appraisals of real property value, undisputed declarations of creditors detailing indebtedness and arrearages, IRS statements of tax arrearages, and court findings.

The LA database yielded 83 single-asset bankruptcy cases that contained 23 submitted plans of reorganization. Of the 23 submitted plans, the bankruptcy court confirmed 13. The two databases, one comprised of national reported decisions and lawyer reports and a second comprised of the LA cases, offer two approaches to understanding SARE cases. I also combined the databases to conduct additional analysis, but focused primarily on the National dataset to avoid allegations that including the LA dataset in the sample would result in improper distortion.[105] Both the National dataset and LA dataset include cases filed after the effective date of the 1994 Amendments. Although it is possible that the 1994 Amendments caused a higher percentage small cases to fail to confirm plans, I did not segregate the data to test this hypothesis. I chose to use the National dataset to test my hypotheses initially and the LA dataset and Combined datasets to test the robustness of my findings.

B. The Findings

The overriding question about SARE cases is whether the game is worth the candle? Does the debtor's opportunity to reorganize bear fruit or does it simply impose cost and delay on the mortgage holder as some law and economics theorists suggest? The answer to this question necessarily sets the parameters for every other discussion about the SARE process.

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[105] The author knows of no reason why SARE cases administered in Los Angeles or by Judge Fenning would be treated differently from judges in other judicial districts.

To begin to answer this question, I analyzed the data to determine the frequency with which SARE debtors confirmed chapter 11 plans.[106] Based on the 45 cases in the National database, 17 debtors (38%) confirmed plans. Some plans resulted in restructuring the secured debt while the debtor retained ownership of the property. Other plans resulted in the sale of the property. Still other plans were hybrids where the debtor retained the property for a specified time and committed to sell the property or permit foreclosure if the mortgage holder's restructured debt was not repaid within that time.

When chapter 11 was enacted, Congress noted that "[t]he purpose of a reorganization . . . case is to formulate and have confirmed a plan of reorganization . . . for the debtor."[107] Although confirmation of a SARE plan is not a fool-proof surrogate for positive social value,[108] it is the recognized hallmark of a successful chapter 11 case,[109] even if some commentators regard it as under-inclusive[110] or

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[106] Previous studies have analyzed the success real property debtors had in liquidating properties and concluded that only one in seven (about 14 percent) were successful. *See* Lynn M. LoPucki, *The Debtor in Full Control – Systems Failure Under Chapter 11 of the Bankruptcy Code*, 57 AM. BANKR. L.J. 99, 109 & n. 49 (1983). *See also See also* Jerome R. Kerkman, *The Debtor in Full Control: A Case For Adoption of the Trustee System*, 70 MARQ. L. REV. 159, (1987) ("[Between 74 and 76 percent] of the operating businesses entering Chapter 11 proceedings were destined to fail . . . .").

[107] *See* H.R. Rep. No. 595, 95th Cong., 1st Sess. 221 (1977).

[108] *See, e.g.,* Douglas G. Baird, Essay, *Bankruptcy's Uncontested Axioms*, 108 YALE L.J. 573, 584 (1998) ("Chapter 11 cannot be judged merely by counting the number of firms that reorganize successfully . . . the rehabilitation goal must be balanced against other interests, including the need to recognize the rights of creditors.").

[109] *See, e.g.,* David P. Bart & Scott Peltz, *Rethinking the Concept of "Success" in Bankruptcy and Corporate Recovery*, AM. BANKR. INST. J., May 1998, at 37 ("The emerging data suggests a far greater chance of 'success,' as narrowly defined by chapter 11 confirmations, than was suggested in previous studies."); Hon. Samuel L. Bufford, *Chapter 11 Case Management and Delay Reduction: An Empirical Study*, 4 AM. BANKR. INST. L. REV. 85, 103 n.82 (1996) (text: "The traditionally recognized purpose of filing a chapter 11 case is to reorganize the finances of the debtor by means of a chapter 11 plan." Footnote 82: "By the traditional measure, the confirmation of a chapter 11 plan constitutes success under chapter 11."); Judge Lisa Hill Fenning, *Mediation, Not Litigation*, AM. BANKR. INST. J., July-Aug. 1996, at 35, 36 ("Success in chapter 11 is . . . typically defined as a confirmed consensual plan of reorganization."). Lynn M. LoPucki & William C. Whitford, *Patterns in the Bankruptcy Reorganization of Large, Publicly Held Companies*, 78 CORNELL L. REV. 597, 599 (1993) ("Bankruptcy lawyers and commentators sometimes consider a reorganization case to be successful if a plan of reorganization has been confirmed."). Moreover, both the Supreme Court and Congress have adopted triggers within chapter 11 based on the reasonable likelihood that a chapter 11 plan will be confirmed within a reasonable time. *See Timbers, supra* note 47, 484 U.S. at 376; 11 U.S.C. § 362(d)(2)-(3) (West 2000).

[110] *See, e.g.,* Hon. Samuel L. Bufford, *What is Right About Bankruptcy Law and Wrong About its Critics*, 72 WASH. U. L.Q. 829, 833 (1994) ("There is a basic misconception about the success rate of Chapter 11 cases . . . [because of] a pervasively narrow view of the nature of Chapter 11 success. Defining success in Chapter 11 requires much more analysis and debate than it has heretofore received. As a first approximation, I propose that success be defined as the achievement of the results sought, or the avoidance of the results unwanted, by the debtor at the

over-inclusive[111] of all successful chapter 11 cases. These commentators might contend that my data counts many failures as successes if the refiling rate is high for the SARE debtors in my datasets.[112] Other commentators might counter that the Bankruptcy Code favors confirmation of a plan and does not condemn refilings so that refiling data are peripheral to my study.[113] This article does not engage in the debate over defining success in chapter 11 bankruptcies. Instead it measures confirmation of plans in chapter 11, which is the benchmark adopted by Congress.

Most chapter 11 debtors file for relief under chapter 11 with the objective of confirming a chapter 11 plan. A confirmed plan can restructure secured and unsecured indebtedness, provide for sale or rehabilitation of the property, or permit the secured lender to foreclose. The outcome is usually consensual, reflecting the will of the parties about what is best to preserve value for each particular single asset real estate project. Occasionally, the parties cannot agree on a consensual plan and the court grants the mortgage holder's request

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time of filing. For example, the debtor may want to sell the business, because the debtor cannot make it profitable. After the filing, a sale is arranged and the case is dismissed. Alternatively, the debtor may be attempting to avoid foreclosure by the principal secured creditor on the principal real estate asset in the bankruptcy estate. The loan is restructured, or a sale is arranged to a better-financed purchaser, and the case is dismissed. Results of this kind are common in Chapter 11 cases, and frequently occur in single-asset real estate cases, even though they do not comply with bankruptcy theory. However, such cases are all excluded from the tally of successful Chapter 11 cases, according to the conventional counting method. The real success rate for Chapter 11 cases is probably in the range of 40%. This estimate is based on my experience with nearly 2000 Chapter 11 cases that have been on my docket: no data have been collected on this subject." (footnotes omitted). *See also* Elizabeth Warren, *Bankruptcy Policymaking in an Imperfect World*, 92 MICH. L. REV. 336, 377 (1993) (noting that chapter 11 might be considered successful even if the business liquidates).

[111] Some commentators contend that "success" should only apply to those cases in which the debtor obtained confirmation of a plan and continued in business. *See, e.g.,* Lynn M. LoPucki & William C. Whitford, *Patterns in the Bankruptcy Reorganization of Large, Publicly Held Companies*, 78 CORNELL L. REV. 597, 599-600 (1993) ("Another test of success of a reorganization case used in conversation among practitioners is whether the business or firm survived. . . . One measure of this kind of success is whether the surviving entity remained out of bankruptcy after confirmation."); Lynn M. LoPucki, *The Debtor in Full Control – Systems Failure Under Chapter 11 of the Bankruptcy Code*, 57 AM. BANKR. L.J. 99, 107 (1983) ("the term "success" will be applied only to proceedings in which the debtor both obtained confirmation of a plan and was able to continue in business . . . ."). Thus they would exclude liquidating plans or plans that result in the debtor refiling for bankruptcy.

[112] *See* Lynn M. LoPucki & Sara Kalin, *The Failure of Public Company Bankruptcies in Delaware and New York: Empirical Evidence of a Race to the Bottom*, 54 VAND. L. REV. 231, 235-36 (2001) ("Refiling constitutes a failure of the bankruptcy process.").

[113] *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, 293-95 (2001) (The Bankruptcy Code neither condemns refilings nor are they costly). *See generally* "*What Other Scholars Think of the LoPucki/Kalin Study*," 36 No. 9 Bankr. Ct. Dec. (LRP) 7 (cover story August 8, 2000).

for relief from stay,[114] dismisses the case, or converts it to chapter 7.[115] Very rarely, the court confirms a "cramdown" plan over the dissent of the mortgage holder following a determination that the plan is "fair and equitable."[116] For the most part, the universe of SARE cases with confirmed chapter 11 plans will reflect a conservative measure of success.[117]

If SARE cases were not likely to result in confirmed plans, then Congress would be justified in barring them entirely from the chapter 11 system instead of allowing them to file subject to an expedited procedure. On the other hand, if there were a reasonable likelihood[118] that SARE cases will produce confirmed plans, there does not appear to be any principled reason to subject them to rules different from other kinds of chapter 11 cases. The key is to identify those characteristics of SARE debtors that are good predictors of confirmed plans. Then Congress would have an informed basis to draw a line.

Based on my practical experience with SARE cases, I had hypothesized that properties with larger property values and value to loan ratios have a greater likelihood of confirmation.[119] To test these hypotheses, I examined the National data to determine whether certain variables were indicative of increased likelihood of confirmation, including the property value, the property value natural log, the value to loan ratio,[120] the value to loan ratio (difference of

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[114] *See* 11 U.S.C. § 362(d)-(f) (West 2000).

[115] *See* 11 U.S.C. § 1112(b) (West 2000).

[116] *See* 11 U.S.C. § 1129(b) (West 2000). *See generally,* Kenneth N. Klee, *All You Ever Wanted to Know About Cram Down Under the New Bankruptcy Code*, 53 AM. BANKR. L.J. 133-71 (1979). Some might argue that a nonconsensual plan is unsuccessful because it diverts value from secured creditors. *See supra* note 52 and accompanying text. It also is possible in some cases for a creditor to propose a confirmable chapter 11 plan. *See, e.g.*, *In re* Holley Garden Apartments, Ltd., 238 B.R. 488, 492 (Bankr. M.D. Fla. 1999) (noting that both debtor's plan and creditor's plan were confirmable). Therefore in some respects confirmation of a SARE plan could be somewhat over-inclusive of "success."

[117] *But see supra* note 111, contending that confirmation measures success only if the debtor survives and does not refile for bankruptcy. Even if confirmation is not dispositive of success, it is certainly relevant to assessing success, except for those commentators who adopt the view that state law foreclosure, with all of its shortcomings, is preferable to any bankruptcy reorganization. *See, e.g., supra* notes 54-58 and accompanying text.

[118] Reasonable minds can differ on the level of probability of confirmation that would support fast-track rules that would disadvantage SARE debtors. Congress is well situated to engage in this kind of line drawing. Figure 1 *infra* presents the kind of data that gives Congress an informed basis to do so.

[119] In my experience, properties with larger values are also better maintained and more current in payment of real property taxes than smaller properties. I tested the data for these effects as well.

[120] The value to loan ratio is calculated by dividing the property value by the unpaid loan balance. For example, a property worth $10 million subject to a $5 million loan balance will have a value to loan ratio of 2:1.

natural logs), and the like. The findings regarding these variables were meaningful with a Pseudo R^2 (Green) of .28,[121] but additional analysis all data was needed to determine the validity of my hypotheses.

Analysis of the data reveals interesting patterns in SARE cases. The National data reveal a strong relationship between property value and confirmation of a chapter plan, a finding that is echoed by the LA data and the Combined data. This means that a case with a very valuable property is more likely to confirm a plan than a case with low valued property. The observed data are consistent with this prediction. Of the 17 cases in the National dataset that resulted in confirmed plans, ten involved properties worth $8.2 million or more.[122] On the other hand only seven involved properties worth less than $8.2 million. Stated another way, of the 18 cases in the upper 40 percentile of property value (valued at $7 million or more), ten (56 percent) resulted in confirmed plans. Of the 27 cases in the lower 60 percentile (valued at $7 million or less), only seven (26 percent) resulted in confirmed plans.[123] At the extremes, the data are even more striking: of the nine cases in the lowest quintile, only one (11 percent) resulted in a confirmed plan, whereas of the nine cases in the highest quintile, six (67 percent) resulted in confirmed plans. Thus, based on the raw data, it appears that somewhere between $7 million and $8.2 million in property value is a flexion point above which the likelihood of confirmation increases substantially. **[insert chart here]**

The LA data involve more properties with lower property values. Of the 16 cases in the lowest quintile, only one (6 percent) resulted in a confirmed plan, whereas six (38 percent) of the 16 cases in the highest quintile resulted in a confirmed plan. The second through fourth quintiles show no clear pattern with confirmation rates of 20 percent, 7 percent, and 13 percent respectively.

[insert chart]

Dissecting the highest quintile of the LA data, however, reveals a flexion point similar to that reflected in the National data. Of the seven cases with property values between $5.8 million and $7.0 million, only one (14 percent) resulted in a confirmed plan, whereas five (56 percent) of the nine cases with property values of at least $8.5

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[121] For a detailed explanation of pseudo R^2 and other statistical measures, *see infra* note 150.

[122] *See infra* Figure 2.

[123] *See id.* Properties valued at $7 million are included in both the lower 60 percentile and the upper 40 percentile.

million resulted in confirmed plans. Thus the LA data also support the inference that somewhere between $7 million and $8.2 million in property value is a flexion point above which the likelihood of confirmation increases substantially.

The finding with respect to SARE chapter 11 cases is consistent with the understanding of chapter 11 generally, that is, that larger companies are more likely to end their chapter 11 cases with a successful reorganization.[124] This finding may reflect the relatively high expenses of a chapter 11 reorganization; in effect, only larger cases can afford the expenses of a reorganization in addition to the expenses of operating the property. Smaller cases may be as complex as larger ones,[125] but if they cannot afford to continue operations[126] and bear the administrative costs of the chapter 11 process,[127] they may not survive.

The National data also reflect a strong relationship between value to loan ratio and the likelihood of confirmation of a chapter 11 plan, a finding on which the LA data and Combined data are inconclusive. The National data suggest, consistent with my experience and hypothesis, that cases with less leveraged capital structures are more likely to confirm chapter 11 plans. But the LA data and Combined data's inconclusive support for this proposition

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[124] *See* Elizabeth Warren & Jay Lawrence Westbrook, *Financial Characteristics of Bankruptcy*, 73 AM. BANKR. L.J. 499, 500 (1999) ("Because the complex structural apparatus of Chapter 11 . . . is based on a prototype of a business with sufficiently large assets and debt to support an expensive restructuring, the businesses in Chapter 11 should be relatively large."). "There has long been a theory that size was related to reorganization success, but generally people supposed that the reason was that larger businesses would present both a greater threat to various constituencies if they failed and would have greater resources to support a rescue." *Id.* at 540. *See also* Lynn M. LoPucki & William C. Whitford, *Patterns in the Bankruptcy Reorganization of Large, Publicly Held Companies*, 78 CORNELL L. REV. 597, 600 (1993) (reporting a 96 percent confirmation rate for large, public companies). Lynn M. LoPucki & Sara Kalin, *The Failure of Public Company Bankruptcies in Delaware and New York: Empirical Evidence of a Race to the Bottom*, 54 VAND. L. REV. 231, 256 (2001) (table showing extremely high confirmation rate for large, public companies through 1997).

[125] *See* Testimony of John A Gose, *Hearings on the Bankruptcy Commission's Report before the Subcomm. on Administrative oversight and the Courts of the Senate Comm. on the Judiciary*, 105th Cong., 1st Sess. (Oct. 21, 1997) (available at 1997 WL 659242 [F.D.C.H.]) ("I can state categorically that size does not bear any relation to complexity. In fact, it is not unusual for a smaller transaction to be more complex than a larger; with less to fight over, more wrinkles may arise.").

[126] *See* Lynn M. LoPucki, *The Debtor in Full Control – Systems Failure Under Chapter 11 of the Bankruptcy Code*, 57 AM. BANKR. L.J. 99, 109 & n.43 (1983). *See also* Jerome R. Kerkman, *The Debtor in Full Control: A Case For Adoption of the Trustee System*, 70 MARQ. L. REV. 159, (1987) ("[Between 74 and 76 percent] of the operating businesses entering Chapter 11 proceedings were destined to fail . . . .").

[127] Chapter 11 administrative costs include attorneys fees, accountants fees, appraisers fees, court fees, postpetition taxes, and the like. *See* 11 U.S.C. § 503(b) (West 2000).

demonstrates the danger of drawing conclusions based on shared experience and anecdotal testimony without adequate empirical research.

Examining the raw historical data is only a beginning. The goal is to develop a model predictive of future outcomes. I selected property values and value to loan ratios as key independent variables against which I could predict the likelihood of confirmation of a plan. Because confirmation is a dichotomous variable, in that it either occurs or does not occur, I assigned the value 1 to a case with a plan that confirmed and zero to a case where no plan confirmed. To understand more clearly the relationship between value to debt ratios, property values, and probability of confirmation, I first plotted value to debt ratios and property values against probability of confirmation. No clear relationship emerged. That is, it was not possible to find a meaningful line around which the data would cluster. But by using a logistic regression[128] the relationships crystallized in a model that predicts the likelihood of confirmation.[129] That is, given a particular property value and value to loan ratio, the model illustrated in Figure 1 forecasts a likelihood of confirmation based on historical relationships imbedded in the dataset.[130]

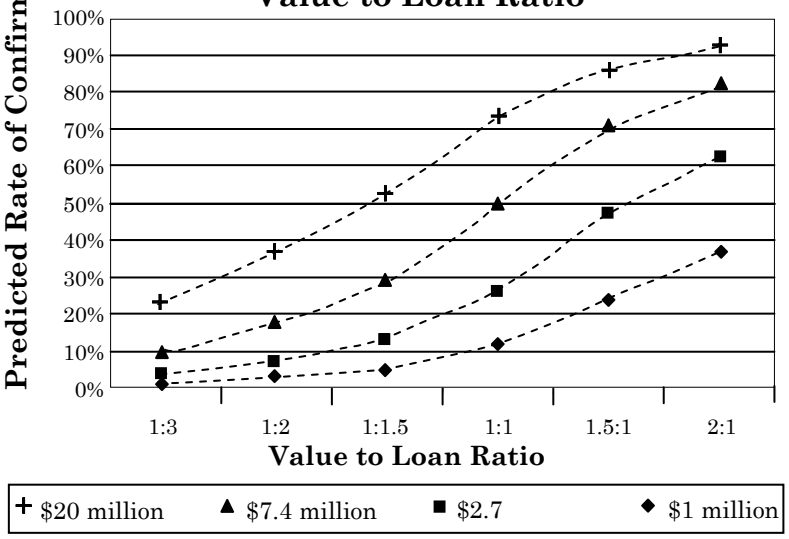
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[128] Logistic regression is a statistical procedure that is useful for predicting dichotomous outcomes, in which the dependent variable can have only two possible values (typically 0 or 1); the predictors can be either continuous or categorical. The relationship between these variables is more clearly understood if we view the distribution of predicted confirmations in a two-way table. *See infra* Table 1 in the Appendix. The figures illustrate how both the property value and the debt ratios appear to be important considerations in the confirmation decisions of bankruptcy courts. The National model predicts that properties with a value of $1million and loans that are twice the property value (1:2) will only be confirmed about 2% of the time; and that expensive ($20 million) properties with the same debt ratio are 20 times more likely to be confirmed (40%). Those with both a high value and a high value-to-debt ratio are almost certainly confirmed (95%). It appears that both value and loan ratio are good predictors of which cases will be confirmed, but that value may be more sensitive to which cases will eventually be confirmed.

[129] *See infra* Table 1 and Figure1.

[130] Figure 1 suggests more precision in the relationships than a dataset with 45 observations warrants. Nevertheless, it properly illustrates the direction of the relationships.

Figure 1. National Model: Predicted Rate of Confirmation by Property Value and Value to Loan Ratio

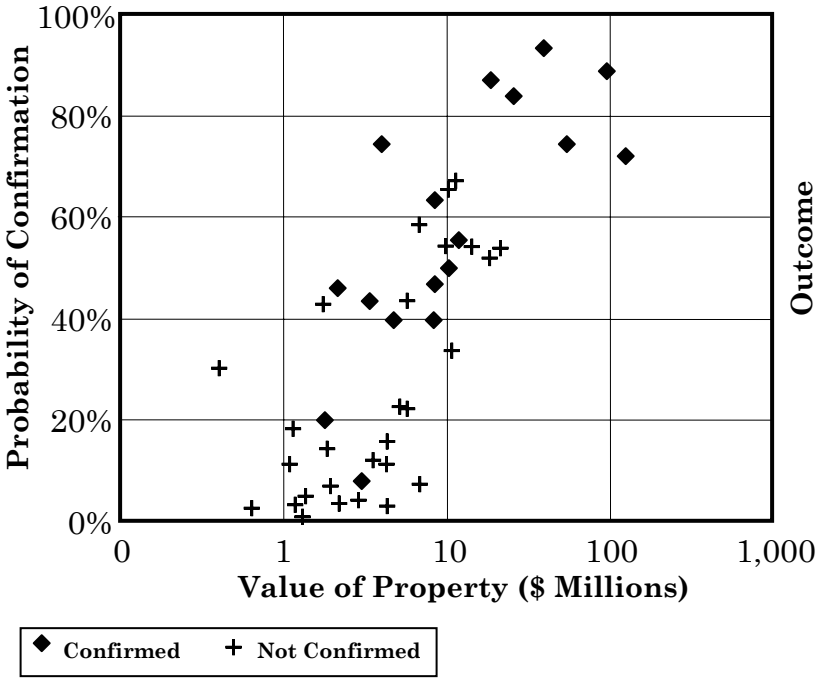


The National data model reflected in Figure 1 shows that both property value and value to debt ratios are good predictors of confirmation.[131] For example, although the National model predicts that properties with a value of $1 million and loans that are twice the property value (1:2) will only be confirmed about 2% of the time, it shows that expensive ($20 million) properties with the same debt ratio are 20 times more likely to be confirmed (40%).[132] Those with both a high value and a high value-to-debt ratio are almost certainly confirmed (95%).[133] The National model indicates that both value and the value to loan ratio are good predictors of which cases will be confirmed.

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[131] *See infra* Table 2.
[132] *See infra* Table 1 and Figure 1.
[133] *See id.*

Figure 2. National Model: Probability of SARE Plan Confirmation by Value of Property



The LA data and Combined data provide strong support for the relationship generated from the National data between property value and probability of plan confirmation.[134] But the LA data and Combined data are inconclusive regarding the relationship between value to loan ratio and probability of plan confirmation.[135] The LA data and Combined data suggest that property value may be more sensitive than value to loan ratio in predicting which cases will eventually be confirmed.[136] As a result, I focused on the property value data alone as a predictor of confirmation.

The National model and data strongly suggest that property value is predictive of confirmation in SARE chapter 11 cases. Thus, property value is a particularly good predictor of the probability that a chapter 11 plan will be confirmed in a SARE case.[137] Figure 2

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[134] *See infra* Table 2.
[135] *See id.*
[136] *See id.*
[137] The Wald statistics are set forth *infra* in Table 2. For a more thorough discussion of the statistical methods employed, see the Appendix *infra.*

demonstrates the fit for the National data using a logarithmic axis for property value and symbols to indicate whether a plan was confirmed.

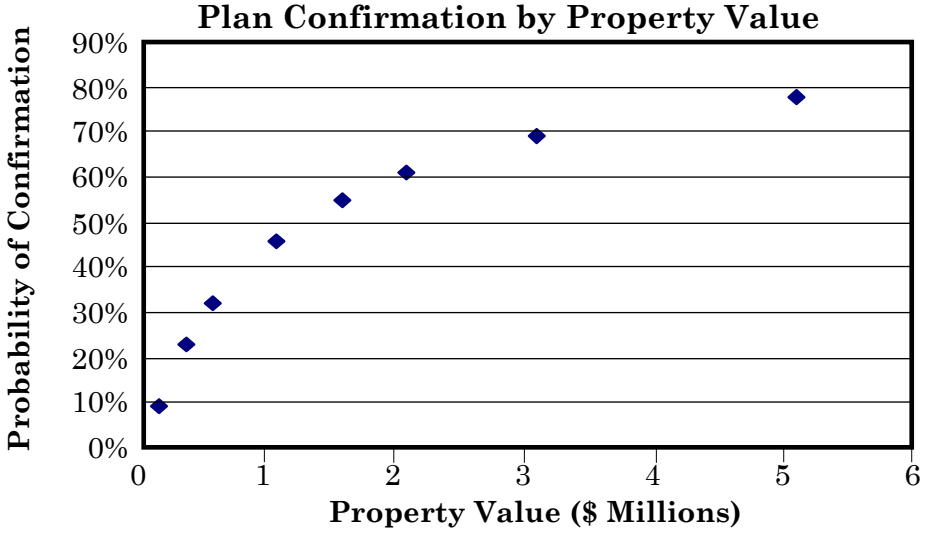
These data may also be tabulated as follows:

Property Value ($ Millions)	1	3	5	10	15	20	30	50
Probability of Confirmation	9%	23%	32%	46%	55%	61%	69%	78%

Based on these data, Congress certainly would have been justified in raising the SARE cap to a property value of $10 million or so. At that level, confirmation is almost an even bet. At the $20 million level, confirmation is about 60 percent certain.

Figure 3 reflects the relationship between property value and probability of confirmation without using a logarithmic scale or including symbolic representation whether a plan was confirmed.

Figure 3. National Model: Probability of Plan Confirmation by Property Value



These figures illustrating the National model support my hypothesis that SARE cases with larger properties have a good chance of having a chapter 11 plan confirmed.[138] More importantly, they clearly show that "one size" chapter 11 process does not fit all SARE

[138] The LA data and Combined data generally reinforce this hypothesis.

cases, at least where the one size procedure does not afford all debtors a reasonable opportunity to reorganize.[139]

Not having made a similar investigation, Congress engaged in its process innocent of such information. It listened to the lenders who lobbied for the bill and blew up the $4 million cap. The resulting decision reflected in the 2001 Amendment was a shot in the dark that missed the mark.

IV. LESSONS FROM APPLYING THE DATA TO THE 2001 AMENDMENT

As a policy matter, Congress blundered when it repealed the $4 million cap in the definition of SARE debtors. Under the 2001 Amendment, larger SARE debtors will be exposed to the strictures of the newly-expanded section 362(d)(3). To survive the chapter 11 process, they will have to file a confirmable chapter 11 plan within 90 days of the order for relief, persuade the court to extend that time, or start making payments to their mortgage holders based on nondefault interest under the contract. This recipe gives secured mortgage holders effective control of the SARE chapter 11 case. These lenders got what they paid for to the detriment of the property owners, the unsecured creditors, and the general public. Congress should have adopted a less restrictive alternative that would have better served and harmonized the competing interests in SARE chapter 11 cases.

Congress could have adopted the position of law and economics critics that chapter 11 is inefficient and should be replaced by an auction system[140] or abolished.[141] But Congress has elected to retain the chapter 11 system for most debtors, including SARE debtors. By

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[139] Before 1994, under the Bankruptcy Code one size fit all SARE cases precisely because the one size was the general, flexible reorganization rules applicable to almost all chapter 11 debtors.

[140] *See* Baird & Morrison, *supra* note 50, at 17 ("In a mandatory auction regime, managers of firms that have value as going concerns will do everything they can to make this information readily available at the start of the case. They will keep their jobs only if a single buyer of the assets can be found and the chances of finding such a buyer go up the more such information is available. . . . Only a system of mandatory auctions both limits the amount of time an inexpert decisionmaker handles the shutdown option and forces insiders to give that decisionmaker sufficient information to exercise the option well while it is in her hands." *See also* Douglas G. Baird, The Uneasy Case for Corporate Reorganization, 15 J. Legal Stud. 127 (1986) (criticizing bankruptcy law); Lucian Ayre Bebchuk, A New Approach to Corporate Reorganization, 101 Harv. L. Rev. 775 (1988) (same).

[141] *See, e.g.,* Michael Bradley & Michael Rosensweig, *The Untenable Case For Chapter 11*, 101 Yale L.J. 1043, 1078 (1992) ("*Chapter 11 should be repealed, abolishing court-supervised corporate reorganizations and, in effect, precluding residual claimants from participating in any reorganization of the firm.* More technically, we propose a federal law repealing Chapter 11 (insofar as it applies to corporate reorganizations) and providing for automatic cancellation of residual claims in the event of default.").

most accounts, at the very least, the mark of success under the chapter 11 system is confirmation of a chapter 11 plan.[142] Thus the question addressed in this article is not whether SARE debtors should be permitted to reorganize under chapter 11, but under what conditions SARE debtors may reorganize.

In 1994 Congress established a separate procedure for small SARE debtors with secured debts not exceeding $4 million. Thereafter, nothing has happened to warrant applying the separate SARE procedure to larger cases. In fact, instead of conducting diligent legislative fact-finding as it had done on other occasions, Congress gathered no empirical data to analyze larger SARE cases. Instead, it chose to receive anecdotal testimony and money from mortgage holders' lobbyists. As this article demonstrates, the data strongly support the proposition that larger SARE cases have high likelihood's of confirming chapter 11 plans. The same may be true of cases with high value to loan ratios. Repealing the $4 million cap to subject all SARE debtors to the requirements of section 362(d)(3) probably will reduce the likelihood of confirmation for several large SARE debtors. By some standards, this will diminish the success of chapter 11, thereby adding fuel to the fire of the commentators who call for chapter 11's repeal.

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[142] *See supra* note 109. *But see, e.g.,* Douglas G. Baird, Essay, *Bankruptcy's Uncontested Axioms*, 108 YALE L.J. 573, 584 (1998) ("Chapter 11 cannot be judged merely by counting the number of firms that reorganize successfully . . . the rehabilitation goal must be balanced against other interests, including the need to recognize the rights of creditors."); Hon. Samuel L. Bufford, *What is Right About Bankruptcy Law and Wrong About its Critics*, 72 WASH. U. L.Q. 829, 833 (1994) ("There is a basic misconception about the success rate of Chapter 11 cases . . . [because of] a pervasively narrow view of the nature of Chapter 11 success. Defining success in Chapter 11 requires much more analysis and debate than it has heretofore received. As a first approximation, I propose that success be defined as the achievement of the results sought, or the avoidance of the results unwanted, by the debtor at the time of filing. For example, the debtor may want to sell the business, because the debtor cannot make it profitable. After the filing, a sale is arranged and the case is dismissed. Alternatively, the debtor may be attempting to avoid foreclosure by the principal secured creditor on the principal real estate asset in the bankruptcy estate. The loan is restructured, or a sale is arranged to a better-financed purchaser, and the case is dismissed. Results of this kind are common in Chapter 11 cases, and frequently occur in single-asset real estate cases, even though they do not comply with bankruptcy theory. However, such cases are all excluded from the tally of successful Chapter 11 cases, according to the conventional counting method. The real success rate for Chapter 11 cases is probably in the range of 40%. This estimate is based on my experience with nearly 2000 Chapter 11 cases that have been on my docket: no data have been collected on this subject. (footnotes omitted); Steven H. Ancel & Bruce A. Markell, *Hope in the Heartland: Chapter 11 Dispositions in Indiana and Southern Illinois, 1990-1996*, 50 S.C. L. REV. 343, 357 ("The consequences outlined above hint at a definition of success in Chapter 11 that is broader than simply confirming a Chapter 11 plan . . . . [T]he authors believe a rough definition of a successful Chapter 11 is one in which all participants receive more than they would have if liquidation had been initiated.").

By drawing a reasonable line to differentiate small SARE debtors from large SARE debtors, Congress could have preserved the economic braking function of chapter 11 in preventing uncontrolled downward spirals in real estate prices when numerous foreclosed properties are dumped on the market simultaneously.[143] Recall that this system benefits society by guarding the economic health of institutions that finance real property in addition to the financial well-being of the property owners.[144] In fact, instead of drawing a line based on the amount of secured debt, Congress might have done better to consider property value and value to loan ratio instead. As Table 1, *infra*, illustrates, even $1 million SARE cases have a 39 percent chance of confirmation when the value to loan ratio is 2:1.[145] Quite clearly, the data support a more textured look at these cases, indeed, raising the question whether debt levels alone should be used as an eligibility limitation for any purpose under the Bankruptcy Code.

Moreover, the case in favor of drawing a reasonable line is compelling. As noted, the National model uses confirmation of a chapter 11 plan as a surrogate for success, but as many commentators acknowledge, confirmation is only part of the measure of success.[146] Some SARE chapter 11 cases that resulted in dismissals were undoubtedly the product of negotiated settlements. Under the 2001 Amendment, however, as it becomes more difficult to confirm plans, there is less reason for a mortgage lender to negotiate a reasonable settlement. Hence, with this change in the law, both the visible and the invisible successes in SARE chapter 11 cases will be less likely.

The data strongly support the application of the more relaxed current chapter 11 procedures in larger SARE cases where the probability of confirmation is high. There is no rational justification for stuffing valuable properties with high values (or possibly high value to debt ratios[147]) into an expedited SARE procedure that will

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[143] If the downward spiral is caused by dumping small SARE properties on the market, then drawing a line to insulate large SARE debtors from the restrictions of section 362(d)(3) will not suffice. To prevent the do spiral, Congress would need to repeal section 362(d)(3).

[144] *See supra* notes 68, 69, 72 and accompanying text.

[145] *See infra* Table 1. Although the National data support using value to loan ratios as indicative of the probability of confirming a SARE plan, the LA data and Combined data are inconclusive on this point. *See infra* Table 2.

[146] *See supra* notes 109-110. *But see* LoPucki, *supra* note 112, ("Refiling constitutes a failure of the bankruptcy process.")

[147] Based on the lack of statistical significance in the LA and Combined datasets, more data would be required to determine definitively the relationship between value to loan ratios and likelihood of confirmation.

almost surely increase their failure rate.[148] Policymakers reasonably can disagree whether a line should be drawn at a property value of $5 million, where the probability of confirmation is 32 percent, $10 million, where the probability of confirmation climbs to 46 percent, or $15 million, where the probability of confirmation is better than even at 55 percent. But it is plain that any line should be drawn based on consideration of actual data, not on a shortcut rule that treats all SARE debtors less favorably than other chapter 11 debtors. If a $50 million property has a 78 percent chance of confirming a plan under existing law, what policy possibly justifies jamming it into an expedited procedure that might jeopardize this result?[149] Whether that line is drawn at $4 million in secured debt or $7.4 million, $20 million, or some different amount of property value is an issue about which reasonable people can differ, but it is plain that a line should have been drawn.

Congress used a meat axe when it should have used a scalpel. Perhaps the next time Congress legislates bankruptcy reform legislation, it will reinstitute a reasonable SARE cap. This article and studies like it should serve to sharpen the debate.

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[148] I did not elicit comprehensive data regarding the length of time it took debtors to confirm chapter 11 plans in large SARE cases. Based on my experience, however, most large SARE cases require more than 90 days to confirm a plan of reorganization. Some of these cases have operating problems that must be fixed before parties in interest reasonably can predict the earning potential of the reorganized debtor and use it to negotiate a plan. Other cases involve debtors with complex capital structures, tax issues, foreign lenders, and the like which delay the plan negotiation and confirmation process. Some SARE debtors will fail to reorganize as a result of exposure to the expedited procedures. Others will reorganize on a different basis than before adoption of the 2001 Amendment as a result of value being shifted from owners and unsecured creditors to secured lenders. A few large SARE debtors may reorganize in a more expeditious fashion than before adoption of the 2001 Amendment. Indeed, based on their previous writings, some commentators might argue that expedition would lead to higher confirmation rates and no lower rate of business survival. *See, e.g.,* Lynn M. LoPucki, *The Debtor in Full Control – Systems Failure Under Chapter 11 of the Bankruptcy Code*, 57 AM. BANKR. L.J. 99, 107-08 (1983) (noting that under Chapter XI of the Bankruptcy Act, shorter proceedings probably resulted in a higher rather than lower confirmation rate than under chapter 11 of the Bankruptcy Code and no lower rate of business survival). Additional empirical research would be required to quantify the results.

[149] Commentators disagree whether expedition of the chapter 11 process will reduce the plan confirmation rate. *See id*.

APPENDIX

As noted above, logistic regression is a statistical procedure that is useful for predicting dichotomous outcomes, in which the dependent variable can have only two possible values (typically 0 or 1); the predictors can be either continuous or categorical. In this study, the dependent variable is whether the court confirmed the plan. It is coded 1 if it was confirmed, and 0 if it was not confirmed. Both of the independent variables (Value of Property and Value to Loan ratio) are continuous.

The logistic regression coefficients reported in Table 2 are exponents, the natural logs of the odds ratio (Ln(p/1-p)). Unlike ordinary least squares coefficients, logistic coefficients cannot be interpreted independently of the model within which they are nested.[150] That is, the entire model is a function which must be

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[150] *See generally* G. David Garson, *PA 765 Statnotes: An Online Textbook*, also available at http://www2.chass.ncsu.edu/garson/pa765/logistic.htm (last visited September 24, 2001), generally describing R^2 and pseudo R^2 statistics as follows:

> **R-squared**. There is no widely-accepted direct analog to OLS regression's R^2. This is because an R^2 measure seeks to make a statement about the "percent of variance explained," but the variance of a dichotomous or categorical dependent variable depends on the frequency distribution of that variable. For a dichotomous dependent variable, for instance, variance is at a maximum for a 50-50 split and the more lopsided the split, the lower the variance. This means that R-squared measures for logistic regressions with differing marginal distributions of their respective dependent variables cannot be compared directly, and comparison of logistic R-squared measures with R^2 from OLS regression is also problematic. Nonetheless, a number of logistic R-squared measures have been proposed. Note that R^2-like measures below are not goodness-of-fit tests but rather attempt to measure strength of association. For small samples, for instance, an R^2-like measure might be high when goodness of fit was unacceptable by model chi-square or some other test.
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> **RL-squared** is the proportionate reduction in chi-square and is also the proportionate reduction in the absolute value of the log-likelihood coefficient. RL-squared shows how much the inclusion of the independent variables in the logistic regression model reduces the badness-of-fit DO coefficient. RL-squared varies from 0 to 1, where 0 indicates the independents have no usefulness in predicting the dependent. RL-squared = GM/DO. RL-squared often underestimates the proportion of variation explained in the underlying continuous (dependent) variable (see DeMaris, 1992: 54). As of version 7.5, RL-squared was not part of SPSS output but can be calculated by this formula.
>
> **Cox and Snell's R-Square** is an attempt to imitate the interpretation of multiple R-Square based on the likelihood, but its maximum can be (and usually is) less than 1.0, making it difficult to interpret. It is part of SPSS output.

calculated in order to determine the effect of an individual independent variable. For this purpose, we can restate the regression as follows:

$$\text{Log Odds of Confirmation} = -2.10 + (\text{Value of Property} * 1.11) + (\text{Value to Loan ratio} * 2.37)$$

In order to recover the probability of confirmation for a given property, or type of property, one would add the values into the equation above, raise Euler's constant (*e*) to the resulting value, and then calculate the odds.

For example, assume that the property is fully mortgaged; the Value to Loan ratio (which is the difference of the logged values) is equal to 0. This allows us to see what happens as the Value of Property varies. The Value of Property variable is composed of the logged values of the properties, in millions of dollars, so that a value of 1 in the variable is equal to $2.72 million in the real world; a value of 2 is equal to $7.39 million, and so on. If we use the National data set and select 1 as the Value of Property, we would get the following equation:

$$\text{Log Odds of Confirmation} = -2.10 + 1 * 1.11 = -0.99$$

$$\text{Odds} = E^{-0.99} = .37:1$$

Once we compute the odds, we generate probability by dividing the odds by one plus the odds:

$$\text{Probability of confirmation} = .37 / 1.37 = .27 \text{ or } 27\%$$

Nagelkerke's R-Square is a further modification of the Cox and Snell coefficient to assure that it can vary from 0 to 1. That is, Nagelkerke's R^2 divides Cox and Snell's R^2 by its maximum in order to achieve a measure that ranges from 0 to 1. It is part of SPSS output. See Nagelkerke (1991).

Pseudo-R-square is a Aldrich and Nelson's coefficient which serves as an analog to the squared contingency coefficient, with an interpretation like R-square. Its maximum is less than 1. It may be used in either dichotomous or multinomial logistic regression.

R-square is OLS R-square, which can be used in dichotomous logistic regression (see Menard, p. 23) but not in multinomial logistic regression. To obtain R-square, save the predicted values from logistic regression and run a bivariate regression on the observed dependent values. Note that logistic regression can yield deceptively high R^2 values when you have many variables relative to the number of cases, keeping in mind that the number of variables includes k-1 dummy variables for every categorical independent variable having k categories.

Now let us assume a property with the same Value to Loan ratio of 0, but a Value of Property variable value of 2 (an actual property value of $7.39 million). The equation for the National data set would be stated:

$$\text{Log Odds of Confirmation} = -2.10 + 2 * 1.11 = .12$$

$$\text{Odds} = E^{.12} = 1.13{:}1$$

$$\text{Probability of confirmation} = 1.13 / 2.13 = .53 \text{ or } 53\%$$

The relationship between these property value and value to loan ratio variables is more clearly understood if we view the distribution of predicted confirmations in a two-way table (Table 1). The figures illustrate how both the property value and the value to loan ratio appear to be important factors underlying the confirmation decisions of bankruptcy courts. The model predicts that properties with a value of $1 million and loans that are twice the property value (1:2) will only be confirmed about 2% of the time; and that expensive ($20 million) properties with the same debt ratio are 20 times more likely to be confirmed (40%). Those with both a high value and a high value-to-debt ratio are almost certainly confirmed (95%). It appears that both value and loan ratio are good predictors of which cases will fail to be confirmed, but value may be more sensitive to predict which cases will eventually be confirmed.

Table 1.
National Model: Predicted Rate of Confirmation, by Property Value and Value to Loan Ratio.
(Entries are the percentage of cases within the cell that are predicted to be confirmed)

	Ratio of Property Value to Loan Principal				
Property Value	**1:2**	**1:1.5**	**1:1**	**1.5:1**	**2:1**
$1 million	2%	4%	11%	24%	39%
$2.7 million	7	12	27	50	66
$7.4 million	18	30	53	75	85
$20 million	40	56	77	90	95

To understand the relationship between the property value, value to loan ratio and the probability of confirmation from a different perspective, consider Figure 1, *supra*. This figure clearly shows a substantial likelihood of confirmation when property value is at least $7.4 million and the value to loan ratio exceeds 1:1.5. In fact, using

that value to loan ratio, if the property value exceeds $20 million, it is more probable than not that a plan will be confirmed.

Table 2.
Factors of Bankruptcy Plan Confirmation in SARE Cases.
(Cell entries are logistic regression coefficients. Wald statistics are in parentheses.)

	Data source		
	National	**LA**	**Combined**
Property Value†	1.11** (8.53) *(mean 1.72, sd 1.26)*	.52* (3.55) *(mean .51, sd 1.20)*	.73** (13.60) *(mean .95, sd 1.35)*
Value to Loan Ratio†	2.37* (5.28) *(mean -.27, sd .51)*	-.68 (1.84) *(mean .31, sd .77)*	-.09 (.08) *(mean .10, sd .74)*
Constant	-2.10** (7.40)	-1.82** (19.58)	-2.02** (29.46)
Pseudo-R^2	.42	.13	.20
N	45	76	121

* p < .05, ** p< .01

†Property value is the natural log of the assessed value in millions. Value to loan ratio is the difference in the natural logs of the property value and the outstanding loan amount in millions.

As noted in the text, the National data predict the probability of confirmation both as a function of property value and value to loan ratio. By contrast, as illustrated by Table 2, the LA data and Combined data support the relationship only for property value, not for value to loan ratio. The LA data thus make the National data on property value more robust despite the lack of a random sample and a small number of cases, but undermine the National data's implications for value to loan ratio. Table 2 also uses Wald

statistics[151] to show the tighter fit for property value data versus value to loan data. Note that Table 2 uses Wald statistics instead of standard errors, but Wald statistics are derived from standard errors and take into account the number of cases, making them as good or better than standard errors for measuring goodness of fit.

Figures 2 and 3, *supra*, demonstrate the effect of isolating the analysis of the National data set to focus on probability of confirmation based on property value alone.

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[151] "Computationally, the Wald statistic = b^2 / ASE_b^2 where ASE_b^2 is the asymptotic variance of the logistic regression coefficient." *See* G. David Garson, *PA 765 Statnotes: An Online Textbook*, also available at http://www2.chass.ncsu.edu/garson/pa765/logistic.htm (last visited September 24, 2001).

> The Wald statistic is commonly used to test the null hypothesis in logistic regression that a particular logit (effect) coefficient is zero. It is the ratio of the unstandardized logit coefficient to its standard error. The Wald statistic tests the significance of the logit coefficient associated with a given independent. The Wald statistic is part of SPSS output in the section "Variables in the Equation." Of course, one looks at the corresponding significance level rather than the Wald statistic itself. . . . Also note that the Wald statistic is sensitive to violations of the large-sample assumption of logistic regression.

See id.

Single Asset Real Estate (SARE) Questionnaire

Please duplicate this Questionnaire and fill out a copy for each single asset real estate deal you have done since October 1, 1979. Please return the completed questionnaires to Professor Ken Klee, UCLA Law School, P.O. Box 951476, Los Angeles, CA 90095-1476 as soon as possible but in no event later than March 13, 1998.

Type of Property (Apartment Building, Raw Land, etc.)_____

_____

2. Valuation Range of Property_____

_____

3. Type of Settlement: Out of Court____; Cramdown _; Consensual Plan_____

4. Were maintenance and taxes current pre-workout or prepetition? (Y/N)____

5. Terms of Debt/Settlement:

   A. Senior Secured Creditor with Mortgage or Deed of Trust on Real Estate

      Priority of Lien: (Should be First; Indicate if any subordination)

      Amount of debt? (Pre and Post Workout or Plan)_____

      _____

      Interest Rate? (Pre and Post Workout or Plan)_____

      _____

      Term? (Pre and Post Workout or Plan)_____

      _____

Other Relevant Information_____

_____

B. Junior Secured Creditor with Mortgage or Deed of Trust on Real Estate

Priority_____

_____

Amount of debt? (Pre and Post Workout or Plan)_____

_____

Interest Rate? (Pre and Post Workout or Plan)_____

_____

Term? (Pre and Post Workout or Plan)_____

_____

Other Relevant Information_____

_____

_____

_____

C. Other Secured Creditor

Priority_____

_____

Amount of debt? (Pre and Post Workout or Plan)

_____

Interest Rate? (Pre and Post Workout or Plan)_____

Term? (Pre and Post Workout or Plan)

Other Relevant Information

Debtor (Identify the Debtor if the information is Not Confidential):

New or Retained Equity

New Capital Infused

Management Contracts, Salaries, or Other Private Benefits

Debt Forgiven

Relevant Information