

Technically Bankrupt

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What is the difference between a robot and a lawyer? The answer is not a joke, and may soon be a matter of great urgency for attorneys, as the legal field attempts to adjust to disruptive technologies that are likely to permanently alter the way that law is practiced throughout the United States. The consequences for failing to adjust to technological disruption for any industry, as demonstrated in recent years by big-name, bankrupt companies, can be disastrous. Legal tools found in chapter 11 of the Bankruptcy Code are largely intended to assist debtors in reorganizing their business affairs, preserving value by shedding unprofitable business activities and redirecting resources to more profitable venues. However, these tools grow less effective as companies become more insolvent, and catching up on technological advancement becomes more difficult the farther a company falls behind. Law firms face an additional incentive to adjust to technology early; although they may file for bankruptcy like other businesses, they have historically struggled to reorganize due in large part to the ability and propensity of firm asset—the attorneys themselves—to simply leave the company. Accordingly, law firms, faced with an array of new and disruptive technologies, should draw on the lessons of prior industry failures and make adjustments swiftly, before finding themselves “technically” bankrupt.

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I. INTRODUCTION

Advances in technology can bring about significant changes. In addition to the positive outcomes typically observed with technological breakthroughs, such as the faster, easier, and more efficient provision of goods and services, such advances can also be highly disruptive.¹ In particular, these new technologies can have the effect of severely devaluing old technologies, and by extension, old ways of doing business. Capital and human resources dedicated to implementing older forms of technology that were previously essential to company production can go from being valuable assets to costly liabilities in a relatively brief span of time.

¹ See James Manyika et al., *Disruptive technologies: Advances that will transform life, business, and the global economy*, MCKINSEY GLOBAL INST. (May 2013), <http://www.mckinsey.com/business-functions/digital-mckinsey/our-insights/disruptive-technologies>.

Technological disruption is an inevitable reality for every industry and an increasingly frequent observation in recent years.² As technological methods such as automation, robotics, data storage, and artificial intelligence improve their ability to accomplish tasks faster, more accurately, and more efficiently, providers of goods and services will need to adjust to the changing technological landscape. Rapidly, the provision of less efficient, less accurate, or otherwise less desirable products will become a losing proposition and companies will need to change with the market in order to stay in business. This is as true for law firms as it is for any other industry and, for reasons described below, the pressure to respond to evolving technology is particularly relevant for big law firms.

Businesses and industries are often slow to realize that innovation and adjustment to technological advances is necessary—that it *was* necessary months or even years prior—and that failure to adjust in the appropriate time frame has had devastating consequences for long-term profitability. For many companies, such tardy realization sparks the need for a bankruptcy filing as a last-ditch effort to preserve the business as a going concern. Bankruptcy proceedings can provide valuable tools that are intended to enable a struggling business to right itself, shedding unprofitable ventures and obtaining fresh capital infusions to invest in updated technology. These proceedings, accessed through chapter 11 of the Bankruptcy Code, establish the creation of a bankruptcy estate.³ The debtor, acting as trustee of the estate (commonly referred to as the debtor in possession or DIP) is able to negotiate with creditors using the leverage of bankruptcy protection, which includes a prohibition against creditors' attempts to collect.⁴ Ideally, through negotiations in bankruptcy overseen by a bankruptcy judge, a debtor and its creditors can come to an agreement through which the debtor may restructure and continue on a more profitable path, arising from the ashes of unprofitability like the fabled phoenix.

However, as demonstrated by noteworthy bankruptcy filings in recent years, a delayed response to technological innovation can create obstacles to long-term profitability that not even powerful bankruptcy tools and sympathetic bankruptcy judges can overcome.⁵ Waiting too long to innovate, to readjust, or even to file for bankruptcy can and has proved fatal to companies that once were household names, such as Blockbuster LLC and

² HENRY C. LUCAS, JR., *THE SEARCH FOR SURVIVAL: LESSONS FROM DISRUPTIVE TECHNOLOGIES* 4 (2012) (observing that compared with previous disruptive periods, the discontinuity introduced by technological disruption is likely to be a permanent state in the economy).

³ See 11 U.S.C. § 541 (2012).

⁴ See 11 U.S.C. §§ 362, 1101 (2012); see also discussion *infra* note 53 and accompanying text.

⁵ See discussion *infra* note 184 and accompanying text.

Borders Group, Inc. Even companies that can survive a bankruptcy provoked by delayed response to technological disruption, such as Eastman Kodak Company, can be permanently altered and face an uncertain future.

The legal profession, with its long history, its reputation for risk-aversion, and its love of precedent, is generally viewed as an industry that is perpetually slow to adapt to technological advances.⁶ While the practice of law may be different from the sale of books, the rental of movies, or the production of film, it is in no way immune from the forces of technical progress that can and will shape the industry, with or without the consent of practitioners. Recent developments in technology, especially the development of artificial intelligence,⁷ can and will have an impact on how law is practiced and how legal services are rendered.⁸

This is especially true for law firms employing over 100 attorneys, commonly referred to as “BigLaw” firms.⁹ Although they comprise a relatively small proportion of the legal industry, BigLaw firms and perceptions surrounding them have a disproportionate impact on the

⁶ See, e.g., Ellie Margolis & Kristen Murray, *Using Information Literacy to Prepare Practice-Ready Graduates*, 39 U. HAW. L. REV. 1, 6 (2016) (“the legal profession has the reputation of being conservative and slow to change in general”); Timothy J. Toohey, *Beyond Technophobia: Lawyers’ Ethical and Legal Obligations to Monitor Evolving Technology and Security Risks*, 21 RICH. J. L. & TECH. 9, 4 (2015).

⁷ Used here, the reference to artificial intelligence (also known as AI) is to “weak” AI, through which machines are able to accomplish tasks performed by humans, rather than “strong” AI, which implies the ability to think like a human by making ethical judgments, applying symbolic reasoning, or managing social situations. As of yet, strong AI is found only in works of fiction. See Monika Hengstler, Ellen Enkel & Selina Duelli, *Applied Artificial Intelligence and Trust—The Case of Autonomous Vehicles and Medical Assistance Devices*, TECH. FORECASTING & SOCIAL CHANGE 105 (2016). But see Anthony J. Casey & Anthony Niblett, *The Death of Rules and Standards* (Univ. of Chi. Pub. Law & Legal Theory, Working Paper No. 550, 2015), <https://ssrn.com/abstract=2693826> (imagining a world in which laws are precisely tailored using technological advances and predictive technology to establish precise directives for any given factual scenario).

⁸ See, e.g., Anthony J. Casey & Anthony Niblett, *Self-Driving Contracts* (Mar. 1, 2017) (unpublished manuscript), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2927459 (suggesting that predictive capabilities created by big data and artificial intelligence will allow parties to draft contracts that permit automatic analytics to fill in contract details to arrive at the parties’ desired outcomes). But see Dana Remus & Frank Levy, *Can Robots Be Lawyers?: Computers, Lawyers, and the Practice of Law* 4 (Nov. 27, 2016) (unpublished manuscript), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2701092 (concluding, based on a technical analysis, that automation has a less significant impact on the demand for lawyers’ time than popular accounts suggest); Steve Lohr, *I, Robot, Esq.? Not Just Yet*, N.Y. TIMES, Mar. 20, 2017, at B1.

⁹ Although a term of art subject to various interpretations, “BigLaw” generally refers to large and typically prestigious law firms employing at least 100 attorneys, which pay market rates to their associates. “BigLaw” positions are accordingly highly desired. See e.g., Alison Monahan, *How to Get a BigLaw Job: Understanding the Basics of BigLaw*, BALANCE (June 9, 2017), <https://www.thebalance.com/how-to-get-a-biglaw-job-2164672>.

American legal culture.¹⁰ In many ways, BigLaw firms shape expectations regarding attorney salary, hours, and practice, despite the fact that the average attorney performs strikingly different functions and makes substantially less than the typical BigLaw attorney. BigLaw firms are particularly vulnerable to technological advances because many of these advances work to remove the advantages of being big. In other words, developments in artificial intelligence make it possible for a single attorney, using the appropriate software, to conduct legal research and review factual records faster and more accurately than a dozen BigLaw partners and associates. This reality severely undermines the BigLaw model, and will at a minimum require an adjustment of priorities in training and using attorneys within BigLaw firms.

The lessons of previously well-known and outwardly successful companies that have failed, in large part because they adjusted to technological disruption too late in the game, would suggest that BigLaw should not delay in responding to technological advances if it wishes to remain a feasible economic model. In fact, BigLaw has an even greater incentive than companies in other more capital-intensive industries to respond before too much time passes. This is because bankruptcy proceedings, typically viewed as the last resort for companies, have proved almost universally fatal for large law firms.¹¹ Although it may be conceivable for a company that has delayed response to technological innovations to “catch up” through bankruptcy proceedings, law firms have historically been unable to do so.¹² The provision of legal services is indeed different from the sale of goods and the manufacturing of products, but not because the legal field is somehow inoculated from technological disruption. Instead, the differences between law firms and bookstores, movie rental conglomerates, and film manufacturers simply limits the comparative usefulness of a bankruptcy remedy. This is all the more reason why law firms should take heed early, to adjust while there is time to do so, and not to rely on bankruptcy proceedings as a last-ditch effort to change course.

This Article operates to some extent as a cautionary tale for all members of the legal profession, but most particularly for large law firms. Part II identifies some of the technological disruptions currently facing the legal

¹⁰ See, e.g., Jordan Weissman, *Why the Fall of Big Law Matters*, ATLANTIC (July 23, 2013), <https://www.theatlantic.com/business/archive/2013/07/why-the-fall-of-big-law-matters/278040/> (suggesting BigLaw drove most of the growth in the legal profession in the years leading up to 2008).

¹¹ See John Morley, *Why Law Firms Collapse* 1 (Yale Law Sch., John M. Olin Ctr. for Studies in Law, Econ. & Public Policy Research Paper No. 521, Mar. 11, 2015), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2580616 (“Law firms don’t just go bankrupt—they collapse.”).

¹² *Id.* at 1–2.

community and looks ahead to the possible (if not probable) technological advances yet to come. Part III briefly explains how companies faced with technological disruption may respond using legal tools available through federal bankruptcy proceedings and how these tools can be helpful. Part IV demonstrates the limitations of bankruptcy proceedings, often a company's last resort, to rehabilitate companies facing obsolescence by virtue of technological advance. This Part also briefly describes the bankruptcy proceedings of three well-known and highly respected companies and identifies generally applicable lessons drawn from their experiences. Part V argues that the lessons derived from these bankruptcies, combined with the historical experience of law firms in bankruptcy, signal the need for law firms to respond early to technological disruption in order to avoid possible collapse.

II. DISRUPTIVE TECHNOLOGY AND THE PRACTICE OF LAW

The headlines are eye-catching, but the prospect for many lawyers is terrifying: *Law Firm Retains a Robot with Powers of Attorney*;¹³ *U.S. Law Firm 'Hires' Robot-Lawyer*;¹⁴ *Billable Milliseconds? Meet Ross, Lawyer of the Future*.¹⁵ Are attorneys truly about to be replaced by robots or artificial intelligence? Although the consensus appears to be, "not anytime soon,"¹⁶ there is a general expectation that technology will advance in a direction that favors increasing use of artificial intelligence and computer software programs to accomplish tasks previously performed exclusively by attorneys. Some practitioners are already taking advantage of technology to assist in tasks such as document review, legal research, and even writing briefs. Current trends suggest that these technologies will only improve in speed and accuracy, leading to the assumption that use of these technologies will only increase with time. The following section describes some of the more prevalent or newsworthy developments.

A. *eDiscovery*

The development of electronic record-keeping was a mixed blessing for the legal field. The ability of computer servers, internet pages, and handheld devices to preserve and reproduce potentially relevant information vastly

¹³ Karen Turner, *Law Firm Retains a Robot with Powers of Attorney*, WASH. POST, May 23, 2016, at A11.

¹⁴ Warren May, *U.S. Law Firm 'Hires' Robot-Lawyer, Ross; He May Not Come into the Office, but Toronto-Created Ross can do an Articling Student's Job*, TORONTO STAR, May 20, 2016, at GT6.

¹⁵ Jeff Gray, *Billable Milliseconds? Meet Ross, Lawyer of the Future*, GLOBE AND MAIL (Toronto), Dec. 12, 2014, at B1.

¹⁶ See Lohr, *supra* note 8.

expanded the universe of discoverable documents and applicable due diligence in any given legal matter. This introduced an added layer of complexity for lawyers, but also dramatically increased their workload by increasing the information to be requested and reviewed for both litigation and transactional purposes.¹⁷ The added workload created a need for a larger number of attorneys to work on cases just to manage the increased volume of paper to be sifted through and flagged as privileged, relevant to litigation, or potentially problematic for deal terms.

Reviewing documents is a tedious, unpleasant task, typically assigned in the larger firms to the most junior associates or even contract attorneys. Those conscripted into document review have long felt that it is a task that a trained monkey could do. Accordingly, it came as little surprise to many that one of the earliest technological developments in the legal field was the ability to better search and filter documents. As software becomes increasingly powerful, it may soon be the case, if it is not already, that computer programs will become more effective than human professionals in locating potentially relevant or privileged information.

These programs have the added advantage of being able to “read” documents faster, more continuously, and at a higher consistency rate than the biggest, best, and most skilled team of attorneys. For example, COIN, a program JPMorgan Chase & Co. adopted in June of 2016, has recently boasted the ability to review commercial loan agreements for errors, accomplishing 360,000 hours of review work in a single year.¹⁸ As described in a recent news story, “[t]he [COIN] software reviews documents in seconds, is less error-prone and never asks for vacation.”¹⁹ Given the ability of computers to perform consistently and efficiently in a way that humans could never match, it is only a matter of time before repetitious tasks like document review, even though historically performed by educated professionals, will be accomplished by machines instead of humans.²⁰

¹⁷ See, e.g., Alan B. Morrison, *The Necessity of Tradeoffs in a Properly Functioning Civil Procedure System*, 90 OR. L. REV. 993, 996 (2012) (“Most recently, electronic record keeping made it possible to discover the previously undiscoverable—albeit at considerable burdens of time and expense—thereby suggesting a need for a different balancing among the competing interests in discovery.”).

¹⁸ Hugh Son, *JPMorgan Software Does in Seconds What Took Lawyers 360,000 Hours*, BLOOMBERG (Feb. 27, 2017, 7:31 PM), <https://www.bloomberg.com/news/articles/2017-02-28/jpmorgan-marshals-an-army-of-developers-to-automate-high-finance> (last updated Feb. 28, 2017, 7:24 AM).

¹⁹ *Id.*

²⁰ Although perhaps less inspiring, it is somewhat amusing to imagine a mighty standoff between a law firm’s most productive associate and a program such as COIN, in the spirit of the ballad of John Henry. See William Grimes, *Taking Swings at a Myth, With John Henry the Man*, N.Y. TIMES, Oct. 18, 2006, at E9 (observing that the John Henry behind the legend likely died of silicosis, a lung disease prompted by the inhalation of silicon dust). One supposes that the associate would surrender long before the computer broke down, although

B. *Chatbots and LegalZoom*

Although pro se representation is nothing new, recent developments have provided greater access and assistance to individuals seeking legal help without hiring a live attorney. Such help may be provided through the use of chatbots, which are simple artificial intelligence programs that can answer questions through text or even via webcam. Chatbots can trace their origins to the Turing test, which was established by Alan Turing, one of the pioneers of computing. Turing suggested that a computer's intelligence could be tested based on how well it could trick humans into thinking it was itself a human based on its responses to questions.²¹ In recent years, chatbots and similar devices have been used to assist individuals in defending themselves in legal proceedings. Perhaps the most famous example involves traffic tickets.

Joshua Browder was a teenager with no formal legal training²² when he began programming DoNotPay, a website that assists motorists in appealing parking tickets by providing a list of potential defenses for the user to select²³ and an online form for users to enter the factual basis for their defenses. The program generates a letter of appeal, incorporating the options selected by the user. One could imagine that this sort of technology, which is both relatively easy to set up and to duplicate, will improve over time to cover an increasing number of applications, potentially implicating legal work outside traffic court.

A more established and well-known company in the realm of pro se legal representation, with perhaps a less memorable back story, is LegalZoom. LegalZoom is an online company that provides customers with assistance in preparing legal documents such as business documents, wills, and divorce filings, through use of software that guides customers to fill out forms themselves, informed by prompts from the software based on previous responses. The company has been challenged on the grounds that it engages in the unauthorized practice of law, but it has largely settled these suits while

suffering a fatal stroke after several days of review would not be inconceivable.

²¹ See Holly Ryan, *When the robots are smarter than us*, N.Z. HERALD (Oct. 14, 2016, 6:12 AM), http://www.nzherald.co.nz/business/news/article.cfm?c_id=3&objectid=11727587 (noting that “[i]n 2014, a computer successfully imitated a 13-year-old boy in a text conversation, fooling a number of judges”).

²² Browder did have an extensive history with parking tickets. Helen Weathers & Beth Hale, *Meet the boy genius who can get you off a parking fine*, DAILY MAIL (Jan. 1, 2016, 5:51 PM), <http://www.dailymail.co.uk/news/article-3381510/Meet-boy-genius-parking-fine-Josh-ua-18-fed-getting-tickets-set-website-help-escape-penalties.html> (last updated Jan. 2, 2016, 3:42 AM).

²³ Examples include “My car was stolen” and “There was a medical emergency,” as well as options for missing or incorrect details on the ticket. See DoNotPay, <http://powerful-journey-59211.herokuapp.com/list/332> (last visited Sept. 25, 2017).

maintaining operations.²⁴ To the extent lawyers would otherwise be hired to perform such tasks, their automation poses a disruption that could conceivably spread to other areas, including more general litigation proceedings.

C. Artificial Intelligence

The most striking and newsworthy development of the past few years has been the rise of artificial intelligence in accomplishing legal work. The recent unveiling of a program touted as the first “robot lawyer,” ROSS Intelligence or ROSS, made headlines.²⁵ Modeled after Watson, the artificial intelligence that beat former winner Ken Jennings on Jeopardy in 2011, ROSS was first adopted commercially in 2016 in the bankruptcy practice area of Baker & Hostetler.²⁶ As of the drafting of this article, ROSS is being used by, or is in trial with, at least seventeen law firms, and is in trial with several law schools.²⁷ Although conceptually related to the Westlaw and Lexis search engines, with which it will likely compete, ROSS claims to be different in terms of its ability to apply “machine learning,” i.e., permitting the program to become more adept in its responses to legal questions through user feedback.²⁸

²⁴ See George Leef, *Why The Legal Profession Says LegalZoom Is Illegal*, FORBES (Oct. 14, 2014, 3:00 PM), <https://www.forbes.com/sites/georgeleef/2014/10/14/why-the-legal-profession-says-legalzoom-is-illegal/#16d79de95663>; Terry Carter, *LegalZoom resolves \$10.5M antitrust suit against North Carolina State Bar*, ABA J. (Oct. 23, 2015, 3:15 PM), http://www.abajournal.com/news/article/legalzoom_resolves_10.5m_antitrust_suit_against_north_carolina_state_bar.

²⁵ See, e.g., Karen Turner, *Meet ‘Ross,’ the newly hired legal robot*, WASH. POST (May 16, 2016), https://www.washingtonpost.com/news/innovations/wp/2016/05/16/meet-ross-the-newly-hired-legal-robot/?utm_term=.777b593298cc.

²⁶ Debra Cassens Weiss, *In a first, a BigLaw firm announces it will use artificial intelligence in one of its practice areas*, ABA J. (May 9, 2016), http://www.abajournal.com/news/article/in_a_first_a_biglaw_firm_announces_it_will_use_artificial_intelligence_in_o/.

²⁷ See Susan Beck, *Inside ROSS: What Artificial Intelligence Means for Your Firm*, LAW.COM (Sept. 28, 2016), <http://www.law.com/sites/almstaff/2016/09/28/inside-ross-what-artificial-intelligence-means-for-your-firm/?slreturn=20170627142627>; see also ROSS Intelligence, *Do more than humanly possible*, (2017), <http://www.rossintelligence.com/> (listing law firms using ROSS).

²⁸ See Brian Baxter, *ROSS Intelligence Lands Another Law Firm Client*, AM. LAW. (Oct. 6, 2016), <http://www.americanlawyer.com/id=1202769384977/ROSS-Intelligence-Lands-Another-Law-Firm-Client?slreturn=20170824105226>. (ROSS co-founder Andrew Arruda has acknowledged the competition posed by Westlaw and Lexis, both of which have a far longer history in the legal field and a much larger subscriber base. However, he has also observed, “When you’re a big company and you’ve built your product around old technology, and a new technology comes out, to change and adapt, you have to gut your underlying technology. Let’s not forget that most companies in the legal research space started as publishing companies, not as technology companies. That gives us a great competitive edge.”) See also Beck, *supra* note 25. User interface with ROSS would be familiar to most people; one would need to simply type a question into the search bar, as if searching Google,

Moreover, ROSS is being constantly developed to include additional features, providing services that have traditionally been the realm of junior associates. One of the most intriguing features is ROSS's ability to write a memo on any given legal topic and deliver it by email. Although the memos currently are less polished than could be provided by a skilled associate,²⁹ the technology continues to advance and improve. Indeed, the program has a built-in feedback loop, whereby attorneys may comment on the quality of the ROSS memo, permitting the program to learn which products are satisfactory and which require further fine-tuning. The memo feature, while still in the early stages of development, has the capacity to take over a significant amount of work currently done by associates, particularly if expanded to include drafting of briefs, contracts, discovery documents, and more. There is no reason to doubt that artificial intelligence will eventually expand in that direction. In an era of rapidly developing technology, "eventually" may be a matter of only a few years, if not a few months.³⁰

Artificial intelligence has developed for transactional attorneys as well. Kira Systems, a perhaps less-touted but equally disruptive technology, was founded by Noah Waisbeg, a former BigLaw associate who looked for ways that artificial intelligence could facilitate the review of contracts as part of due diligence.³¹ Kira Systems operates to extract vital information from documents faster and more accurately than human review could ever hope to accomplish. One of Kira Systems's clients reported efficiency gains of between forty and seventy percent.³² Deloitte, perhaps the most well-known client of Kira Systems, has widely implemented the program in its day-to-day operations.³³

and, within seconds, applicable rulings with appropriately summarized passages that are ready for quoting or inclusion in a brief are available on the screen.

²⁹ See Beck, *supra* note 27.

³⁰ Within the past several months, artificial intelligence has made progress that few dared to predict. See Cade Metz, *In a Huge Breakthrough, Google's AI Beats a Top Player at the Game of Go*, WIRE (Jan. 27, 2016), <https://www.wired.com/2016/01/in-a-huge-break-through-googles-ai-beats-a-top-player-at-the-game-of-go/> ("Earlier this month, top AI experts outside of Google questioned whether a breakthrough could occur anytime soon, and as recently as last year, many believed another decade would pass before a machine could beat the top humans [at Go].").

³¹ Artificial Lawyer, *The Kira Systems Story*, ARTIFICIAL LAW. (Aug. 16, 2016), <https://www.artificiallawyer.com/2016/08/16/the-kira-systems-story/>.

³² Eric Rosenbaum, *Can elite law firms survive the rise of artificial intelligence? The jury is still out*, CNBC (Nov. 17, 2016, 2:31 PM), <http://www.cnbc.com/2016/11/17/can-cash-cow-of-elite-legal-firms-survive-ai-the-jury-is-still-out.html>.

³³ *Id.*

D. *BigLaw's Vulnerability*

It would be premature to suggest that the advances documented above signal the end of lawyers as we know it, although others have so claimed.³⁴ This article also does not suggest that these advancements, in isolation, will have the effect of systematically destroying demand for BigLaw work. Instead, the argument here is more modest: technological developments will require a reevaluation of how large law firms function, particularly how they train their associates, bill their time, and market their products. Law firms that do not reevaluate and adjust to technologies run the substantial risk of becoming uncompetitive and too large and unwieldy to make the necessary adjustments to meet a changing market demand. In light of the technological innovations described above, BigLaw is likely to require a significant business overhaul, in large part because of the sheer size of its firms.

BigLaw firms earn the title by being big, although compared to law firms half a century ago, they are huge, enormous, even gargantuan. For example, in 1960, the largest firm in the United States had only 169 lawyers.³⁵ In the year 2016, 17 law firms had over 1,000 U.S.-based attorneys, with thousands more overseas.³⁶ There are various explanations for why firms have expanded so significantly in recent years, the most plausible being the perceived need for a large number of attorneys to service large clients on large matters.³⁷ Large matters involve, among other things, large populations of documents, complex issues requiring research, and a significant amount of drafting, alongside a healthy amount of strategizing, negotiating, and planning.

³⁴ See, e.g., RICHARD SUSSKIND, *THE END OF LAWYERS: RETHINKING THE NATURE OF LEGAL SERVICES* (Oxford Univ. Press 2010); Paul Lippe & Daniel Martin Katz, *10 Predictions About How IBM's Watson Will Impact the Legal Profession*, ABA J. (Oct. 2, 2014), http://www.abajournal.com/legalrebels/article/10_predictions_about_how_ibms_watson_will_impact ("Once we have fully artificial intelligence enhanced programs like LegalZoom, there will be no need for lawyers, aside from the highly specialized and expensive large-law-firm variety."). See also Larry E. Ribstein, *The Death of Big Law*, 2010 WIS. L. REV. 749, 752 (2010) (arguing that Big Law operates on a basically precarious business model, and demonstrating the need for changes to that model). But see Bernard A. Burk & David McGowan, *Big But Brittle: Economic Perspectives on the Future of the Law Firm in the New Economy*, 2011 COLUM. BUS. L. REV. 1, 101 (2011) (rejecting Ribstein's claim that the large American law firm is dying, even while acknowledging that the form is "brittle" and subject to change).

³⁵ ANTHONY T. KRONMAN, *THE LOST LAWYER: FAILING IDEALS OF THE LEGAL PROFESSION* 273–74 (1993).

³⁶ For a discussion of how law firms have grown and changed over the past 50 years, see Burk & McGowan, *supra* note 34, at 11.

³⁷ See, e.g., Ribstein, *supra* note 34, at 758 (observing that legal work often involves a peak load problem, where clients may require a significant amount of work on short notice, making it difficult to outsource portions of the work to multiple smaller firms); Burk & McGowan, *supra* note 34, at 57–58.

Law firms can currently afford to employ a large number of attorneys on large client matters because those matters produce large fees. Most law firms use the billable hour model to charge clients. Under this model, attorneys keep track of their time, usually in six- or fifteen-minute increments, and report their totals along with a brief explanation of the work performed during that time period. Attorneys charge an hourly rate depending on their experience and skill, often tracking the number of years out of law school and partnership status. Clients pay for the minutes worked by each attorney at that attorney's going rate, rather than the overall product obtained.³⁸ Although the billable hour is an easy and simple method for calculating the cost of legal services, it is also highly problematic. For one thing, it encourages inefficiency, as the more the number of hours worked on a product, the larger the revenue. This incentive is exacerbated by internal firm policies that reward associates for exceeding a certain number of billable hours in a year, or punish associates who fail to meet that benchmark number. This effect is further distorted when there is insufficient work to keep all associates occupied, encouraging associates to pad their hours further, take longer to finish products, or otherwise spend more time in the office absent pressing work or meaningful tasks.³⁹

Indeed, Biglaw associates have a reputation for being deeply unhappy, despite earning highly competitive salaries. The most obvious source of discontent is the high number of hours associates are expected to dedicate to their craft in order to maximize revenue from the billable hour model. Another, less obvious problem arises from the structure of the firms themselves—in particular, their size and managerial makeup. Most big firms operate on a model under which each partner is supported by multiple associates. Partners partake in firm profits, whereas associates are paid a set salary, determined by the voting partners. Partners are able to increase their own incomes by maximizing the profit of the associates. This has typically been accomplished by hiring more associates and requiring them to work additional hours under the billable hour model. In order to get the highest level of profits, BigLaw firms will typically only take on significant client matters that will support high hourly rates over a significant number of hours, keeping multiple associates busy on small slices of the case or transaction.⁴⁰

³⁸ There are, of course, exceptions to this rule. Some firms will bill on a product model, although the quoted cost often incorporates the amount of time worked, and there are cases taken on a contingency basis.

³⁹ As observed by one critic, “[n]othing requires leaders to use the billable hour regime that causes so much misery, but almost all big firms and many others have adhered to it. . . . Clients detest its perverse rewards for inefficiency; associates crumble under its pressures. . . . Long ago, clients should have rebelled. For some reason, they still don’t.” STEVEN J. HARPER, *THE LAWYER BUBBLE: A PROFESSION IN CRISIS* 171 (2013).

⁴⁰ *Id.* at 77–78 (“The regime [of high associate to partner ratios, high hourly rates, and

Because associates typically work on small sections of a larger case, they are significantly less likely to be involved in the types of experiences that attracted them to the law in the first place. For example, large cases rarely go to trial, and when they do, junior associates are typically only tangentially involved with courtroom experiences or client interactions. In some firms, associates may compete with each other for the ability to participate in meaningful experiences, creating an even more difficult work environment, as associates must out-work (or out-ingratiate) each other in order to merit what work is available.⁴¹ Opportunities for mentorship with partners are also diminished as the ratio of associates to partners increases. Taken together, these factors go a long way towards explaining the dissatisfaction of many associates, who frequently leave BigLaw after only a few years. BigLaw firms, for their part, recognize associate dissatisfaction, but rather than ameliorate it, simply build associate turnover into their hiring and staffing models.⁴²

It is generally accepted that technology can and will permit attorneys to accomplish many of the tasks accomplished by junior associates faster, cheaper, and more accurately as technology improves. The ability of artificial intelligence such as ROSS to eventually provide responses to legal research questions more quickly, succinctly, and accurately than even the most skilled associate calls into question the value of paying flesh-and-blood associates to perform such tasks.⁴³ As the artificial intelligence improves, it will make even less sense to hire attorneys except to interact with the computer software, perhaps through editing, proofreading, or otherwise providing feedback for more polished products later on.⁴⁴ Although

high billable hours] yields predictable results. Only large client matters will support associates' high hourly rates. Small cases and disputes that enabled an earlier generation of lawyers to develop courtroom and client experiences have dropped away.”)

⁴¹ *Id.* at 59 (“The prevailing model of the big law firm bears much of the blame for increasing dissatisfaction among attorneys in such institutions. Too often, the model deprives lawyers of autonomy, creates an environment that rewards selfish behavior, and does little to promote collegiality. As for their daily tasks, most big-firm attorneys spend the vast majority of their time on small slices of large cases or transactions. Those matters can be financially lucrative and professionally rewarding for the firm’s senior partners, but junior attorneys often feel little connection to an overall mission.”).

⁴² For some, this means simply maintaining a significant associate/partner ratio. *See id.* at 180 (“Between 1985 and 2010, the average leverage ratio for the Am Law 50 firms doubled, from 1.76 to 3.54.”).

⁴³ This is the promise of “machine learning.” *See* Arthur L. Samuel, *Some Studies in Machine Learning Using the Game of Checkers*, 3 *IBM J. OF RESEARCH & DEV.* 210, 211 (1959), <https://www.cs.virginia.edu/~evans/greatworks/samuel1959.pdf> (suggesting that programming computers to learn from their own experiences will allow computers to greatly outperform the average person and eliminate the need for detailed programming).

⁴⁴ As predicted by Professor Ryan Calo at the University of Washington School of Law, “[e]ventually, I bet *not* using these systems will come to be viewed as antiquated and even irresponsible, like writing a brief on a typewriter.” Karen Turner, *Meet ‘Ross,’ the newly*

promoters of ROSS, as well as its early adopters, have stressed that the product is not intended to “replace” attorneys, but rather “to help them move faster, learn faster, and continually improve,”⁴⁵ such technology will necessarily change how attorneys work, how they spend their time, and how they can justify billable hours, particularly in BigLaw firms.⁴⁶

One of the principal effects of technology is to undermine the value of being big.⁴⁷ With machines accomplishing more historically time-consuming tasks, fewer individuals are required to manage cases. As one commentator observed, “[l]arge law firms have no advantage whatsoever when it comes to technology.”⁴⁸ Another predicted, “[t]here are now so many ways in which corporate clients can cut legal costs that the very expensive legal services of large law firms are going to be called for in a shrinking number of situations.”⁴⁹ There is already evidence that corporate clients are turning to sources other than large law firms to satisfy their legal servicing needs. A recent study examining the productivity of 51 Am Law 100 firms,⁵⁰ 44 Am Law Second 100 firms,⁵¹ and 57 additional midsize firms indicated that lawyer productivity, measured by hours billed, has suffered a steady decline over the past 10 years.⁵² Overall, billable hours have fallen roughly 10%, although much more significantly for non-equity partners and senior or staff counsel.⁵³ Even associates, whose numbers have been

hired legal robot, WASH. POST (May 16, 2016), https://www.washingtonpost.com/news/innovations/wp/2016/05/16/meet-ross-the-newly-hired-legal-robot/?utm_term=.08e194076985.

⁴⁵ *Id.*

⁴⁶ This reassessment is intended by Ross founders. See The Atlantic, *Watson Takes the Stand*, ATLANTIC, <http://www.theatlantic.com/sponsored/ibm-transformation-of-business/watson-takes-the-stand/283/> (last visited Sept. 25, 2017) (“People are reassessing the structure in place which revolves around the billable hour,” says Andrew Arruda, another of the ROSS co-founders. ‘A lot of clients have refused to pay for the time spent doing research. They see it as part of what you should be doing anyway.’”). As one adopter of Kira Systems explained, “It’s not the death of the law firm partnership model, but it will change over time. No one can say how, exactly, but we have to think about how we price and work.” Rosenbaum, *supra* note 32.

⁴⁷ See Ribstein, *supra* note 34, at 761 (observing that technical advances have eroded the advantages of BigLaw).

⁴⁸ Valerie Katz, *Size Matters: Small Firms and Big Technology*, ABOVE THE LAW (Mar. 3, 2011), <http://abovethelaw.com/2011/03/size-matters-small-firms-and-big-technology/>.

⁴⁹ Elizabeth G. Olson, *Big Law has a shrinkage problem*, FORTUNE (Jun. 26, 2013), <http://fortune.com/2013/06/26/big-law-has-a-shrinkage-problem/?iid=sr-link10>.

⁵⁰ This term refers to the ranking of law firms by gross revenue as published by The American Lawyer. See, e.g., The American Lawyer, *The Am Law 100: Firms Ranked by Gross Revenue*, (Apr. 26, 2017), <http://www.americanlawyer.com/id=1202784616627>.

⁵¹ See *supra* note 48.

⁵² See GEO. LAW: CTR. FOR THE STUDY OF THE LEGAL PROFESSION ET AL., 2017 REPORT ON THE STATE OF THE LEGAL MARKET, <http://legalexecutiveinstitute.com/wp-content/uploads/2017/01/2017-Report-on-the-State-of-the-Legal-Market.pdf>.

⁵³ *Id.*

significantly reduced over the past 10 years, experienced a drop in productivity. In the meantime, firms have compensated for the lack of productivity by raising their rates, which has then resulted in greater client pushback and a decreasing rate of collection realization.⁵⁴ It should be obvious to most observers that a pattern in which firms maintain profits by charging more for less work is not sustainable, particularly in a competitive market.

Law firms, unlike other industries, do not enjoy economies of scale based on their size. As reported by one consulting firm, “[l]arger firms almost always spend more per lawyer on staffing, occupancy, equipment, promotion, malpractice and other non-personnel insurance coverages, office supplies and other expenses than do smaller firms.”⁵⁵ It may not be the case that large law firms will disappear overnight, but it seems very likely that the BigLaw model will soon lose its competitive edge if it does not adjust to technological advances.⁵⁶ Smaller firms may be able to accomplish the same amount of work as BigLaw firms by using machines and a fewer number of attorneys, particularly if those attorneys are better trained and more motivated.⁵⁷

This observation has ramifications for law firms, lawyers, and law schools as well. If computers are able to better accomplish much of what junior associates used to do, lawyers must be better at engaging in tasks that computers are not yet able to accomplish in order to compete with the machines. Incoming associates will need to be trained and prepared to engage more in the “classical” practice of law: client interaction, negotiation with opposing counsel, and court appearances. In addition, associates will need to become skilled in monitoring technological product—editing computer-generated memos and briefs, and providing feedback through the user interface. Further, associates will need to learn (or re-learn) skills associated with being “human.”⁵⁸ Although artificial intelligence is

⁵⁴ *Id.*

⁵⁵ HARPER, *supra* note 39, at 75. *See also* Ribstein, *supra* note 34, at 772 (observing that multiple recent law firm bankruptcies can be attributed in part to an over commitment to office space and an inability to repay loans). *See also* Burk & McGowan, *supra* note 34, at 70 (noting that large law firms may introduce diseconomies of scale in the way of multiple conflicts of interest, friction inherent in management, and coordination problems).

⁵⁶ *See* Burk & McGowan, *supra* note 34, at 86 (“[I]f the client is going to demand that a firm use contract lawyers or a third party for document review anyway, who cares whether the lawyers that do the core legal work have 10 lawyer colleagues or 1000?”).

⁵⁷ There is some evidence to suggest that BigLaw firms may already be looking to reduce associate to partner ratios. *See id.* at 94 n.221.

⁵⁸ *See* Matthew Kay, *Robot Lawyers: How Humans Can Fight Back*, TIMES (U.K.) (May 26, 2016), <https://www.thetimes.co.uk/article/robot-lawyers-how-human-ones-can-fight-back-8qmwqlfwx> (“[I]n an age where real-life lawyers are starting to have to differentiate themselves from new cyborg competitors, they need to focus on polishing up their human

constantly improving in its ability to interact with humans,⁵⁹ the best computers are still not able to appear in court or to engage in “the practice of law” as defined by most legal standards. Absent a major breakthrough in how technology is used, attorneys will remain necessary for higher-level strategy and skill, and this, in addition to their ability to successfully implement a strategic approach with clients, opponents, and the court, is where their value still lies.

There is much work to be done on how law firms can and should adjust to new technology—far more than can be covered in this Article. But perhaps the more pressing concern is how to convince firms and practicing attorneys to begin adjustment now. Extensive training or retraining of associates is likely to be costly and difficult. Why should BigLaw firms attempt such an endeavor when profits are not currently threatened, and the technology, although promising, is not yet able to fully replicate a good associate’s work product? The answer is tied up in the history of firms that face technological disruption. The time to adjust is early on, because waiting can be disastrous, if not fatal.

III. RESPONSIVE TOOLS FOR TECHNOLOGY-INDUCED FINANCIAL OR ECONOMIC DISTRESS⁶⁰

By virtue of the inherent costs associated with restructuring a business model or making any other major change, companies are typically loathe to do so until faced with outside pressures, such as a decrease in earnings or a slump in stock price. If the economic pressure is not significant, then businesses may be able to respond incrementally, spreading the costs of restructuring over time. If adjustment is not particularly expensive, because it need not be particularly large or particularly significant, then companies may also borrow, offer additional securities, or otherwise increase capital sufficient to take the company in a new direction. However, when significant changes must be made in response to severe pressure, when costs are high and the necessary adjustments are overdue, companies must typically resort to more drastic measures, up to and including bankruptcy proceedings. Bankruptcy proceedings are very useful when companies cannot otherwise acquire the working capital they need to make adjustments due to being overleveraged or otherwise lacking in credit worthiness. As explained below, such companies, as debtors, have the ability to restructure old debt

skills, particularly their emotional intelligence”).

⁵⁹ See Tom Simonite, *Customer Service Chatbots Are About to Become Frighteningly Realistic*, MIT TECH. REV. (Mar. 22, 2017), <https://www.technologyreview.com/s/603895/customer-service-chatbots-are-about-to-become-frighteningly-realistic/>.

⁶⁰ See the discussion on the distinction between economic and financial distress *infra* Part IV.

and to attract new investment through bankruptcy tools. The longer companies wait to respond to technological disruption, the more likely they are to require bankruptcy proceedings in order to access outstanding capital and restructure obligations. What is more, if companies wait too long to file, the bankruptcy itself is less likely to be successful.

A bankruptcy filing is a legal proceeding in the federal courts that has the effect of superseding the state law rights of creditors. The primary advantage for bankruptcy filers is the ability to coerce creditors into negotiation. A debtor cannot compel creditors to accept less than they are owed pursuant to state law, even though creditors may voluntarily accept a lesser amount. In bankruptcy, debtors may propose plans that force creditors, broadly defined as anyone with an interest in the debtor, to accept less than they would otherwise be rightfully owed, with the difference discharged as a matter of law. The ability to discharge debt is a primary distinguishing factor between state law remedies and bankruptcy, one actually captured in the Contracts Clause of the United States Constitution. Pursuant to the Contracts Clause,⁶¹ states cannot pass laws “impairing the Obligation of Contracts,” which has been interpreted to prohibit state insolvency laws that discharge debt.⁶² Also prohibited by the Contracts Clause are coerced alterations to the creditor’s agreement with the debtor, including the extension of time to repay debt, the refusal to perform under a contract, or any other alteration of terms. Outside of bankruptcy, a debtor is at the mercy of its creditors with regards to performance under the contract.

Accordingly, for many businesses, chapter 11 is a mechanism for forcing negotiations with creditors, and for permitting debtors to continue to manage and retain an ownership interest, often after previous efforts to negotiate have failed. In this regard, bankruptcy provides valuable tools to debtors that are unavailable in other contexts. These tools are intended to facilitate a debtor’s recuperation in a way that maximizes the return for stakeholders—creditors, investors, and other parties in interest.⁶³ Although

⁶¹ U.S. CONST. art. I, § 10, cl. 1.

⁶² See generally *Sturges v. Crowninshield*, 17 U.S. 122 (1819); 7 C.J.S. *Attachment* § 506 (2016). For an interesting discussion on how a dispute over the Contracts Clause might be considered the most important case of its millennium, see also Robert E. Shapiro, *Back to the Future: Ogden v. Saunders*, 27 LITIG. 73, 74 (2001).

⁶³ The extent to which chapter 11 policy should recognize the impact that a business’s bankruptcy should have on individuals who are *not* creditors is a matter of wide dispute among scholars. Compare, e.g., Matthew Bruckner, *The Virtue in Bankruptcy*, 45 LOY. U. CHI. L.J. 233, 269 (2013) (“One of Chapter 11’s primary purposes is to preserve jobs.”); Richard V. Butler & Scott M. Gilpatric, *A Re-Examination of the Purposes and Goals of Bankruptcy*, 2 AM. BANKR. INST. L. REV. 269, 281–82 (1994) (noting that a business’s going concern value is only partly captured by the recovery it can provide for its creditors, and also comprises relationships with non-creditor third parties, suggesting an independent bankruptcy interest in preserving this value); Nathalie D. Martin, *Noneconomic Interests in Bankruptcy: Standing*

there are too many of such tools to permit a careful indexing of them all—indeed, there are hornbooks and treatises dedicated to the topic—five stand out as particularly useful for businesses seeking to reorganize in chapter 11, particularly those attempting to respond to technological advances.

A. *The Automatic Stay*

The automatic stay is usually the first bankruptcy tool debtors actively use in their efforts to reorganize. The automatic stay arises as a matter of law when a bankruptcy case is filed.⁶⁴ The stay renders void or voidable⁶⁵ any action taken to commence, continue, or enforce an action against the debtor, or to obtain possession or a lien against the debtor's property.⁶⁶ Creditors are accordingly prohibited from exercising their legal rights during the duration of the stay, even in cases where there is no dispute regarding those rights.⁶⁷ Creditors may petition the court for relief from the automatic stay,⁶⁸ which may be granted after notice and a hearing, but only upon a showing that: (1) the creditor's interest in estate property is not adequately

on the Outside Looking in, 59 OHIO ST. L.J. 429, 439 (1998), and Elizabeth Warren, *Bankruptcy Policymaking in an Imperfect World*, 92 MICH. L. REV. 336 (1993) (arguing that reorganization produces substantial positive externalities such as maintaining employment, preserving the local tax base, and advancing community stability), with THOMAS H. JACKSON, *THE LOGIC AND LIMITS OF BANKRUPTCY LAW* 24 (1986) (arguing that bankruptcy law should be limited to concerns of how to maximize the value of a given pool of assets, not to how those assets should be distributed); Douglas G. Baird, *Loss Distribution, Forum Shopping, and Bankruptcy: A Reply to Warren*, 54 U. CHI. L. REV. 815, 822 (1987) (arguing that the rules determining loss distribution inside and outside bankruptcy should be the same, suggesting no independent policy interest in the continuation of a failing debtor), and CHRISTOPHER F. SYMES, *STATUTORY PRIORITIES IN CORPORATE INSOLVENCY LAW: AN ANALYSIS OF PREFERRED CREDITOR STATUS* 70 (2008) (noting the dominance of the creditors' bargain theory).

⁶⁴ Both voluntary and involuntary, single and joint cases, give rise to the automatic stay. See 11 U.S.C. § 362(a) (2012).

⁶⁵ There is a difference of opinion as to whether all actions taken in violation of the automatic stay are null and void *ab initio* or whether they must be voided by the court. The majority takes the view that actions taken in violation of the automatic stay are without legal effect, and cannot later be validated by a retroactive annulling of the automatic stay. See CHARLES TABB, *THE LAW OF BANKRUPTCY* 246 (2d ed. 2009).

⁶⁶ See 11 U.S.C. § 362(a). The automatic stay technically applies to "property of the estate," rather than property of the debtor. The filing of bankruptcy results in the creation of a bankruptcy estate, which generally consists of all legal or equitable interests of the debtor. See 11 U.S.C. § 541 (2012). Accordingly, it is technically incorrect, although practically accurate, to describe the automatic stay as applying to all the debtor's property.

⁶⁷ There are some exceptions to the automatic stay, found in 11 U.S.C. § 362(b). These exceptions include the commencement of a criminal action against the debtor, the withholding of pension funds from a debtor's wages, and eviction proceedings in a case involving residential property in which the lessor has obtained a judgment for possession, but do not include generic efforts to repossess personal property, foreclose on homes, or otherwise obtain judgments or liens. See 11 U.S.C. § 362(b).

⁶⁸ See 11 U.S.C. § 362(d).

protected;⁶⁹ (2) the creditor should be allowed to move against a particular piece of property because the debtor has no equity in the property and it is not necessary to the debtor's reorganization;⁷⁰ or (3) the debtor has filed for bankruptcy as part of a scheme to delay, hinder, or defraud creditors.⁷¹ Accordingly, because of the "automatic" nature of the stay and the necessity for relief prior to taking action, whatever the underlying merits of the debt or the likelihood of success in reorganization, a bankrupt debtor is immediately afforded a period of "breathing room," where creditors cannot take any action against the debtor to enforce the debt absent explicit permission from the court.⁷²

The benefits of the automatic stay to the debtor and the estate are immediate and obvious. There are benefits to most creditors as well. Because the stay prohibits all actions by all creditors (with some exceptions as noted above), no creditor can improve his or her position at the expense of other creditors. In the absence of a convincing reason justifying relief from the stay, all creditors must wait for the orderly distribution of the estate, either under the debtor's plan of reorganization or through liquidation. Accordingly, state law rules that encourage a race to the spoils are preempted by bankruptcy procedure, and creditors can be reassured that no one may beat out the others as they all wait for the bankruptcy case to proceed.

B. *Executory Contracts*

A second powerful tool in the hands of a technologically bankrupt debtor is the ability to reject unprofitable contracts and terminate wasteful leases at an effective discount and, to some extent, on the debtor's timetable. The act of filing for bankruptcy does not itself constitute a contractual breach, even if the contractual instrument says as much; *ipso facto* clauses purporting to terminate a debtor's property interest upon bankruptcy filing are not enforceable in bankruptcy.⁷³ Accordingly, contracts or leases that are determined to be outstanding or "executory"⁷⁴ may be assumed or rejected

⁶⁹ This argument is typically made in situations where the creditor has a security interest in collateral that is rapidly depreciating in value. See 11 U.S.C. § 362(d)(1).

⁷⁰ See 11 U.S.C. § 362(d)(2).

⁷¹ The ability to lift the automatic stay under this provision is limited to those creditors with an interest in real property. See 11 U.S.C. § 362(d)(4). The automatic stay may also be lifted without cause 90 days after filing in cases where the debtor's estate consists primarily or exclusively of a single piece of real property, which generates substantially all of the gross income and on which no substantial business is being conducted. See 11 U.S.C. §§ 362(d)(3), 101(51B). In certain situations involving repeat filers, the automatic stay may terminate early or may not go into effect at all. See 11 U.S.C. § 362(c)(3)–(4).

⁷² See 11 U.S.C. § 362(a).

⁷³ See 11 U.S.C. § 541(c)(1)(B).

⁷⁴ The debate over the "executoriness" of contracts is a quagmire that the author declines to enter here. See, e.g., Michael T. Andrew, *Executory Contracts in Bankruptcy*:

at the will of the debtor,⁷⁵ subject to court approval. Although it is true that all parties to a contract are free to continue or breach the contract at any time,⁷⁶ a debtor in bankruptcy has the advantage of treating the damages arising from any breach as though they arose prior to the bankruptcy filing. This means, of course, that the damages are considered pre-bankruptcy debt, which can be repaid over time pursuant to a plan of liquidation or reorganization, and discharged, in whole or in part, pursuant to that plan.⁷⁷ Furthermore, in cases where the debtor seeks to assume a contract or lease, any breach by the debtor in the days leading up to bankruptcy may be cured, and the debtor may assume the contract or lease as though the breach had not taken place.⁷⁸

The debtor is frequently afforded a significant period of time in which to decide whether or not to assume contracts and leases. Although a trustee in chapter 7 must act within sixty days of the bankruptcy filing,⁷⁹ in chapter 11, the debtor may decline to assume or reject until confirmation of the plan of reorganization.⁸⁰ There is no set time frame for plan confirmation, and the timeline may extend for a year or more, giving the debtor the luxury of time and the creditor the pain of uncertainty.⁸¹

The ability to assume beneficial contracts, even those the debtor may have breached prior to filing, is an undoubtedly beneficial tool to a debtor seeking to shift resources towards more valuable aspects of its business. But

Understanding "Rejection", 59 U. COLO. L. REV. 845, 850 (1988) ("[I]n several respects Countryman's analysis has clouded rather than clarified the law."); Vern Countryman, *Executory Contracts in Bankruptcy: Part I*, 57 MINN. L. REV. 439, 450 (1973) (noting that "[a]ll contracts to a greater or less extent are executory," but asserting that such an expansive meaning cannot be applied in bankruptcy); Morris G. Shanker, *Bankruptcy Asset Theory and its Application to Executory Contracts*, 1992 ANN. SURV. BANKR. L. 3, 3 (describing the situation surrounding the executory contract section of the Bankruptcy Code as "one approaching legal chaos"); TABB, *supra* note 65, § 8.2.

⁷⁵ The section refers to the powers of the trustee, but at least in chapter 11, the debtor in possession has all rights and powers of the trustee, accordingly the terms are practically synonymous. See 11 U.S.C. §§ 365(a), 1107(a).

⁷⁶ The nature of contract permits individuals to breach their contractual agreements, but generally does not allow them to escape the consequences of that breach. See Oliver Wendell Holmes, *The Path of the Law*, 10 HARV. L. REV. 457, 462 (1897), reprinted in 110 HARV. L. REV. 991, 995 (1997) ("The duty to keep a contract at common law means a prediction that you must pay damages if you do not keep it,—and nothing else.").

⁷⁷ See 11 U.S.C. § 365(g).

⁷⁸ See 11 U.S.C. § 365(b)(1).

⁷⁹ See 11 U.S.C. § 365(d)(1). The trustee may also request additional time from the court, which the court may grant for cause shown. *Id.*

⁸⁰ See 11 U.S.C. § 365(d)(2).

⁸¹ See *NLRB v. Bildisco & Bildisco*, 465 U.S. 513, 529 (1984) (observing that the difference between the liquidation and reorganization proceedings justifies a difference in treatment for executory contracts, giving a debtor in reorganization greater latitude in deciding whether to assume or reject).

perhaps even more valuable is the ability to shed less profitable contracts and leases at a fraction of the cost under state law. Although a debtor will be responsible for damages arising from the debtor's breach of contract, these damages will be paid out at a fraction and discharged along with the debtor's other unpaid debts. This tool has permitted debtors to rid themselves of a myriad of unprofitable arrangements, ranging from future contracts to pension obligations. In rejecting these agreements, a debtor will often transfer its own risk of loss onto its contracting partners, inflicting financial pain on individual creditors for the benefit of the debtor and its estate and, at least in theory, the creditors as a whole.

C. *Asset Sales*

A third advantage enjoyed by debtors in bankruptcy is the ability of the bankruptcy trustee⁸² to sell property of the estate free and clear of liens, typically in lieu of a foreclosure sale. Frequently, both inside and outside of bankruptcy proceedings, an organization's assets are encumbered by voluntary liens for the sake of obtaining financing, and occasionally by virtue of a judicial lien imposed by a court judgment against the debtor. A lien grants the lienholder the first right to the proceeds of any sale of the property. For example, if a debtor's estate included equipment encumbered by a security interest held by a bank, when the estate property was sold, the bank would have a first priority right over the proceeds, until the debtor's debt to the bank was satisfied. Similarly, if the debtor's estate included inventory encumbered by a judicial lien entered in favor of a judgment creditor, when the inventory was sold, the judgment creditor would have a first priority right over the proceeds of the sale, until the judgment creditor's debt was satisfied.

More importantly, both the bank and the judgment creditor would continue to hold property rights securing their respective interests until those rights were extinguished by virtue of a foreclosure sale, or unless they authorized a sale free and clear of their interests.⁸³ Such a continuation of rights permits secured creditors (a term typically used for those who reach a consensual agreement with the debtor) and lien creditors (those who acquire a judicial lien against the debtor) a degree of assurance that their interests will be protected in the collateral until the collateral is sold. Outside of bankruptcy proceedings, if a debtor is in default to a secured creditor, or any time after a judicial lien has attached to collateral, the creditor holding the

⁸² In chapter 11, the trustee is more frequently the debtor in possession. *See supra* note 63.

⁸³ *See* U.C.C. § 9-315(a) (AM. LAW INST. & UNIF. LAW COMM'N 2010). There are some exceptions to this rule, most notably for sales of goods in the ordinary course of business. *See* U.C.C. § 9-320(a) (AM. LAW INST. & UNIF. LAW COMM'N 2010). In such cases, the buyer would take free and clear of the security interest even with knowledge that the security interest existed and was perfected.

lien may look to the collateral for satisfaction of its debt. For secured creditors, the collateral may be repossessed and sold pursuant to judicial foreclosure, or through out-of-court proceedings in a “commercially reasonable” manner, with surplus proceeds remitted back to the debtor.⁸⁴ For lien creditors, an officer of the court (typically the sheriff) conducts a sale of the property and transmits the proceeds to the creditor, again remitting any surplus to the debtor.

While court oversight of such sales may discourage the debtor from absconding with sale proceeds, the nature of foreclosure sales also tends to dramatically depress the sale price. Although the Supreme Court has presumed that the price received at a foreclosure sale constitutes “reasonably equivalent value” for the property, so long as all applicable state requirements have been met,⁸⁵ in practice foreclosure sale prices are often “shockingly low.”⁸⁶ As observed by one set of scholars, although many state courts will set aside foreclosure sales that “shock the conscience,” courts may be surprisingly hard to shock.⁸⁷ The “commercial reasonableness” of a secured creditor’s sale of personal property may also be challenged by a debtor in court, although the standard does not require that the sale result in a price that satisfies “fair market value.”⁸⁸ Further, a finding that the sale was not commercially reasonable does not unwind the sale; it only deprives the creditor of the right to a deficiency judgment.⁸⁹ Accordingly, a debtor’s ability to maximize the sale value of encumbered assets is limited pursuant to state law.

In contrast, bankruptcy proceedings may provide debtors and creditors with a sale mechanism that provides a greater return and fewer possibilities for a post hoc challenge. Pursuant to Section 363 of the Bankruptcy Code, a trustee or debtor in possession may sell estate assets outside of the ordinary

⁸⁴ Non-judicial sale is typically reserved for personal, not real property. See U.C.C. §§ 9-610; 9-615(d) (AM. LAW INST. & UNIF. LAW COMM’N 2010).

⁸⁵ See *BFP v. Resolution Tr. Corp.*, 511 U.S. 531, 545 (1994) (“We deem, as the law has always deemed, that a fair and proper price, or a ‘reasonably equivalent value,’ for foreclosed property, is the price in fact received at the foreclosure sale, so long as all the requirements of the State’s foreclosure law have been complied with.”).

⁸⁶ LYNN M. LOPUCKI ET AL., *SECURED TRANSACTIONS: A SYSTEMS APPROACH* 61 (8th ed. 2016).

⁸⁷ *Id.*; see also *First Bank v. Fischer & Frichtel, Inc.*, 364 S.W.3d 216, 221 (Mo. 2012) (observing that Missouri has one of the strictest standards for setting aside sales, upholding prices that came to only 20% to 30% of the fair market value); *Amalgamated Bank v. Superior Court*, 57 Cal. Rptr. 3d 686, 689, 696 (Cal. Ct. App. 2007) (declining to set aside a foreclosure sale for irregularities with factual findings that a \$6.5 million building was sold at foreclosure for \$2,000); *Am. Sav. & Loan Ass’n of Hous. v. Musick*, 531 S.W.2d 581, 587 (Tex. 1975) (affirming a foreclosure sale of property valued at \$338,365 for \$20,000 on the ground that there was no evidence of irregularity in the proceedings).

⁸⁸ See U.C.C. § 9-627(a) (AM. LAW INST. & UNIF. LAW COMM’N 2010).

⁸⁹ See U.C.C. § 9-626(a) (AM. LAW INST. & UNIF. LAW COMM’N 2010).

course of business upon approval of the bankruptcy court, after notice and opportunity for a hearing.⁹⁰ These assets may be sold free and clear of preexisting liens in the time frame that suits the debtor, not the creditor. By virtue of the automatic stay, debtors are afforded time to market the assets, permit inspection of those assets, and generate interest among multiple buyers. The bankruptcy court provides a forum for auction of the assets, with oversight by the judge herself. These sales, enjoying the oversight of the bankruptcy court, are generally viewed as less susceptible to legal challenge than a typical foreclosure or sale pursuant to the Uniform Commercial Code. Given these advantages (marketing, inspection, and court oversight), bankruptcy sales may fetch a higher price than would the sale of the same assets in foreclosure.⁹¹ This is particularly true when assets may be sold as a group, or portions of the business sold as a going concern, permitting the preservation of value in the course of the sale itself.⁹²

In some cases, liens may actually be stripped from property, such that creditors who would have been treated as secured under state law find themselves unsecured in bankruptcy. This typically occurs when creditors have failed to obtain perfection of their security interest prior to the bankruptcy filing. Creditors who are unperfected at the time of filing, and in some cases, just before,⁹³ are treated as unsecured creditors by virtue of the trustee's "strong-arm" powers, which permit a trustee (or debtor in possession) to step in front of the security interest and distribute assets accordingly.⁹⁴ Unlike secured creditors, unsecured creditors have no guaranteed interest in the proceeds of collateral. Accordingly, the proceeds of any sale of unsecured assets may be used to assist in the debtor's

⁹⁰ See 11 U.S.C. § 363(b)(1) (2012); FED. R. BANKR. P. 6004(e) (providing that a hearing may be set "[i]f a timely objection is made," suggesting that courts need not set a hearing without objection).

⁹¹ Challenges to the desirability of section 363 sales have largely focused on whether such sales produce a higher value than reorganization. See Lynn M. LoPucki & Joseph W. Doherty, *Bankruptcy Fire Sales*, 106 MICH. L. REV. 1, 3 (2007) (finding in a study comparing the sale of thirty public companies with the reorganization of 30 companies that companies sold for an average of 35% of book value compared, but reorganized for an average of 80% of book value); but see James J. White, *Bankruptcy Noir*, 106 MICH. L. REV. 691 (2008) (criticizing the methodology of the LoPucki & Doherty study as to the conclusions they draw from the evidence).

⁹² The advantages of a court sale described here are part of what has led many debtors to attempt a total liquidation of their businesses pursuant to section 363. See Jared A. Wilkerson, *Defending the Current State of Section 363 Sales*, 86 AM. BANKR. L.J. 591, 595–96 (2007).

⁹³ For example, pursuant to bankruptcy preference law, perfection of a pre-existing security interest constitutes the transfer of value to or on behalf of a creditor, and can be avoided under 11 U.S.C. § 547.

⁹⁴ In situations where personal exemptions are applicable (usually not in the corporate context) personal exemptions in property can also justify the stripping of even perfected judicial liens. See 11 U.S.C. § 522(f).

reorganization, rather than being surrendered to satisfy the claims of the newly-unsecured creditor.

D. *DIP Financing*

A fourth bankruptcy advantage stems from the ability of bankruptcy proceedings to alter or undercut contractual agreements between parties, particularly, again, between a debtor and its secured creditors. As a general matter, struggling companies require capital infusions to assist in restructuring, reorganizing, and revitalizing their businesses. An unfortunate side product of being heavily indebted to the point of requiring a bankruptcy filing, is often a lack of cash reserves and an inability to borrow additional money. Fortunately for debtors, bankruptcy law provides an opportunity to solicit additional funds, and the ability to offer additional incentives to would-be lenders that would be unavailable outside of bankruptcy.

The simplest bankruptcy tool regarding post-petition financing is the ability to allow new lenders to take priority in repayment over old debt.⁹⁵ Post-petition extensions of credit are treated as administrative expenses of the bankruptcy estate, and receive top priority in repayment.⁹⁶ If this is insufficient to attract new lenders, the court may also approve a lending arrangement whereby the debtor can grant the lender priority over all other administrative expenses, grant a security lien in unencumbered estate assets, and/or grant a so-called “priming lien” on already-encumbered assets, displacing pre-petition security interests.⁹⁷ This ability provides a powerful incentive for pre-petition lenders to provide post-petition financing as well, or risk having their security interests downgraded to junior interests in collateral encumbered by post-petition liens.

Other bankruptcy rules regarding a lender’s security interest work to backstop a debtor’s ability to obtain post-petition financing. For example, bankruptcy law negates any after-acquired clause in a lender’s security agreement or financing statement, such that property acquired by the debtor after a bankruptcy filing within the description of the security agreement will nonetheless be free of the lender’s security interest.⁹⁸ Although a secured creditor’s interest in the proceeds of collateral is preserved in bankruptcy, it is also subject to a bankruptcy court’s determination of whether bringing

⁹⁵ See 11 U.S.C. § 364(a) (2012).

⁹⁶ See generally 11 U.S.C. § 507 (2012). Administrative expenses do technically fall behind domestic support obligations, but there is a carve-out for administrative expenses incurred in the administration of assets used to pay such obligations. See 11 U.S.C. § 507(a)(1)(C). In any event, domestic support obligations are usually inapplicable in corporate reorganizations.

⁹⁷ See 11 U.S.C. § 364(c) and (d). Debtors may also, with court approval, grant post-petition lenders a junior interest in encumbered property.

⁹⁸ See 11 U.S.C. § 552(a).

assets into the banner of “proceeds” is consistent with “the equities of the case.” Creditors also face the possibility that the court, although typically inclined to recognize such an interest in proceeds, could “order[] otherwise.”⁹⁹

E. *Drawn Out and Reduced Repayment*

Finally, bankruptcy permits debtors to repay their debts, both secured and unsecured, over time, and also permits unsecured debts to be repaid at a reduced rate. In chapter 11, the specific time period and amount for repayment is left to the debtor to propose, with creditors voting in favor of or against the debtor’s proposal and the court confirming the plan of reorganization based on that vote. With creditor support, the debtor may propose a repayment plan stretching over years, if not decades. Unsecured creditors may be paid mere pennies on the dollar for their claims. In the meantime, the debtor can continue to function and operate the business.

The principal constraints on a debtor’s proposed plan, aside from the creditor vote, are requirements that similarly-situated creditors receive similar treatment, that creditors who do not consent to the plan receive at least what they would have gotten in liquidation,¹⁰⁰ that secured creditors are paid in full,¹⁰¹ that the plan is “fair and equitable,”¹⁰² and that the plan is feasible. If the debtor is unable to get all creditors¹⁰³ to vote in favor of its plan, the debtor must also meet the “absolute priority” requirement.¹⁰⁴ Under

⁹⁹ See 11 U.S.C. § 552(b); see also *In re Cafeteria Operators, L.P.*, 299 B.R. 400, 410 (Bankr. N.D. Tex. 2003) (“[T]he Court finds that the equities of this case warrant a finding that Bank Group’s security interest does not flow to all cash generated by Debtors To grant Bank Group a blanket lien on all of Debtors’ cash generated post-petition would represent a windfall to Bank Group, in the face of Debtors’ utilization of estate resources, *i.e.* the services of their employees, to increase the value of Bank Group’s collateral, and would unfairly deplete the funds available for general unsecured creditors.”).

¹⁰⁰ This is a simplified explanation. What the law actually requires is that any class of creditors that votes against the plan must receive what they would in a chapter 7 liquidation. Debtors divide creditors into classes for purposes of voting on the plan, subject to the constraint that all claims or interests in the class must be “substantially similar” to each other. See 11 U.S.C. § 1122.

¹⁰¹ See 11 U.S.C. § 1129(a)(9)(C) (2012). Secured debts must be repaid via cash installments within five years, unless creditors have consented to alternative treatment under the plan.

¹⁰² See generally § 1129.

¹⁰³ Again, this is a simplification. The actual requirement is that the debtor get at least two-thirds in number and more than one-half in total claims within each class of creditors to vote in favor of the plan. See 11 U.S.C. § 1126(c).

¹⁰⁴ See § 1129(b). This rule is subject to significant criticism for a variety of reasons. See, e.g., Anthony J. Casey, *The Creditors’ Bargain and Option-Preservation Priority in Chapter 11*, 78 U. CHI. L. REV. 759, 764 (2011) (arguing that the absolute priority rule eliminates the contractual rights of the junior creditor by collapsing all interest in future values of the company).

absolute priority, creditors are ranked according to the priority of their rights under state law to the debtor's assets, and no junior creditor is permitted to recover against those assets until more senior creditors are paid in full. In practice, this means that equity will recover nothing unless creditors are repaid in full or voluntarily share a portion of their recovery. These legal constraints on the plan of reorganization seek to strike the balance between preserving the interests of lenders and enabling a struggling debtor to regroup and succeed moving forward. The laws are generally perceived as very generous to the debtor, and even more generous in implementation.

Taken altogether, these tools, protections, and allowances in bankruptcy permit businesses both the space and the legal ability to accomplish value preservation, and in many situations, to re-chart a negative trajectory. Chapter 11 is intended to give companies the opportunity to refocus their efforts on productive and profitable areas, expanding their operations where economically feasible and eliminating ventures proved to be unprofitable. In cases of technological disruption, chapter 11 can assist businesses in shedding old, value-reducing mechanisms and investing in more profitable mechanisms. Ideally, these adjustments should be made incrementally, before old technology becomes obsolete, to avoid extreme shocks to revenue or overhead. Bankruptcy can be a tool of last resort in preserving a company if major adjustments become overdue, requiring a more extensive and costly overhaul.

IV. THE LIMITATIONS OF BANKRUPTCY

Even the most useful bankruptcy tools,¹⁰⁵ in the hands of skilled bankruptcy and insolvency professionals, cannot guarantee an outcome where the debtor will emerge intact from the bankruptcy. In part, the success of a company in chapter 11 will depend on whether it suffers from economic distress, defined as weaknesses in the business model, or simply financial distress, defined as cash flow or leverage issues. It is generally understood that companies with poor business models are more likely to fail rather than reorganize, although one type of distress can easily lead to the other.¹⁰⁶ The

¹⁰⁵ Bankruptcy policy in chapter 11 is largely concerned with how to make such tools more useful for reorganizing debtors without undermining the rights of creditors, a difficult balance. See generally Michelle M. Harner, *Final Report of the ABI Commission to Study the Reform of Chapter 11*, AM. BANKR. INST. (2014), <http://digitalcommons.law.umaryland.edu/cgi/viewcontent.cgi?article=1096&context=books>.

¹⁰⁶ See, e.g., Lemma W. Senbet & Tracy Yue Wang, *Corporate Financial Distress and Bankruptcy: A Survey*, 5 *FOUND. & TRENDS IN FIN.* 243 (2010) (arguing that an efficient bankruptcy code would reorganize firms suffering from financial distress but liquidate firms suffering from economic distress); Michelle M. Harner & Jamie Marincic Griffin, *Facilitating Successful Failures*, 66 *FLA. L. REV.* 205, 213 (2014) (noting that either type of distress may lead to the other).

failure to adjust to technological changes can cause economic distress, because the company's goods and services become obsolete or lose their demand. As a consequence, the company may then face financial distress. Accordingly, failure to act in a timely fashion can prove fatal for a company.

Severe economic distress may necessitate a liquidation of the flawed business model rather than a restructuring. However, weaknesses in the business model do not necessarily make liquidation a foregone conclusion, and it is possible for companies to successfully alter their business models, or "pivot" in time to save the company.¹⁰⁷ The relief provided by bankruptcy might theoretically provide space for a company to pivot, although in practice this is rarely the case. Companies are typically reluctant to file for bankruptcy, despite the advantages that bankruptcy proceedings can provide, until other means of reorganization have proved insufficient, or until it is effectively too late to reorganize at all.¹⁰⁸

It is not entirely clear why companies are so reluctant to file for bankruptcy. At least one study has concluded that such reluctance may stem from management's perception that distress is temporary, or from management's refusal to acknowledge the challenges facing the company.¹⁰⁹ Some may believe that the company can resolve its challenges pursuant to out-of-court workouts, and may be wary of the costs of bankruptcy or dubious of its benefits.¹¹⁰ It may be that decision makers view bankruptcy only as a liquidation mechanism, despite evidence of other companies that have emerged from a restructuring under chapter 11. Perhaps companies seek to avoid the perceived stigma of a bankruptcy filing, believing (not without cause) that a filing will serve as a public admission that the company is struggling, with consequences that are likely to include a dramatic drop in stock price and increased scrutiny of its operations.¹¹¹ Ultimately, these

¹⁰⁷ Eric Ries, author of *The Lean Startup* (2011), coined this term to mean "a change in strategy without a change in vision." See Eric Ries, *Pivot, don't jump to a new vision*, STARTUP LESSONS LEARNED BLOG (June 22, 2009), <http://www.startuplessonslearned.com/2009/06/pivot-dont-jump-to-new-vision.html>; see also Network Languages, *Eric Ries explains The Pivot*, TEDED, <https://ed.ted.com/on/7gLF8601>.

¹⁰⁸ See Harner & Griffin, *supra* note 106, at 208–10 (observing that management may be slow to consider restructuring discussions, and be particularly reluctant to file for bankruptcy because they view it as an "option of last resort"); Harner, *supra* note 105, at 12.

¹⁰⁹ Harner & Griffin, *supra* note 106, at 236 n.118.

¹¹⁰ For example, it is a common perception that chapter 11 bankruptcy proceedings are unnecessarily expensive and time consuming. See Stephen J. Lubben, *The Costs of Corporate Bankruptcy: How Little We Know* (Seton Hall Public Law Research Paper No. 2446663, June 5, 2014), <https://ssrn.com/abstract=2446663> (arguing that costs associated with chapter 11 fees are regulated for historical reasons and not because they are necessarily disproportionate to the services provided).

¹¹¹ *But see* Harner & Griffin, *supra* note 106, at 236 n.118 (finding in a study of restructuring professionals that less than 15% of clients who resisted filing for bankruptcy did so on account of the potential stigma associated with bankruptcy).

concerns amount to a self-fulfilling prophecy—reluctance to file for bankruptcy early enough to permit successful restructuring ensures that more companies, when they do file, will have done so too late.

In the three cases listed below, large, profitable companies were unable to move quickly enough to take advantage of technological advances that fundamentally changed the way that the goods and services they supplied were demanded by customers and clients. When customers ceased to shop for books in stores and started purchasing reading material through online stores or on digital media, Borders was too heavily invested in store fronts to respond successfully to the shift. When customers stopped renting VHS tapes from stores and instead purchased DVDs or had them mailed directly to their homes, Blockbuster was too vested in its storefront service to successfully adjust its business model in the face of strong competition. Kodak became complacent in its profitable business model and neglected to act until it was too late to transition smoothly away from its flagship products to digital cameras. Presumably, if each industry had adjusted its model earlier, before the technology moved out of its grasp, the outcome would have been different, and a chapter 11 reorganization would have been more successful or even avoidable altogether.

A. *Borders Bookstore: Retail Book Sales in the Era of E-Books and Online Purchasing*

Borders first gained its competitive advantage as a retail book store through employing its own type of sophisticated, cutting-edge technology. As a consequence, it was able to expand beyond its humble origins to become a household name. At its height, it was the second-largest bookseller in America, after Barnes & Noble.¹¹² However, within a few decades of Borders' rise, the sale of books and printed materials dramatically changed with a confluence of technological advances, like the advent and popularity of eBooks and the ability to order books online. Borders largely ignored these advances for a significant period of time, even turning over its online sales to a technological competitor—Amazon. As a consequence, Borders was unable to recuperate when hit by the global economic crisis of 2008, such that even its chapter 11 bankruptcy filing proved insufficient to permit its ongoing survival.

¹¹² CORPORATE DISASTERS: WHAT WENT WRONG AND WHY 49 (Miranda H. Ferrara & Michele P. LaMeau eds., Gale, Cengage Learning 2012). Notably, Barnes & Noble, the only surviving major bookstore chain in the U.S., is facing its own struggles with reinvention in the era of Amazon. See Paul R. La Monica, *Barnes & Noble reeling as Amazon eats its lunch*, CNN MONEY (Sept. 8, 2016), <http://money.cnn.com/2016/09/08/investing/barnes-and-noble-earnings-amazon/>.

1. Beginnings

Opened in 1971 by two brothers, Tom and Louis Borders, Borders Bookstore became competitive because of a software system developed by Louis that allowed the store to manage inventory and accurately project sales.¹¹³ By 1988, the brothers had turned management of the store over to Robert DiRomualdo, who oversaw the expansion of the company and the integration of music and movies into some of its stores, beginning in 1991.¹¹⁴ In 1995, Borders Group, Inc. went public on the New York Stock Exchange.¹¹⁵ Borders' early embrace of technology was responsible for much of its success. As noted by one publisher at the time, "[t]he Borders inventory and reordering systems have been the envy of the industry."¹¹⁶

Borders continued to expand its physical storefronts, and launched its first online retail presence, Borders.com, in May of 1998.¹¹⁷ In November of 1999, Greg Josefowicz replaced DiRomualdo as CEO,¹¹⁸ and in August of 2001 made the crucial decision to contract to sell its products through Amazon, which had already been selling books online for about six years.¹¹⁹ In retrospect, this decision was arguably the greatest single cause for Borders' downfall, but at the time, Borders' focus was on providing the largest selection of books for its brick-and-mortar storefronts. In this regard, Borders was very successful, beating out Barnes & Noble in terms of selection and becoming known as the place to buy hard-to-find books.¹²⁰

¹¹³ Nathan Bomey, *Borders' Rise and Fall: A Timeline of the Bookstore Chain's 40-year History*, ANN ARBOR NEWS (July 18, 2011), <http://www.annarbor.com/business-review/borders-rise-and-fall-a-timeline-of-the-bookstore-chains-40-year-history/>.

¹¹⁴ CORPORATE DISASTERS, *supra* note 112; Bomey, *supra* note 113.

¹¹⁵ *Id.*

¹¹⁶ Edwin McDowell, *The Media Business: Revamping Set at Kmart Book Unit*, N.Y. TIMES (Nov. 30, 1994), <http://www.nytimes.com/1994/11/30/business/the-media-business-revamping-set-at-kmart-book-unit.html?scp=5&sq=borders%20group%20kmart&st=cse>.

¹¹⁷ Bomey, *supra* note 113.

¹¹⁸ DiRomualdo had stepped down as CEO in November of 1998 in favor of Philip Pfeffer, who resigned less than a year later. DiRomualdo replaced Pfeffer as CEO on a temporary basis. Bomey, *supra* note 113.

¹¹⁹ BRAD STONE, *THE EVERYTHING STORE: JEFF BEZOS AND THE AGE OF AMAZON* 110 (2013) (noting that while this deal helped Borders to overcome its blunder of building a single massive distribution facility rather than smaller, geographically dispersed warehouses, it "delayed a necessary education on an important new frontier and ceded the loyalty of [Borders'] customers to an aggressive upstart.").

¹²⁰ CORPORATE DISASTERS, *supra* note 112.

2. Fallout of Technological Innovation

The focus on brick-and-mortar stores would soon prove to be a bad investment,¹²¹ and Borders' reluctance to make technological advances a priority would prove a losing strategy. With the increasing ease of making online purchases, Borders' focus on providing a wide selection at its large superstores became a liability. In 2007, the company lost \$157.4 million,¹²² and stock shares plummeted in value. In March of 2008, Borders attempted to boost its financial position by taking out a \$42.5 million loan from Pershing Square Capital Management, due on April 15, 2009.¹²³ In May of 2008, Borders also severed its relationship with Amazon to launch its own e-commerce Web site, a remake of the original Borders.com.¹²⁴ In a late move to catch up on a clear shift towards reading books in electronic format, Borders also attempted to market an e-reader to compete with Amazon's Kindle and Barnes & Noble's Nook. Rather than develop its own product, Borders took partial ownership of a Canadian e-book company, Kobo.¹²⁵ A decade behind its competitors, Borders fared poorly in its efforts.¹²⁶

Recognizing its shaky economic position, Borders attempted to market itself for sale as a going concern throughout 2008, without success.¹²⁷ By this point, the global financial crisis had begun and Borders' future was deeply uncertain. Pershing Square granted a one-year extension on its loan,¹²⁸ but Borders continued to post staggering losses. Borders admitted to cash flow issues in early 2011, when it delayed payments to vendors and landlords in order to conserve cash.¹²⁹ At this news, Professor John Pottow predicted Borders' bankruptcy,¹³⁰ which came roughly six weeks later on

¹²¹ CORPORATE DISASTERS, *supra* note 112, at 50 ("The company did not appear to understand how outdated the superstore model was becoming.").

¹²² Bomey, *supra* note 113.

¹²³ Bomey, *supra* note 113.

¹²⁴ Steve Pepple, *Borders hopes new e-commerce web site will help turn financial fortunes around*, ANN ARBOR NEWS (May 27, 2008), http://blog.mlive.com/annarbornews/2008/05/borders_hopes_new_ecommerce_we.html.

¹²⁵ CORPORATE DISASTERS, *supra* note 112, at 50.

¹²⁶ In his book on Amazon, Brad Stone reports that one Borders executive, speaking anonymously, reported the early version of Amazon was that it "was just another catalog—a version of Lands' End." STONE, *supra* note 119, at 276. Borders' refusal to take the threat from Amazon seriously undermined its ability to respond quickly enough.

¹²⁷ Bomey, *supra* note 113.

¹²⁸ Stefanie Murray, *Borders reaches agreement with top shareholder for loan extension*, ANN ARBOR NEWS (Mar. 31, 2009), http://www.mlive.com/business/ann-arbor/index.ssf/2009/03/borders_reaches_agreement_with.html.

¹²⁹ Jim Milliot, *Borders Delays January Payments*, PUBLISHERS WKLY. (Jan. 30, 2011), http://www.publishersweekly.com/pw/by-topic/industry-news/bookselling/article/45953-borders-delays-january-payments.html?utm_source=Publishers+Weekly%27s+PW+Daily&utm_campaign=7b83fb6a92-UA-15906914-1&utm_medium=email.

¹³⁰ Nathan Bomey, *Borders Group bankruptcy filing may be inevitable*, University of

February 16, 2011. At the time of filing, Borders operated 642 brick and mortar stores in the United States.¹³¹

3. Bankruptcy

In its chapter 11 filing, Borders listed its total assets at \$1,275,430,500 and overall debts of \$1,293,112,600. The top 30 unsecured creditors disclosed in the bankruptcy filings were all designated as “trade debt,” and consisted mostly of publishers like Penguin Putnam, Inc. (owed \$41,118,914.47) and Simon & Schuster, Inc. (owed \$33,757,444.75).¹³²

On the day of filing, Borders submitted an Emergency Motion seeking authorization to close and sell the assets of 200-336 stores.¹³³ The proposal was to “cut costs by closing highly unprofitable stores and restructuring around a core group of favorably-performing stores.”¹³⁴ Borders argued that such a move would “ensur[e its] continued and stabilized viability.”¹³⁵ Borders proposed that a coalition of three investment groups would act as a stalking horse bidder for the sale of closing stores.¹³⁶ The coalition proposed to pay 73% of cost value of all merchandise at the store plus 50% of all net

Michigan expert says, ANN ARBOR NEWS (Jan. 6, 2011), <http://www.annarbor.com/business-review/borders-group-merger-or-bankruptcy-filing-inevitable-expert-says/>.

¹³¹ Debtors’ Omnibus Motion Pursuant to 11 U.S.C. §§ 365(a) and 554(a) and Fed. R. Bankr. P. 6006, 6007 and 9014 for Approval of Rejection of Certain Unexpired Leases of Non-Residential Real Property and Authorization to Abandon Certain Property Effective as of the Commencement Date at ¶ 2, *In re Borders Grp., Inc.*, No. 1:11-bk-10614 (Bankr. S.D.N.Y. Feb. 16, 2011), ECF No. 23.

¹³² Voluntary Petition (Chapter 11) at Ex. A, *In re Borders Grp., Inc.*, No. 1:11-bk-10614 (Bankr. S.D.N.Y. Feb. 16, 2011), ECF No. 1.

¹³³ Debtors’ Emergency Motion for Entry of Order (I) Authorizing the Debtors to Sell Certain Assets Through Store Closing Sales and to Enter into Agency Agreement with (A) Joint Venture Composed of Hilco Merchant Resources, LLC, SB Capital Group, LLC, and Tiger Capital Group, LLC or (B) Other Successful Bidder at the Auction, (II) Approving Stalking Horse Fee, (III) Authorizing Debtors to Abandon Unsold Property, (IV) Waiving Compliance with Contractual Store Closing Sale Restrictions, (V) Exempting (A) State and Local “Fast Pay” Laws and (B) Laws Restricting Store Closing Sales, and (VI) Granting Related Relief at 3, *In re Borders Grp., Inc.*, No. 1:11-bk-10614 (Bankr. S.D.N.Y. Feb. 16, 2011), ECF No. 7 [hereinafter Emergency Motion]; Declaration of Holly Felder Etlin In Support of Store Closing Sale Motion at 3, *In re Borders Grp., Inc.*, No. 1:11-bk-10614, (Bankr. S.D.N.Y. Feb. 16, 2011), ECF No. 10.

¹³⁴ Emergency Motion at 2.

¹³⁵ *Id.*

¹³⁶ A “stalking horse bid” is a term of art in bankruptcy sales. The bid places a floor on a proposed asset sale, setting a minimum opening price for other potentially interested purchasers. For an explanation for why the term is functionally inaccurate from a historical perspective, see Stephen Sather, *Shakespeare for Lawyers: Stalking Horse*, AM. BANKR. INST. J., May 1996, at 37 (“As used [in this context], the term ‘stalking horse’ is not an accurate metaphor . . . In its original context, a ‘stalking horse’ allowed a hunter to sneak up on its quarry. However, in this usage, the stalking horse does not sneak up on anything; rather, it flushes out higher bids.”).

proceeds from sales of that merchandise.¹³⁷

Another “first day” motion sought to reject unexpired leases associated with some of the stores Borders proposed to close.¹³⁸ The motion identified four outstanding leases for stores Borders had already closed. Borders asserted that “marketing the [l]eases for assignment or sublease to a third party would not generate any significant value for the estates”; however, rejection and abandonment of the leases would save Borders an estimated \$22.7 million over their remaining terms.¹³⁹ Borders would later bring another similar motion seeking to reject executory contracts.

Borders also sought court approval of a postpetition financing proposal, under which the postpetition lenders would loan \$505 million pursuant to a “senior secured, superpriority priming loan”—that is, a senior security interest in all Borders’ postpetition collateral.¹⁴⁰ Prepetition secured lenders would receive adequate protection in the form of a junior lien on Borders’ collateral, priority of payment as an administrative claim, and a funded indemnity reserve up to \$500,000.¹⁴¹ As required by statute,¹⁴² Borders demonstrated that funding was not available any other way; virtually all Borders’ assets were subject to prepetition liens, and the lenders Borders had approached were unwilling to issue credit as junior or unsecured creditors.¹⁴³

These three motions, along with a variety of other motions relating to administration of the estate and the continued operation of the company even within bankruptcy,¹⁴⁴ reflected Borders’ exercise of a debtor’s tools in

¹³⁷ Emergency Motion at 3.

¹³⁸ Debtors’ Omnibus Motion Pursuant to 11 U.S.C. §§ 365(a) and 554(a) and Fed. R. Bankr. P. 6006, 6007 and 9014 for Approval of Rejection of Certain Unexpired Leases of Non-Residential Real Property and Authorization to Abandon Certain Property Effective as of the Commencement Date at ¶ 7, *In re* Borders Grp., Inc., No. 1:11-bk-10614 (Bankr. S.D.N.Y. Feb. 16, 2011), ECF No. 23.

¹³⁹ *Id.*

¹⁴⁰ Motion to Authorize Debtors’ Motion for Entry of Interim and Final Orders Pursuant to 11 U.S.C. 105, 361, 362, 363, 364 and 507 (1) Approving Postpetition Financing, (2) Authorizing Use of Cash Collateral, (3) Granting Liens and Providing Superpriority Administrative Expense Status, (4) Granting Adequate Protection, (5) Modifying the Automatic Stay, and (6) Scheduling a Final Hearing, *In re* Borders Grp., Inc., No. 1:11-bk-10614 (Bankr. S.D.N.Y. Feb. 16, 2011), ECF No. 27.

¹⁴¹ Prepetition debt was tentatively calculated in Borders’ Motion as “not less than \$196,050,000 and \$33,699,708 of issued and outstanding letters of credit.” *Id.*

¹⁴² See discussion *supra* note 88 and accompanying text.

¹⁴³ Debtors’ Motion for Entry of Interim and Final Orders Pursuant to 11 U.S.C. 105, 361, 362, 363, 364 and 507 (1) Approving Postpetition Financing, (2) Authorizing Use of Cash Collateral, (3) Granting Liens and Providing Superpriority Administrative Expense Status, (4) Granting Adequate Protection, (5) Modifying the Automatic Stay, and (6) Scheduling a Final Hearing at 24–25, *In re* Borders Grp., Inc., No. 1:11-bk-10614 (Bankr. S.D.N.Y. Feb. 16, 2011), ECF No. 27.

¹⁴⁴ For example, Debtors’ motions to implement certain notice and case management procedures, for authorization to pay employee obligations and continue employee benefit

bankruptcy. With the automatic stay protecting Borders from creditors' collection efforts, Borders began efforts to cut ties with old debts and slim down outstanding obligations, as well as secure future financing, all with greater ease and less cost than could be obtained outside of bankruptcy.¹⁴⁵ As described by Borders' CFO, Scott Henry, Borders commenced the chapter 11 case

to pursue an operational and financial restructuring, to restore and revitalize Borders as the second largest chain of bookstores in the nation, and to save thousands of jobs. Among other things, we hope, through the approval of certain First Day Motions, to regain access to capital that Borders sorely needs to remain viable, and to shed approximately 200 stores that we cannot afford to keep.¹⁴⁶

The court supported these goals: Borders' motion for approval of postpetition financing was granted on an interim basis the next day.¹⁴⁷ The motion to sell the assets of the closing stores pursuant to auction was granted the day after.¹⁴⁸ The motion to reject unexpired leases took slightly longer, but was also granted less than three weeks later.¹⁴⁹

At the same time that Borders attempted to reorganize the company it

programs, and for continuation of deadlines to file schedules of assets and liabilities. *See generally In re Borders Grp., Inc.*, No. 1:11-bk-10614 (Bankr. S.D.N.Y. Feb. 16, 2011), ECF Nos. 11, 12, and 14.

¹⁴⁵ As explained above, *supra* notes 76–92 and accompanying text, asset sales conducted with the oversight of the court permits the debtor greater control over the outcome of the sale, while the rejection of unexpired leases in bankruptcy permits any default of the debtor to be paid in “bankruptcy dollars,” that is, whatever pro rata percentage the debtor ultimately pays to unsecured creditors. Finally, the bankruptcy court can force previously senior secured creditors to accept a downgrade in priority to make way for new estate financiers, a move that could not be accomplished outside of bankruptcy without their consent.

¹⁴⁶ Declaration of Scott Henry Pursuant to Local Bankruptcy Rule 1007-2 in Support of First Day Motions at 2, *In re Borders Grp., Inc.*, No. 1:11-bk-10614 (Bankr. S.D.N.Y. Feb. 16, 2011), ECF No. 20.

¹⁴⁷ Interim Order Granting Motion (1) Approving Postpetition Financing, (2) Authorizing Use of Cash Collateral, (3) Granting Liens and Providing Superpriority Administrative Expense Status, (4) Granting Adequate Protection, (5) Modifying the Automatic Stay, and (6) Scheduling a Final Hearing at 19, *In re Borders Grp., Inc.*, No. 1:11-bk-10614 (Bankr. S.D.N.Y. Feb. 17, 2011), ECF Nos. 69, 2462. The final order, after the court heard objections, was entered about a month later. *See* Final Order Pursuant to 11 U.S.C. §§ 105, 361, 362, 363, 364 and 507 (1) Approving Postpetition Financing, (2) Authorizing Use of Cash Collateral, (3) Granting Liens and Providing Superpriority Administration Expense Status, (4) Granting Adequate Protection, and (5) Modifying Automatic Stay, *In re Borders Grp., Inc.*, No. 1:11-bk-10614 (Bankr. S.D.N.Y. Mar. 16, 2011), ECF No. 404.

¹⁴⁸ Order Approving Agency Agreement, Store Closing Sales and Related Relief at 6, No. 1:11-bk-10614 (Bankr. S.D.N.Y. Feb. 18, 2011), ECF No. 91.

¹⁴⁹ Order Pursuant to 11 U.S.C. §§ 365(a), and 554(a) and Fed. R. Bankr. P. 6006, 6007 and 9014 Approving the Rejection of Certain Unexpired Leases of Non-Residential Real Property and Authorizing the Abandonment of Certain Personal Property Effective as of the Commencement Date at 2, *In re Borders Grp., Inc.*, No. 1:11-bk-10614 (Bankr. S.D.N.Y. Mar. 4, 2011), ECF No. 258.

also began considering a sale of the business as a going concern, pursuant to the demands of unsecured creditors.¹⁵⁰ On June 30th, a little over four months into the bankruptcy, Borders filed a motion seeking approval of the sale of substantially all assets free and clear of all liens to a pre-specified stalking horse bidder, Najafi Companies, for \$215 million.¹⁵¹ Multiple creditors filed objections, most notably, the Official Committee of Unsecured Creditors (OCC).¹⁵² The OCC indicated that, although it would not object to the sale of substantially all of Borders' assets through a going concern sale, the proposed agreement permitted the buyer to liquidate the assets immediately upon sale, such that the arrangement "neither maximizes value for the benefit of unsecured creditors nor provides for the other benefits of a going concern—preservation of the business and the thousands of jobs that go along with that business."¹⁵³ In other words, the buyer in the sale would take advantage of whatever value was contained in the raw assets of the company. The buyer was not buying Borders as a continuing entity, only the company's physical assets.

The court agreed with the OCC, and following a court-supervised auction with no bidders, Borders was sold to the stalking horse buyer preferred by the OCC, one who specialized in the winding down and piecemeal sale of companies.¹⁵⁴ As of July 21, Borders' reorganization had officially become a liquidation.

4. Going Concern Value

Although the original intent was to restructure the company by closing

¹⁵⁰ See Notice of Hearing on Debtors' Motion for an Order Pursuant to Sections 105, 363 and 365 of the Bankruptcy Code and Rules 2002, 6004, 6006 and 9014 of the Federal Rules of Bankruptcy Procedure (I) Approving the Sale of Substantially All of the Debtors' Assets Free and Clear of All Liens, Claims, Encumbrances and Interests and the Assumption and Assignment of Executory Contracts and Unexpired Leases Related Thereto, (II) Approving the Sale Procedures and Break-Up Fee, and (III) Granting Related Relief, *In re Borders Grp., Inc.*, No. 1:11-bk-10614 (Bankr. S.D.N.Y. June 30, 2011), ECF No. 1130.

¹⁵¹ *Id.*; Michael J. De La Merced, *Borders Faces Liquidation After Takeover Bid's Rejection*, N.Y. TIMES (July 13, 2011), http://dealbook.nytimes.com/2011/07/13/borders-faces-liquidation-after-takeover-bids-rejectionthe-borders-group-was-dealt-a-potentially-lethal-blow-on-wednesday-when-a-committee-of-its-unsecured-creditors-rejected-a-proposed-takeover-by/?ref=business&_r=0.

¹⁵² Objection of the Official Committee of Unsecured Creditors to Bid Procedures and Break-Up Fee Contained in the Debtors' Motion for an Order Pursuant to Sections 105, 363 and 365 of the Bankruptcy Code and Rules 2002, 6004, 6006 and 9014 of the Federal Rules of Bankruptcy Procedure (I) Approving the Sale of Substantially All of the Debtors' Assets Free and Clear of All Liens, Claims, Encumbrances and Interests and the Assumption and Assignment of Executory Contracts and Unexpired Leases Related Thereto, (II) Approving the Sale Procedures and Break-Up Fee, and (III) Granting Related Relief at 3, *In re Borders Grp., Inc.*, No. 1:11-bk-10614 (Bankr. S.D.N.Y. July 13, 2011), ECF No. 1216.

¹⁵³ *Id.*

¹⁵⁴ De La Merced, *supra* note 151.

unprofitable stores and transitioning to a focus on electronic offerings, it soon became apparent that the contribution of the company was the provision of services that proved to be totally obsolete, easily replicated by others, and available at a lower cost than Borders could provide. The market in which Borders had sought to compete changed dramatically over the course of its existence, and the company simply failed to adjust to the change. Its downfall was compared by analysts to the death of the dinosaurs, “swept up in forces they were not prepared for and did nothing to prevent.”¹⁵⁵

Borders’ enormous storefronts, stocked with literature that was difficult to find, could not compete with the ease of online purchases, or the accessibility of text through electronic devices. What is more, the stores were staggeringly more expensive to maintain. Borders’ failure to invest in electronic technologies, notably the online sales of books and the provision of electronic books, completely undermined its ability to compete in the age of the internet.¹⁵⁶ Whatever value Borders could provide as a going concern was eroded over time, such that, by the point it filed for bankruptcy, there was no real value to exploit apart from the simple liquidation of its assets. In other words, the cost to bring an outdated behemoth such as Borders into the 21st century was too much to justify preservation of the Borders name.¹⁵⁷

B. *Blockbuster: From Renting VHS to Digital Streaming*

Blockbuster’s history suggests a watershed moment, when the company could have and should have altered its business model in such a way to embrace the transition of the movie rental business from a strictly hard-copy, in-store model to one that would allow for mailing and streaming media over the internet. Unfortunately for Blockbuster, other forces prevailed. A shareholder proxy fight was waged over the issue of what direction the company would take, and this resulted in a decision to retrench in established business practices rather than adjust to a changing market. Early abandonment of new technologies would later prove disastrous for the company’s long-term prospects.

1. Beginnings

Blockbuster Video was opened in 1985 by husband and wife team

¹⁵⁵ CORPORATE DISASTERS, *supra* note 112, at 51.

¹⁵⁶ See Ben Austen, *The End of Borders and the Future of Books*, BLOOMBERG BUSINESSWEEK (Nov. 10, 2011, 8:37 PM), <http://www.bloomberg.com/news/articles/2011-11-10/the-end-of-borders-and-the-future-of-books>.

¹⁵⁷ Borders’ failure did open space for the revival of many smaller independent bookstore owners, who were able to capitalize on the market for physical storefronts while simultaneously integrating the demand for e-books. See Austen, *supra* note 156 (quoting the owner of Parnassus, an independent bookstore, as saying, “We’re building our store from the bones of the superstores.”).

David and Sandy Cook, leasing movies on videotapes to individuals that they could watch on their personal videocassette recorders (VCRs).¹⁵⁸ At the time, VCRs were widely owned, and increasingly available to average households.¹⁵⁹ Most people rented movies from small local video rental stores, and doing so was the only real alternative to going to a movie theater. Blockbuster's initial strength was in its inventory of cassettes, which dramatically exceeded those of contemporary competitors, and in its use of barcodes, magnetic strips, and computers to keep track of inventory, discourage theft, and facilitate checkout.¹⁶⁰ The variety of selection Blockbuster was able to offer quickly translated into significant profits and growth. Early expansion meant that Blockbuster had nearly 400 stores by 1988, only three years after its formation.¹⁶¹

Before Blockbuster's tenth anniversary, the chain would have more than 3,400 stores, and had begun to partner with movie studios in promoting and advertising particular films.¹⁶² In 1994, Blockbuster merged with Viacom and began experimenting with sales of other products, such as snacks, t-shirts, magazines, CDs, and toys.¹⁶³ Competition from other big names such as Hollywood Video and even Wal-Mart restricted overall profits, and in 1996, Blockbuster experienced a new challenge—a change in format from cassettes to DVDs. For Blockbuster, this required a wholesale turnover in inventory to reflect the new format. It also meant the emergence of a new competitor, which quickly capitalized on the technological advance.

2. Fallout of Technological Innovation

Netflix, Inc., one of the pioneers of the new DVD market, was formed in 1997 with the business model of subscribing customers to rent DVDs by mail.¹⁶⁴ The slim and durable design of the DVDs, especially as compared to the bulky VHS cassettes, made this proposal economically feasible, as the DVDs could be more safely and inexpensively delivered and returned. Although initially the market for DVD rentals was small, limited to those who could afford the more expensive DVD players, by 2003, Netflix had

¹⁵⁸ CORPORATE DISASTERS, *supra* note 112, at 154.

¹⁵⁹ In 1985 an estimated 11.5 million VCRs were sold in America, with prices from \$200 to \$400. See Johnnie L. Roberts, *The Vcr Boom: Prices Drop As Their Popularity Continues To Grow*, WALL ST. J. (Sept. 22, 1985), reprinted in http://articles.chicagotribune.com/1985-09-22/news/8503040687_1_vcr-boom-suppliers-marketers.

¹⁶⁰ CORPORATE DISASTERS, *supra* note 108, at 154.

¹⁶¹ *Id.* at 154.

¹⁶² *Id.* at 155.

¹⁶³ *Id.*

¹⁶⁴ Jeffrey M. O'Brien, *The Netflix Effect*, WIRED (Dec. 1, 2002, 12:00 PM), <https://www.wired.com/2002/12/netflix-6/>.

acquired more than one million subscribers.¹⁶⁵ Netflix had already acquired revenue sharing agreements with movie producers that permitted it to purchase DVDs at a reduced rate in exchange for a cut of rental receipts, and had begun to acquire large numbers of independent and hard-to-find videos that would not be available at most video stores.¹⁶⁶

From the consumer perspective, Netflix eliminated the need to travel to a storefront to get a desired DVD, which could be ordered online in advance.¹⁶⁷ In addition, Netflix, pursuant to its subscription model, permitted customers to keep a DVD as long as desired, with the caveat that no further DVDs would be issued before it was returned.¹⁶⁸ Netflix also incorporated technology known as CineMatch, which allowed subscribers to rate the movies they viewed and receive recommendations of movie titles similar to those they liked.¹⁶⁹ The ability to easily request additional, similar titles expanded customers' tastes beyond what was immediately popular, at a cost-savings to Netflix, as box office hits typically require larger revenue-sharing than other movies.¹⁷⁰

Recognizing the competitive threat from Netflix, Blockbuster moved to adopt several of the Netflix innovations in 2004.¹⁷¹ However, it continued to see a slide in rentals as more people became Netflix subscribers and/or began purchasing their own collection of DVDs from Amazon or Wal-Mart.¹⁷² In spite of these numbers, CEO John Antioco was optimistic about Blockbuster's future, proposing to spend \$200 million to launch Blockbuster Online, an online DVD subscription.¹⁷³ He also eliminated late fees for in-store rentals, a popular move among customers, but at the cost of another \$200 million to the company.¹⁷⁴ These expenditures were controversial among Blockbuster shareholders and sparked a proxy fight.¹⁷⁵ Investor Carl Icahn launched the challenge in 2005, and was able to successfully bring himself onto the board of directors.¹⁷⁶ After the board clashed with Antioco

¹⁶⁵ CORPORATE DISASTERS, *supra* note 112, at 155.

¹⁶⁶ *Id.*

¹⁶⁷ O'Brien, *supra* note 160.

¹⁶⁸ *Id.*

¹⁶⁹ *Id.*

¹⁷⁰ *Id.*

¹⁷¹ Stephen Gandel, *How Blockbuster Failed at Failing*, TIME (Oct. 17, 2010) <http://content.time.com/time/magazine/article/0,9171,2022624,00.html>.

¹⁷² John Antioco, *How I Did It: Blockbuster's Former CEO on Sparring with an Activist Shareholder*, HARV. BUS. REV. (Apr. 2011) <https://hbr.org/2011/04/how-i-did-it-blockbusters-former-ceo-on-sparring-with-an-activist-shareholder#comment-167712680>; CORPORATE DISASTERS, *supra* note 112, at 155.

¹⁷³ Antioco, *supra* note 172.

¹⁷⁴ *Id.*

¹⁷⁵ *Id.*

¹⁷⁶ *Id.*

over salary, he stepped down as CEO in 2007.¹⁷⁷ At roughly the same time, Blockbuster collided with yet another form of technologically innovative competition.

Redbox Automated Retail, LLC began placing DVD rental kiosks in 2002, and by 2007 had more than 6,000 kiosks in restaurants, grocery stores, and shopping malls around the country.¹⁷⁸ These kiosks permitted customers to reserve DVDs online and then pick them up at the kiosk, renting them by the day, with the ability to return the DVD at any convenient time.¹⁷⁹ Customers could also peruse availability at the kiosk, which compared in expense to a Blockbuster store the way a vending machine might compare to a grocery store, with no full-time employees and minimal expenses for leases or utilities. What Redbox lacked in variety it compensated for in ease and convenience, and it quickly became one of the largest rental services in the nation.¹⁸⁰

Unable to keep up with these developments, an early competitor of Blockbuster and another store-based rental model, Hollywood Video, filed for bankruptcy in 2007.¹⁸¹ Blockbuster's response, under new CEO Jim Keyes, was to shift focus back to its in-store business, raising prices for online rentals and losing scores of customers as a result.¹⁸² In early 2009, Blockbuster launched its own line of vending kiosks, building a base of over 6,000 kiosks by 2010.¹⁸³ It also augmented its by-mail subscription program by permitting customers to exchange online movie rentals for in-store movies.¹⁸⁴

But Blockbuster continued to lose market share to its competitors. In 2008, Netflix began to offer movie streaming services to subscribers, who could stream movies directly from the internet.¹⁸⁵ At this time, Netflix was generating \$115 million in profit, while Blockbuster was recording losses of \$517 million.¹⁸⁶ In 2009, Blockbuster closed nearly 1,000 of its stores (which by then numbered more than 7,000) and took other steps to reduce

¹⁷⁷ *Id.*

¹⁷⁸ CORPORATE DISASTERS, *supra* note 112, at 156.

¹⁷⁹ Kim Iskyan, *Here's a look back at one of Carl Icahn's gigantic mistakes*, BUS. INSIDER (May 3, 2016), <http://www.businessinsider.com/carl-icahn-blockbuster-mistake-2016-5>.

¹⁸⁰ CORPORATE DISASTERS, *supra* note 112, at 156.

¹⁸¹ Associated Press, *Hollywood Video owner files for bankruptcy*, NBCNEWS (Feb. 3, 2010), http://www.nbcnews.com/id/35222092/ns/business-us_business/t/hollywood-video-owner-files-bankruptcy/#.WKcmpPkrKM8.

¹⁸² Antioco, *supra* note 172.

¹⁸³ Todd Davis & John Higgins, *A Blockbuster Failure: How an Outdated Business Model Destroyed a Giant*, CHAPTER 11 BANKRUPTCY CASE STUDIES 160 (2013) at 5, http://trace.tennessee.edu/utk_studlawbankruptcy/11.

¹⁸⁴ *Id.*

¹⁸⁵ CORPORATE DISASTERS, *supra* note 112, at 156.

¹⁸⁶ *Id.*

general and administrative expenses, in addition to refinancing transactions and freeing up cash.¹⁸⁷ These steps proved inadequate to curb financial problems. Blockbuster began to struggle with illiquidity, and share prices for Blockbuster stock dropped until July 7, 2010, when Blockbuster was delisted from the New York Stock Exchange.¹⁸⁸ Blockbuster filed for chapter 11 on September 23, 2010, only a few months after Hollywood Video initiated liquidation proceedings.¹⁸⁹

3. Bankruptcy

Blockbuster Inc. filed its chapter 11 petition joined by a dozen sister corporations, including Blockbuster Canada, Blockbuster International Spain, and Blockbuster Video Italy.¹⁹⁰ Blockbuster's listed assets topped \$1 billion, but its liabilities exceeded \$1.5 billion.¹⁹¹ Blockbuster's petition listed unsecured claims topped by over \$300 million in bond debt, followed by a series of smaller trade debts to various studios, ranging from \$21 million to just over \$162 thousand.¹⁹² Secured debt, to the tune of about \$630 million,¹⁹³ was in the form of Senior Secured Notes, with an interest in "all assets of the debtors."¹⁹⁴

The petition included an affidavit from newly-appointed Chief Restructuring Officer Jeffery J. Stegenga, who blamed Blockbuster's financial challenges on the general economic recession and the rise of competitive alternatives to Blockbuster's products, along with "unsustainable levels of debt."¹⁹⁵ Stegenga later described in detail how "technological advances" along with "changing consumer preferences" and

¹⁸⁷ *Id.*; Davis & Higgins, *supra* note 183.

¹⁸⁸ Affidavit of Jeffery J. Stegenga Pursuant to Local Bankruptcy Rule 1007-2 in Support of First Day Motions at 13, *In re BB Liquidating Inc.*, No. 10-14997-cgm (Bankr. S.D.N.Y. Sept. 23, 2010), ECF No. 3. [hereinafter Stegenga Affidavit].

¹⁸⁹ Voluntary Petition (Chapter 11), *In re BB Liquidating Inc.*, No. 10-14997-cgm (Bankr. S.D.N.Y. Sept. 23, 2010), ECF No. 1. Roughly 40% of Blockbuster stores were outside the United States at the time of filing.

¹⁹⁰ *Id.* Stegenga Affidavit, *supra* note 188, at 51.

¹⁹¹ *Id.*

¹⁹² Stegenga Affidavit, *supra* note 188, at 55.

¹⁹³ Different filings differ on the precise number. See Stegenga Affidavit, *supra* note 188, at 14; Voluntary Petition, *supra* note 189, at 6.; Debtors' Motion for Entry of an Order, on an interim and Final Basis, (I) Authorizing the Debtors to Obtain Postpetition Superpriority Financing Pursuant to 11 U.S.C. §§ 105, 361, 362, 364(c), 364(d)(1), and 364(e), (II) Authorizing Debtors' Use of Cash Collateral Pursuant to 11 U.S.C. § 363, (III) Granting Liens and Superpriority Claims to DIP Lenders Pursuant to 11 U.S.C. § 364, (IV) Providing Adequate Protection Pursuant to 11 U.S.C. §§ 361, 362, 363 and 364, and (V) Scheduling a Final Hearing Pursuant to Bankruptcy Rules 2002, 4001(b), 4001(c) and 6004, *In re BB Liquidating Inc.*, No. 10-14997-cgm (Bankr. S.D.N.Y. Sept. 23, 2010), ECF No. 16 [hereinafter Motion for Entry of an Order].

¹⁹⁴ Stegenga Affidavit, *supra* note 188, at 63.

¹⁹⁵ *Id.* at 15.

“the rapid growth of disruptive new competitors” had “changed the landscape of the industry.”¹⁹⁶ Demonstrating significant self-awareness, he further noted that competitors, using alternative distribution methods, had garnered market share and eroded Blockbuster’s “traditional ‘brick and mortar’ retail store based customer market.”¹⁹⁷ He observed, “[w]hile Blockbuster has successfully launched its own channels of distribution in the by-mail and . . . vending kiosk markets, the revenues and profits from these new channels have not offset the negative economic results from the reduced traffic within, and downsizing of, its traditional store-based channel.”¹⁹⁸

In the same document, Stegenga put forth a set of restructuring goals, indicating that Blockbuster had already begun to document a recapitalization transaction structure, arranged for DIP financing, and established contractual terms with movie studios going forward.¹⁹⁹ Through pre-bankruptcy negotiations, Blockbuster entered chapter 11 with a “Plan Support Agreement,” which had the support of 80% of secured creditors.²⁰⁰ The plan would convert debt into equity and provide Blockbuster with fresh capital “to effect a restructuring that will maximize value and assure Blockbuster’s long-term viability.”²⁰¹

With these goals in mind, Blockbuster raised first day motions seeking, among other things, authorization to grant postpetition financing by superpriority priming²⁰² old secured debt to the amount of \$125 million.²⁰³ A motion to reject unexpired leases followed the next day.²⁰⁴ The debtor’s motion for postpetition financing was granted (albeit on an interim basis) almost immediately.²⁰⁵ An order on the debtor’s motion regarding the rejection of unexpired leases was delayed subject to an objection, but

¹⁹⁶ *Id.* at 16.

¹⁹⁷ *Id.*

¹⁹⁸ *Id.*

¹⁹⁹ *Id.* at 24-25.

²⁰⁰ Stegenga Affidavit, *supra* note 188, at 25.

²⁰¹ *Id.*

²⁰² *See supra* note 92.

²⁰³ Motion for Entry of an Order, *supra* note 193, at 3.

²⁰⁴ Motion to Approve / Debtor’s Omnibus Motion Pursuant to 11 U.S.C. §§ 365(a) and 554(a) and Fed. R. Bankr. P. 6006, 6007, and 9014 for Approval of Rejection of Certain Unexpired Leases of Non-Residential Real Property and Authorization to Abandon Certain Property Effective as of the Commencement Date, *In re* BB Liquidating Inc., No. 10-14997-cgm (Bankr. S.D.N.Y. Sept. 24, 2010), ECF No. 73 [hereinafter Omnibus Motion].

²⁰⁵ Bridge Order (I) Authorizing Postpetition Superpriority Secured Financing Pursuant to 11 U.S.C. §§ 105(a), 361, 362, 364(c)(2), 364(c)(30), 364(d)(1) and 364(e), (II) Authorizing Postpetition Use of Cash Collateral Pursuant to 11 U.S.C. § 363, (III) Granting Adequate Protection Pursuant to 11 U.S.C. §§ 361, 362, 363 and 364 and (IV) Scheduling a Final Hearing Pursuant to Bankruptcy Rules 4001(b) and 4001(c), *In re* BB Liquidating Inc., No. 1:10-bk-14997-cgm (Bankr. S.D.N.Y. Sept. 23, 2010), ECF No. 74 [hereinafter Bridge Order].

approval was granted roughly four weeks later.²⁰⁶

Given that Blockbuster had the pre-negotiated agreement with senior lenders and the support of the bankruptcy court in its proposed use of bankruptcy tools, it was not unreasonable to expect a successful reorganization.²⁰⁷ However, the bankruptcy quickly stalled, as business continued to decline and the debtor was unable to reach an agreement with its post-petition financiers.²⁰⁸ After being granted two extensions of time to file a plan, Blockbuster ultimately requested, and was granted, the ability to sell substantially all of its assets to Dish Network Corporation pursuant to Section 363 of the Bankruptcy Code.²⁰⁹ The sale transferred all stores and operations to the buyer, leaving Blockbuster an empty shell “with no ongoing operations and only one remaining employee.”²¹⁰ Blockbuster changed its name to BB Liquidating Inc. and converted its chapter 11 reorganization to a chapter 7 liquidation.²¹¹

4. Going Concern Value

Dish Network invested roughly \$320 million in its purchase of Blockbuster’s assets and its brand.²¹² Dish then quickly used the Blockbuster streaming service to boost its own satellite TV plans and attempt to compete with Netflix streaming services.²¹³ However, Blockbuster’s strength was still in its hard-copy (rather than digital) library, with more than 100,000 available titles on DVD compared with 3,000 to 4,000 available to stream.²¹⁴

²⁰⁶ Order Establishing and Authorizing Procedures for the Rejection of Unexpired Leases of Nonresidential Real Property, *In re* BB Liquidating Inc., No. 1:10-bk-14997 (Bankr. S.D.N.Y. Oct. 21, 2010) ECF No. 362.

²⁰⁷ Blockbuster indeed had every expectation of a quick plan confirmation. *See* Notice of Hearing Regarding Debtor’s Motion, Pursuant to Section 1112(a) of the Bankruptcy Code and Bankruptcy Rules 1017(f) and 1019, to Convert their Chapter 11 Cases to Cases under Chapter 7 of the Bankruptcy Code at 3, *In re* BB Liquidating Inc., No. 1:10-bk-14997 (Bankr. S.D.N.Y. May 29, 2013), ECF No. 2856 [hereinafter Notice of Hearing].

²⁰⁸ *Id.*

²⁰⁹ *See* Debtors’ Emergency Motion, Pursuant to 11 U.S.C. §§ 105 and 363 and Fed. R. Bankr. P. 2002, 4001, 6004, and 9014, for Entry of a Supplemental Order Approving Amended and Restated Asset Purchase and Sale Agreement By and Among Blockbuster, Inc., the Debtor Subsidiaries Party Thereto, and Dish Network Corporation, *In re* BB Liquidating Inc., No. 1:10-bk-14997 (Bankr. S.D.N.Y. Apr. 21, 2011) ECF No. 1692; Supplemental Order, Pursuant to 11 U.S.C. §§ 105 and 363 and Fed. R. Bankr. P. 2002, 4001, 6004, and 9014, Approving Amended and Restated Asset Purchase and Sale Agreement By and Among Blockbuster, Inc., The Debtor Subsidiaries Party Thereto, and Dish Network Corporation, *In re* BB Liquidating Inc., No. 1:10-bk-14997 (Bankr. S.D.N.Y. Apr. 26, 2011) ECF No. 1723.

²¹⁰ *Id.*

²¹¹ Notice of Hearing, *supra* note 207.

²¹² Ryan Lawler, *So Why Did Dish Really Buy Blockbuster?*, GIGAOM (Apr. 6, 2011, 6:33 AM) <https://gigaom.com/2011/04/06/dish-blockbuster-acquisition/>.

²¹³ *Id.*

²¹⁴ *See* Matt Burns, *Blockbuster Movie Pass: Dish Network’s \$10/Month Answer to*

Customers did not latch on to the advertised ability to return videos in-store the way that promoters had hoped, and within two years of its purchase, after gradually shutting lower-performing stores, Dish Network announced that it would close all remaining Blockbuster Video retail locations, laying off nearly 3,000 employees.²¹⁵

Former investor Icahn, who initially resisted Antioco's shift toward more digital offerings, is reported to have lost nearly \$200 million in the company.²¹⁶ In the *Harvard Business Review*, he described Blockbuster as "the 'worst investment' he ever made."²¹⁷ He went on to say, "It failed because of too much debt and changes in the industry. It had too many stores, Netflix created a better business model, and then Redbox kiosks and the whole digital phenomenon eliminated the need for consumers to go to a separate DVD store."²¹⁸ In his statement, Icahn does not acknowledge that, as winner of the proxy fight, he was ideally situated to prevent Blockbuster's disastrous loss of value due to declining assets in a time of changing technology.

C. Kodak: Protecting Old Investments By Abandoning New Ideas

1. Beginnings

The Eastman Kodak Company was founded in 1888, and over the course of a century became a household name and an industry giant.²¹⁹ Known for its pioneering technology and innovative marketing,²²⁰ Kodak created and sold inexpensive household cameras, along with the film, chemicals, and paper required to develop photographs.²²¹ It developed a successful marketing campaign encouraging individuals to capture that "Kodak Moment" by preserving images of daily life on film.²²² The term

Netflix, TECHCRUNCH (Sept. 23, 2011) <https://techcrunch.com/2011/09/23/blockbuster-movie-pass-dish-networks-answer-to-netflix-and-qwikster/>.

²¹⁵ Liana B. Baker, *Dish Network to close all Blockbuster stores, lay off 2,800*, REUTERS (Nov. 6, 2013), <http://www.reuters.com/article/us-blockbuster-dish-idUSBRE9A511Z20131106>.

²¹⁶ Kim Iskyan, *Here's a look back at one of Carl Icahn's gigantic mistakes*, BUS. INSIDER (May 3, 2016), <http://www.businessinsider.com/carl-icahn-blockbuster-mistake-2016-5>.

²¹⁷ Jeanine Poggi, *Icahn: Blockbuster 'Worst Investment' I Ever Made*, THE STREET (Mar. 21, 2011), <https://www.thestreet.com/story/11053480/1/icahn-blockbuster-worst-investment-i-ever-made.html>.

²¹⁸ *Id.*

²¹⁹ *The last Kodak moment?*, ECONOMIST (Jan. 14, 2012), <http://www.economist.com/node/21542796>.

²²⁰ *Id.*

²²¹ *Id.*

²²² See Deborah L. Jacobs, *What Will Become of The 'Kodak Moment'?*, FORBES (Jan. 19, 2012), <http://www.forbes.com/sites/deborahljacobs/2012/01/19/what-will-become-of-the-kodak-moment/#44c4fb295c29>.

eventually became part of the popular lexicon, meaning “[a] sentimental or charming moment worthy of capturing in a photograph.”²²³ Following the company’s spectacular demise, the slang came to also mean “[t]he situation in which a business fails to foresee changes within its industry and drops from a market-dominant position to being a minor player or declares bankruptcy.”²²⁴

In 1976, Kodak accounted for 90% of film sales and 85% of camera sales in America, and was regularly rated one of the world’s five most valuable brands.²²⁵ One year earlier, in 1975, the company had built one of the first digital cameras.²²⁶ Rather than fully develop the technology, Kodak dropped it, reportedly out of fear that it would threaten the photographic film business it had built up.²²⁷ Within a few years, Kodak became distracted by challenges from Fujifilm, a Japanese competitor, and competition with Fuji’s lower-priced alternative came to dominate its market outlook.²²⁸ Kodak’s frustration with cheap Japanese film even led to trade friction between America and Japan during the 1990s, to the point that the United States issued a complaint against Japan to the World Trade Organization, without success.²²⁹

2. Fallout of Technological Innovation

When digital products began to gain traction in the market in the mid-1980s, Kodak integrated digital features into its product lines.²³⁰ This approach seemed to serve it well, and in 1996, revenues peaked at nearly \$16 billion.²³¹ Kodak profits peaked a few years later, reaching \$2.5 billion in 1999.²³² Throughout this time period, however, consumers began to switch in ever-growing numbers to digital cameras, even in third-world countries.²³³ In middle-class China, for example, many consumers purchased digital cameras first, skipping the older film models entirely.²³⁴ Kodak continued to participate in the digital market, and by 2001, it was the second largest

²²³ *Kodak moment*, WIKTIONARY (July 27, 2016), https://en.wiktionary.org/wiki/Kodak_moment.

²²⁴ *Id.*

²²⁵ *See The last Kodak moment?*, *supra* note 219.

²²⁶ *Id.*

²²⁷ *Id.*

²²⁸ *See* Michael Hiltzik, *Kodak’s Long Fade to Black*, L.A. TIMES (Dec. 4, 2011), <http://articles.latimes.com/2011/dec/04/business/la-fi-hiltzik-20111204>.

²²⁹ *See The last Kodak moment*, *supra* note 219.

²³⁰ *See* Hiltzik, *supra* note 228.

²³¹ *See The last Kodak moment*, *supra* note 219.

²³² *Id.*

²³³ *See id.*

²³⁴ This was unfortunate for Kodak, which had been relying on China as an emerging market. *See* LUCAS, JR., *supra* note 2, at 16.

seller of digital cameras.²³⁵

However, Kodak had already begun to lose money on the digital camera model, which did not require the additional film, chemical, and paper products their older cameras had. Beginning around 2001, film sales began to fall 20-30% per year.²³⁶ Many photos taken during that time period were never developed, but rather were saved in digital form on computers or other devices. As people began to take more and more pictures using cell phones and other devices rather than digital cameras, Kodak's share of the market shrunk even more.²³⁷ Although Kodak developed and then humored the digital camera, it did not envision or anticipate that digital cameras would entirely replace what had been, up to then, Kodak's "razor and blades" (camera and film) approach to picture taking.²³⁸

Many within Kodak pushed for greater recognition of the digital market early on. Larry Matteson, a former Kodak executive, wrote a report in 1979 detailing the ways in which the market would switch from film to digital—beginning with the government, then professional photography, and then the market at large, by 2010.²³⁹ But the profit on digital cameras paled in comparison to the profit on film. Matteson reported that: "Wise businesspeople concluded that it was best not to hurry to switch from making 70 cents on the dollar on film to maybe five cents at most in digital."²⁴⁰ Although it was true that Kodak could make substantially more in the short-term under the old model, failure to adjust to the new technology spelled disaster in the long run.²⁴¹

By 2003, only a few years out from Kodak's peak performance, the company announced that it would halt investing in traditional film in light of plummeting demand.²⁴² Instead, under the leadership of CEO Antonio M. Perez, Kodak began investing in inkjet printers and patent lawsuits, drawing on its formidable library to target companies like LG and Sony, among others.²⁴³ The company reduced its workforce by approximately 75% from

²³⁵ See Hiltzik, *supra* note 228.

²³⁶ Quentin Hardy, *At Kodak, Clinging to a Future Beyond Film*, N.Y. TIMES (Mar. 20, 2015), <https://www.nytimes.com/2015/03/22/business/at-kodak-clinging-to-a-future-beyond-film.html>.

²³⁷ See Hiltzik, *supra* note 228.

²³⁸ *Id.*

²³⁹ See *The last Kodak moment?*, *supra* note 219.

²⁴⁰ *Id.*

²⁴¹ See LUCAS, JR., *supra* note 2, at 24.(quoting Carly Fiorina's observation that Kodak "protected its franchise for as long as it could" and only entered digital photography "when it was completely obvious to everyone that the old model simply would not survive").

²⁴² De La Merced, *supra* note 151.

²⁴³ *Id.*; Marius Meland, *Kodak Sues Sony Over Digital Camera Patents*, LAW360 (Mar. 10, 2004), <https://www.law360.com/articles/1094/kodak-sues-sony-over-digital-camera-patents>. These lawsuits were responsible for billions of dollars of revenue in the years leading

2003 to 2011.²⁴⁴ Revenue did not meet expectations, however,²⁴⁵ and in a last-ditch effort to avoid bankruptcy, Kodak announced the sale of its digital imaging patents in 2011, suggesting the company intended to abandon the digital photography market altogether.²⁴⁶ In the absence of sufficiently interested buyers, Kodak filed for bankruptcy protection on January 19, 2012.²⁴⁷

3. Bankruptcy

Kodak listed \$5.1 billion in total assets and \$6.75 billion in debts on its chapter 11 bankruptcy filing.²⁴⁸ In its preliminary statement accompanying the filing, Kodak blamed its liquidity issues on difficulties in collecting licensing fees from infringers of its intellectual property, as well as substantial legacy costs, particularly costs associated with post-employment benefits for thousands of retired Kodak employees.²⁴⁹ It indicated that its primary motivation in filing for bankruptcy protection was to obtain postpetition DIP finance,²⁵⁰ and consistent with this desire, filed a motion pursuant to Section 364 to borrow \$950 million secured by estate property.²⁵¹ Kodak proposed to offer DIP lenders the highest protection possible: superpriority, priming liens, and the ability to “roll-up” prepetition lien debt.²⁵² The same day, Kodak also filed motions to reject unexpired aircraft

up to bankruptcy. See Affidavit—Declaration of Antoinette P. McCorvey at 3, *In re Eastman Kodak Co.*, No. 1:12-bk-10202 (Bankr. S.D.N.Y. Jan. 19, 2012), ECF No. 2 [hereinafter *McCorvey Affidavit*].

²⁴⁴ Kodak went from having approximately 63,900 employees in 2003 to roughly 17,000 employees by the time of its bankruptcy filing in 2011. See *McCorvey Affidavit*, *supra* note 243, at 3.

²⁴⁵ This was in part due to flawed estimates in the market for film. As acknowledged by Kodak, the company had anticipated a 20% decline in film sales between 2008 and 2010, which was roughly half of the actual decline. See *McCorvey Affidavit*, *supra* note 243, at 14.

²⁴⁶ De La Merced, *supra* note 151.

²⁴⁷ *In re Eastman Kodak Co.*, Case No. 1:12-bk-10202 (Bankr. S.D.N.Y. Jan. 19, 2012), ECF No. 1.

²⁴⁸ *Id.*

²⁴⁹ See *McCorvey Affidavit*, *supra* note 243, at 13. Kodak listed the Kodak Pension Plan of the United Kingdom as its largest unsecured creditor, with a claim that was as-yet undetermined. Statement—Notice of Filing of Amended Consolidated List of Creditors Holding 50 Largest Unsecured Claims at 4, *In re Eastman Kodak Co.*, No. 1:12-bk-10202 (Bankr. S.D.N.Y. Jan. 19, 2012), ECF No. 80.

²⁵⁰ See *McCorvey Affidavit*, *supra* note 243, at 5.

²⁵¹ Motion to Approve Debtor in Possession Financing at 3–4, *In re Eastman Kodak Co.*, No. 1:12-bk-10202 (Bankr. S.D.N.Y. Jan. 19, 2012), ECF No. 16.

²⁵² *Id.* at 5–6, *In re Eastman Kodak Co.*, No. 1:12-bk-10202 (Bankr. S.D.N.Y. Jan. 19, 2012), ECF No. 16. A “roll-up” permits a post-petition lender to shift its pre-petition unsecured debt into post-petition administrative debt, thereby making repayment significantly more likely.

leases²⁵³ and nonresidential real property leases,²⁵⁴ as well as various executory contracts.²⁵⁵

Kodak's bankruptcy motions were resisted by creditors who accused them of "burning the furniture"—selling off valuable assets in one-time cash generation events—and were skeptical of Kodak's ability to effectively reorganize.²⁵⁶ Indeed, there was little doubt that Kodak was engaging in dramatic downsizing as part of its process of reorganization. Kodak made multiple motions to sell off assets in bankruptcy,²⁵⁷ including its impressive Digital Imaging Patent Portfolio.²⁵⁸ This was a particularly noteworthy step; Kodak's patents were seen by many as the most valuable and distinctive assets owned by the company. They were eventually sold to long-time competitor Fujifilm, as part of a syndicate of buyers.²⁵⁹

²⁵³ Debtors' Motion for an Order Authorizing Rejection of Certain Unexpired Aircraft Leases Effective as of the Petition Date, *In re Eastman Kodak Co.*, No. 1:12-bk-10202 (Bankr. S.D.N.Y. Jan. 19, 2012), ECF No. 27.

²⁵⁴ Motion to Reject Lease or Executory Contract—Motion for an Order Authorizing Rejection of Certain Unexpired Nonresidential Real Property Leases, *In re Eastman Kodak Co.*, No. 1:12-bk-10202 (Bankr. S.D.N.Y. Jan. 19, 2012), ECF No. 31.

²⁵⁵ Motion to Reject Lease or Executory Contract—First Omnibus Motion for an Order Authorizing Rejection of Various Executory Contracts, *In re Eastman Kodak Co.*, No. 1:12-bk-10202 (Bankr. S.D.N.Y. Feb. 28, 2012), ECF No. 449.

²⁵⁶ See Objection/Omnibus Objection of Ad Hoc Committee of Second Lien Noteholders to Debtors' First Day Relief and Statement Regarding the Debtors' DIP Financing Motion at 2, *In re Eastman Kodak Co.*, No. 1:12-bk-10202 (Bankr. S.D.N.Y. Jan. 19, 2012), ECF No. 39.

²⁵⁷ See Motion to Authorize—Motion for Order (i)(A) Authorizing Certain Debtors Entry into the Stalking Horse Purchase Agreement, (B) Authorizing and Approving the Bidding Procedures and Break-Up Fee, (C) Approving the Notice Procedures, (D) Authorizing the Filing of Certain Documents Under Seal and Setting a Date for the Sale Hearing and (II) Authorizing and Approving the Sale of Certain Assets of Kodak Imaging Network Inc. Free and Clear of All Claims and Interests, *In re Eastman Kodak Co.*, No. 1:12-bk-10202 (Bankr. S.D.N.Y. Mar. 2, 2012), ECF No. 474; Motion to Approve Expedited Procedures for the Sale, Transfer, Donation and/or Abandonment of De Minimis Assets, *In re Eastman Kodak Co.*, No. 1:12-bk-10202 (Bankr. S.D.N.Y. Jan. 31, 2012), ECF No. 173.

²⁵⁸ Motion to Authorize—Debtors' Motion for Orders (I)(A) Conditionally Authorizing the Sale of Patent Assets Free and Clear of Claims and Interests, (B) Establishing a Competitive Bidding Process and (C) Approving the Notice Procedures and (II) Authorizing the Sale of Patent Assets Free and Clear of Claims and Interests, *In re Eastman Kodak Co.*, No. 1:12-bk-10202 (Bankr. S.D.N.Y. June 11, 2012), ECF No. 1361.

²⁵⁹ Order Authorizing the Sale of Patent Assets Free and Clear of Claims and Interests, The License of Patents, The Assumption of Patent Cross License Agreements With Fujifilm and the Settlement of Claims Related to Certain Patents, *In re Eastman Kodak Co.*, No. 1:12-bk-10202 (Bankr. S.D.N.Y. Jan. 11, 2013), ECF No. 2847. See also Sarah Mitroff, *Kodak Sells Digital Camera Patents to Apple, Google, Other Tech Giants*, WIRED (Dec. 19, 2012), <https://www.wired.com/2012/12/kodak-patents/>.

Despite some creditor reservations and complexities of the case which necessitated a motion to extend the time to submit a plan,²⁶⁰ Kodak's plan was ultimately confirmed. As part of the plan, Kodak settled legacy pension claims and made reduced payments to noteholders. Shareholder claims were entirely wiped out. Although these shareholders voted against the plan, it was approved over their objection by virtue of "cramdown" provisions that permit a plan that has been accepted by other classes of creditors to proceed, if fair and equitable.²⁶¹ Kodak was officially reorganized, and emerged from bankruptcy discharged of debts as provided in the plan, albeit a very different creature than it was entering bankruptcy.

4. Going Concern Value

Following its massive shed of assets, Kodak has struggled to define itself. As part of its bankruptcy transformation, Kodak fully exited what it described as the "low-growth dedicated capture device business," meaning digital cameras, pocket video cameras, and digital picture frames,²⁶² essentially sacrificing the niche in which it had been known. No longer would customers seek to capture a "Kodak moment," at least not on a Kodak device. Instead, Kodak proposed to be a leader in inkjet-based digital presses, digital printing plates, and other related products. It remains to be seen what value Kodak can contribute in this field. Its brand, once so familiar to consumers, is becoming less and less prominent to consumer audiences. There is a sense that whatever Kodak determines to become, it has little time to get there in the face of strong competitive forces,²⁶³ and the danger of a second bankruptcy filing continues to loom.

D. Common Themes

Each of the companies described above were not always technological dinosaurs. To the contrary, they were themselves built, at least initially, on technological innovation. Borders and Blockbuster became industry giants using advanced methods and models of inventory tracking, enabling them to

²⁶⁰ Motion to Extend Exclusivity Period for Filing a Chapter 11 Plan and Disclosure Statement and Solicit Acceptances Thereof, *In re Eastman Kodak Co.*, No. 1:12-bk-10202 (Bankr. S.D.N.Y. Jan. 19, 2012), ECF No. 831 [hereinafter Motion to Extend Exclusivity].

²⁶¹ See Debtors' Memorandum of Law in Support of Confirmation of First Amended Joint Chapter 11 Plan of Reorganization of Eastman Kodak Company and Its Debtor Affiliates, *In re Eastman Kodak Co.*, No. 1:12-bk-10202 (Bankr. S.D.N.Y. Aug. 16, 2013), ECF No. 4863; Notice of Filing of Revised Proposed Findings of Fact, Conclusions of Law and Order Confirming the First Amended Joint Chapter 11 Plan of Reorganization of Eastman Kodak Co. and its Debtor Affiliates Pursuant to Chapter 11 of the Bankruptcy Code, *In re Eastman Kodak Co.*, No. 1:12-bk-10202 (Bankr. S.D.N.Y. Aug. 19, 2013), ECF No. 4897.

²⁶² Motion to Extend Exclusivity, *supra* note 260, at 42.

²⁶³ See Quentin Hardy, *At Kodak, Clinging to a Future Beyond Film*, N.Y. TIMES, Mar. 20, 2015, at BU1.

provide goods more closely tailored to client demand. Kodak brought the product of film and picture-taking to the consumer. These innovations allowed each company to grow exponentially and capitalize on their respective markets. However, each of these companies also failed, in large part because they came to rely on their size or became complacent in the provision of services that would quickly become obsolete in the face of disruptive technologies.

In the case of Borders and Blockbuster, each company defined itself by its ability to provide customers with multiple physical locations containing shelves and shelves of product—books, movies, or other media. When the ability to access these forms of media improved, first through online sales, which soon were able to beat even the most well-stocked shelves in terms of inventory, and then through wholesale digital streaming, which ceased to require the purchase of any hard-copy materials, the companies were either unable or unwilling to alter their business models in time. Technological disruption proved to be the downfall of each, to the point that not even bankruptcy proceedings, with their inherent advantages, were sufficient to salvage them.²⁶⁴

In the case of Kodak, the company had early access to technology that would eventually reshape the world of photography and picture-taking. However, the company realized that although the technology would improve the ability of customers to take photos, it would also make photography much less expensive, requiring significantly less of the product that Kodak had traditionally marketed. Rather than accepting a short-term reduction in profits, Kodak instead bartered away its future by refusing to change course until the money in film had been entirely exhausted, and the alternatives uncertain and rife with competition.

There are generally applicable lessons to be gleaned from these stories. The most obvious is the clear need to act promptly when faced with a technological disruption. In each scenario, the companies seemed to realize the necessity of responding to technological changes embarrassingly late, after new and disruptive innovators had already obtained a strong presence in the market.²⁶⁵ In addition, even after recognizing the threat, each company seemed to flounder with regard to establishing an effective strategic response. Once it had acknowledged the threat posed by Amazon and terminated its agreement with them, Borders initially attempted to respond

²⁶⁴ See Stephen Gandel, *How Blockbuster Failed at Failing*, TIME (Oct. 17, 2010), <http://content.time.com/time/magazine/article/0,9171,2022624-2,00.html>.

²⁶⁵ See CLAYTON M. CHRISTENSEN, *THE INNOVATOR'S DILEMMA* 8 (1997) (comparing coping with the onslaught of technological changes to climbing a mudslide raging down a hill—"You have to scramble with everything you've got to stay on top of it, and if you ever once stop to catch your breath, you get buried.").

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to the phenomenon of online book purchases by borrowing from a sympathetic lender. It then limped along for three years, accruing debt and bleeding cash reserves, before eventually filing for bankruptcy. Blockbuster behaved erratically in response to its technological crisis, initially diving into the online market under Antioco's leadership, but then largely shifting its approach back to the old business model under Keyes. The company did not file for bankruptcy until three years after the bankruptcy of its former competitor, Hollywood Video. Kodak deliberately delayed the transition into digital photography in a conscious effort to maximize the profit to be made from traditional film. But even after it had concluded that a transition was necessary, it attempted to do so outside of bankruptcy for nearly eight years, only finally accepting bankruptcy relief when it could not sell its most valuable assets.

It is impossible to say with certainty how circumstances might have played out differently had these companies been faster to adjust to technology, or even more prompt in taking advantage of bankruptcy protection. Perhaps, if Borders had taken steps to jettison less-profitable leases earlier and focused on the stores that maintained their profitability, it would have retained its label and maintained an economic presence. If Blockbuster had determined earlier to restructure its business through bankruptcy proceedings, there might have been sufficient value in the business to avoid a sale to Dish and instead exploit the Blockbuster brand through its own online offerings. Finally, Kodak might have been more able to salvage its value through an earlier going concern sale in bankruptcy, as opposed to the piecemeal sale of individual assets over the course of several years. This might have preserved the relevance of the term "Kodak moment" in the realm of image preservation, rather than a hindsight reference to a poor decision.

A second important lesson is that being large is not necessarily a protection against failure, and may in fact be an obstacle in the effort to adjust to new technologies. Although bankruptcy proceedings permit companies to reject unprofitable leases and to sell assets in court auctions, heavy investments in the wrong sorts of capital are not easily undone. Large debt obligations, such as secured loans or pension plans, may be similarly difficult to avoid, with significant consequences for the company and for third parties. The larger the obligations and more complicated the industry, the more difficult it may be to make those adjustments in a short period of time.

In retrospect, it seems apparent that each of the three companies described above were mismanaged in the years leading up to bankruptcy. Management should have made adjustments to the business model earlier, observing the changes on the horizon. It was management's lack of vision

and refusal to pivot that caused the companies to fail. These examples demonstrate that management cannot place their trust in consumer loyalty when cheaper, more reliable options for service become available, even when the company brand is far-reaching and powerful. Bankruptcy protection cannot encourage the greater use of a debtor's products or services when they become obsolete. In fact, bankruptcy may actually undermine the marketing of products or services by virtue of the stigma associated with a bankruptcy filing.

V. LAW FIRM BANKRUPTCIES

This Article argues that law firms are not immune to failure as a consequence of technological disruption, and that the experiences of other firms that have so failed demonstrate the need for law firms, and the industry at large, to respond and adjust quickly to innovation affecting the legal field. An obvious response to this cautionary tale, from the perspective of a law firm, is that the practice of law is fundamentally different from the provision of goods, and law firms are fundamentally different from corporations, with different regulatory requirements and capital makeup. This is all true. However, the unique character of a law firm makes the lessons of the Blockbuster, Borders, and Kodak bankruptcies described above *more* relevant, not less.

As demonstrated above, the advancement of technology is certainly capable of rendering current models of providing legal services entirely obsolete, as tasks traditionally performed by attorneys can be accomplished faster and more efficiently by computer software programs. Law firms, like any other business, may quickly find themselves unable to compete with alternative providers who have adopted more robust technological methods, such that their overhead costs are lower, their provision of services is faster and more accurate, or they are otherwise a more desirable choice for clients. However, law firms have even greater reason than other businesses to respond and readjust to technological advances before bankruptcy becomes a necessary reaction, because for law firms, bankruptcy proceedings almost inevitably signal total demise, whether the reasons for filing are economic or simply financial in nature.

Law firms find themselves in bankruptcy on a fairly frequent basis, similar to firms in any other industry. However, unlike typical corporate bankruptcy cases, these filings are much more likely to be involuntary—filed by creditors of the firm rather than the partners themselves²⁶⁶—and

²⁶⁶ Although this paper has largely addressed the benefits of bankruptcy to the filing debtor, they may be benefits to creditors as well, making an involuntary bankruptcy an attractive alternative. For example, creditors may prefer the less rigorous process of filing a claim for payment in bankruptcy to obtaining a legal judgment and attempting to enforce it,

significantly more likely to end in liquidation of firm assets rather than preservation of the company as a going concern.²⁶⁷ This may be explained by two attributes shared by virtually all law firms. First, law firms are generally formed as partnerships or, even more commonly, limited liability partnerships (LLPs).²⁶⁸ Second, the principal, if not the only significant non-cash assets of law firms are the personnel—the partners, associates, and staff.²⁶⁹ Law firm partners are thus both the assets and the owners of the company, and when partners begin to leave, their loss can trigger a partner run that quickly bleeds the firm of value and renders it insolvent.²⁷⁰ These attributes also have the effect of making a law firm bankruptcy significantly more painful for its partners, who lose their jobs in addition to their major capital investments.

Unlike typical partnership agreements, which require dissolution of the firm upon the exit of any partner,²⁷¹ law firms, particularly large law firms, permit the entrance and exit of partners without forcing dissolution of the firm as a whole, permitting firms to survive beyond the lifetimes of the founding individuals. However, this policy also permits partners to leave and join other firms, frequently taking clients, projects, and associates with them. Ethical rules typically prohibit the imposition of non-compete clauses or other restrictions on an attorney's ability to take firm clients.²⁷² Accordingly, law firms have little ability, other than the powers of persuasion, to convince remaining partners to stay with the firm through a period of financial distress.

When a critical number of partners leave a law firm, or when the remaining partners lose their faith in the firms' ability to thrive in the long term, there arises a strong incentive for remaining partners to also leave, rather than attempt to reorganize or otherwise rehabilitate a firm struggling

recognizing that under state law creditors will be competing amongst themselves in a race to the debtor's assets. See 11 U.S.C. §§ 101(5)(A), 502(a) (defining claims broadly and allowing all claims unless a party in interest objects). In addition, and of particular relevance in the context of a law firm debtor, bankruptcy proceedings may permit the recovery of preferential payments made while the debtor was insolvent. See *supra* note 90.

²⁶⁷ Although law firms may file under chapter 11 of the bankruptcy code, it is generally to confirm a liquidation plan. See Morley, *supra* note 11, at 1–2.

²⁶⁸ Lawyers are generally prohibited by rules of professional conduct from allowing non-lawyers to share in legal fees. This has generally restricted a law firm's ability to organize as a corporation, rather than a partnership. See Model Rules of Professional Conduct, Rule 5.4: Professional Independence of a Lawyer.

²⁶⁹ See Jacqueline Palank, *Debts of Defunct Law Firms Haunt Partners in Next Job*, WALL ST. J., Nov. 7, 2011 (quoting bankruptcy expert Paul A. Rubin as saying “[t]he most valuable assets of a law firm go home every night”).

²⁷⁰ See Morley, *supra* note 11, at 2.

²⁷¹ *Id.* at 18.

²⁷² MODEL RULES OF PROF'L CONDUCT R. 5.6.

to maintain its cash flow.²⁷³ Particularly when the firm's profits have fallen below what may be offered by competitors, partners are incentivized to move, not just for future income but also to protect their capital investment.²⁷⁴ The moment a firm becomes insolvent, that investment becomes worthless, and in bankruptcy, may actually be a liability, opening them up to recovery actions by the bankruptcy estate.²⁷⁵ Once partners begin to leave, there is nothing to prevent others from following. Although bankruptcy operates as a stay against the withdrawal of typical "assets" from the bankruptcy estate, it cannot force attorneys to stay in the employ of the law firm, and in the event of a bankruptcy filing, attorneys almost never do.²⁷⁶

In fact, there is a strong motivation to leave in advance of the firm dissolution to avoid being caught in the relevant "clawback" period. Partners whose law firm dissolves frequently find themselves liable for a firm's unpaid debts in bankruptcy court, pursuant to clawback lawsuits,²⁷⁷ by virtue

²⁷³ Red flags of an eventual bankruptcy include the voluntary departure of attorneys. As observed by Al Togut, "[a] trickle can become a flood fairly quickly. With each departing partner, income diminishes and that exacerbates the problem. A law firm's principal asset is its people who go home each night. If they go home one night and don't return in the morning, the firm is out of business." David J. Parnell, *Al Togut of Togut, Segal, On Avoiding Law Firm Bankruptcies*, FORBES (Aug. 4, 2014), <http://www.forbes.com/sites/davidparnell/2014/08/04/al-togut-of-togut-segal-on-avoiding-law-firm-bankruptcies/3/#7b7a57f82f91>.

²⁷⁴ Most law firms tend to require a capital investment from partners, which can be substantial. Rule 5.6 of the Model Rules of Professional Conduct requires law firms to return capital to partners when they leave.

²⁷⁵ See Matthew C. Heyn, *The Application of Jewel v. Boxer to Law Firm Dissolutions*, L.A. LAW., Nov. 2014, at 14, <https://www.lacba.org/docs/default-source/lal-back-issues/2014-issues/november2014.pdf> ("The dissolution of a law firm can be a financial catastrophe for its partners.").

²⁷⁶ There is a notable counterexample to this trend, however, in the chapter 11 filing of Ruden McClosky, P.A., in 2011. Ruden filed for chapter 11 after the financial crisis in 2008 precipitated three-and-a-half years of net losses. Ruden blamed these losses on both a substantial reduction in work and "the departure of many Ruden attorneys, voluntary and involuntary, which further reduced Ruden's income." Disclosure Statement in Connection with Joint Chapter 11 Plan of Liquidation of Ruden McClosky P.A. at 8, *In re Ruden McClosky P.A.*, No. 11-bk-40603 (Bankr. S.D. Fla. Mar. 16, 2012), ECF No. 355. Ruden attempted to accomplish a merger or a sale outside of bankruptcy, but was unsuccessful. As revenue continued to decline, Ruden reached an agreement with Greenspoon Marder, P.A., pursuant to which Ruden would accomplish a sale of all its assets to Greenspoon through bankruptcy proceedings. Included in the agreement was a provision that permitted remaining Ruden employees to join Greenspoon. *Id.* Although Ruden, like other bankrupt law firms, was ultimately liquidated and ceased to exist as a going concern, bankruptcy was effective in keeping the assets and the personnel of the Ruden firm in the same organization, even if it no longer retained the firm name. By most standards, this would be categorized as a successful chapter 11 case.

²⁷⁷ In such litigation, a bankruptcy trustee will demand that former partners return all or a substantial portion of their draws made in the period leading up to the firm's dissolution. These claims may be made pursuant to applicable state law. See 11 U.S.C. § 544 (1978) (permitting a trustee to void any transfer of the debtor avoidable under state law or pursuant

of fraudulent conveyance or preference litigation, or on the basis of the unfinished business doctrine, as most famously set forth in the case *Jewel v. Boxer*.²⁷⁸ Under the doctrine of unfinished business, partners who take clients and client matters from the old firm to a new firm may have a duty to account to the old firm, or in the case of insolvency, the old firm's creditors, for a portion of the fees received.²⁷⁹

There have been several notable law firm bankruptcies within the past decade, almost all of which ended in liquidation and included a fair amount of clawback from former partners. For example, in the bankruptcy of Brobeck, Phleger & Harrison LLP, a firm of over 900 attorneys that dissolved and filed an involuntary bankruptcy in 2003, partners eventually agreed to the trustee's demand to return over \$22 million.²⁸⁰ Heller Ehrman LLP had more than 500 attorneys just before filing its chapter 11 petition in response to being declared in default by its major lender.²⁸¹ Heller's former partners (termed shareholders by the firm) were required to repay an average of \$100,000 each.²⁸² Perhaps the largest law firm collapse in living memory was that of Dewey & Leboeuf LLP in 2012.²⁸³ Prior to dissolution, Dewey boasted roughly 1,400 attorneys spread throughout twenty-six offices.²⁸⁴ In order to obtain a release of claims against them, partners repaid \$71.5 million, with several partners individually paying more than \$1 million back to the bankruptcy estate.²⁸⁵

to bankruptcy-specific provisions permitting the recovery of funds distributed while the debtor was insolvent.). See, also e.g., 11 U.S.C. §§ 547–48.

²⁷⁸ *Jewel v. Boxer*, 156 Cal. App. 3d 171 (1984).

²⁷⁹ See Michael D. DeBaecke & Victoria A. Guilfoyle, *Law Firm Dissolutions: When the Music Stops, Does Anyone Need to Account for Any Unfinished Business?*, 14 DEL. L. REV. 41, 44 (2013) (noting a difference between states as to whether the unfinished business doctrine applies to hourly fee matters in addition to contingency fee matters); Christine Hurt, *The Limited Liability Partnership in Bankruptcy*, 89 AM. BANKR. L.J. 567, 577–86 (2015) (detailing application of the *Jewel* doctrine in recent high-profile law firm bankruptcies).

²⁸⁰ See Ribstein, *supra* note 34, at 771–72.

²⁸¹ See Tom Abate & Andrew S. Ross, *Heller Ehrman law firm to dissolve friday*, S.F. GATE (Sept. 26, 2008), <http://www.sfgate.com/business/article/Heller-Ehrman-law-firm-to-dissolve-Friday-3193215.php>.

²⁸² Heyn, *supra* note 275, at 14.

²⁸³ See Edward S. Adams, *Rethinking the Law Firm Organizational Form and Capitalization Structure*, 78 MO. L. REV. 777, 777 (2013). Those with longer memories would also remember Finley Kumble as an industry giant that failed spectacularly. With nearly 700 lawyers at the time of its bankruptcy in 1987, it was by far the largest law firm failure of its time. See E.R. Shipp, *Finley, Kumble, Major Law Firm, Facing Revamping or Dissolution*, N.Y. TIMES (Nov. 11, 1987), <http://www.nytimes.com/1987/11/11/business/finley-kumble-major-law-firm-facing-revamping-or-dissolution.html>.

²⁸⁴ Peter Lattman, *Dewey & LeBoeuf Files for Bankruptcy*, N.Y. TIMES (May 28, 2012), <http://dealbook.nytimes.com/2012/05/28/dewey-leboeuf-files-for-bankruptcy/>.

²⁸⁵ See Heyn, *supra* note 275.

Although each law firm described above failed in slightly different ways, they shared a common pattern. As one author has recognized, law firms that failed demonstrated the pattern of “growth for the sake of growth,” celebrating “bigness” as a virtue, a characteristic which, as described above, is unlikely to be beneficial in the face of technological advance and may in fact be a liability.²⁸⁶ As demonstrated by these firms, and by the cases of Blockbuster, Borders, and Kodak above, a large, significant investment in outdated technology can prove far more costly than beneficial in the face of technological innovation. BigLaw firms should recognize the limited value and the very real danger in simply being big.

In addition, in light of the continual technological advances characteristic of our times, BigLaw firms should recognize the danger in complacency. There is evidence that many law firms have seen the advantages of artificial intelligence and are investing in its technology, although its experimental and potentially threatening nature may provoke resistance amongst those firms that have profited under the old model.²⁸⁷ This is Kodak’s story, and firms seeking a future would be well-advised not to grow too comfortable in an ever-changing present.

BigLaw firms should also avoid large investment in out-of-date technology or its supporting capital structure, analogous to Borders’ unprofitable leases. This could include, unfortunately, investing in associates in reliance on the model of churn—individuals who the firm has no intention of making a partner and in whom the firm is unwilling to invest time and training. As coveted as BigLaw jobs are now, they may become even more competitive, particularly if changes in the type of work and the level of firm investment induce more associates to stay at their jobs. Law

²⁸⁶ See, e.g., HARPER, *supra* note 39, at 149 (“Dewey & LeBoeuf had some unique problems, including multiyear compensation packages to legacy partners of the merged firms and massive debt that included millions in outside investor bonds and outstanding IOUs to partners when the firm failed to meet annual profit targets. But it was also a vivid example of ubiquitous trends in big law firms: growth for the sake of growth; combining firms without respect for their differing cultures; concentrating wealth and power at the top within so-called partnerships; eroding a middle class of equity partners who might bring more accountability to their firm leaders; using client silos as definitive measures of value; offering expensive guaranteed contracts as part of an aggressive lateral hiring approach that undermines collegiality and community.”); see also Hurt, *supra* note 279, at 567 (observing that large, brand-name law firms that had filed in recent years “expanded through hiring and mergers, took on expensive lease commitments, borrowed large sums of money, and then could not meet financial obligations once markets took a downturn and practice groups scattered to other firms”).

²⁸⁷ See Jane Croft, *Artificial intelligence disrupting the business of law*, FIN. TIMES (Oct. 5, 2016), <https://www.ft.com/content/5d96dd72-83eb-11e6-8897-2359a58ac7a5>; George S. Bellas, *Is the Future of the Practice of Law in Jeopardy?*, ATT’YS CREATIVE ROUNDTABLE, <http://www.attorneyscreativeroundtable.com/is-the-future-of-the-practice-of-law-in-jeopardy/> (last visited Sept. 25, 2017).

schools may do their part to better prepare students for jobs, not just in BigLaw but elsewhere, by training students in human interaction as well as the cultivation of artificial intelligence.²⁸⁸

By far, the most important lesson to be derived from these historical examples is not to delay in responding to technological disruption. Value is best preserved early, and bankruptcy reorganization proceedings can be most effective when there is still sufficient value in the company to justify them. For many, the uncertain and unknowable nature of technological advances can encourage a state of paralysis.²⁸⁹ Giving into this paralysis will both increase the likelihood of requiring bankruptcy proceedings and decrease the likelihood that such proceedings will result in a successful reorganization.

VI. CONCLUSION

Firms fail for a variety of reasons, but as technological advances permit the shift of work from professionals to increasingly capable machines,²⁹⁰ it is rational to expect a broader range of businesses, including law firms, to make adjustments to the new market reality or become uncompetitive. As this Article has demonstrated, companies that were once at the top of their industries have been felled by their inability or reluctance to adjust to technological disruption. The tools provided by the Bankruptcy Code are intended to permit firms to reassess and redirect assets in order to maximize value. When adopted too late, even these tools are insufficient to save companies that have squandered their opportunities for early readjustment. For law firms, bankruptcy tools may be particularly ineffective in light of the particular constraints associated with law firm capital—attorneys and other personnel. Accordingly, as technology changes, law firms should be prepared to make adjustments early on in order to avoid the failure associated with unanswered technological disruption.

²⁸⁸ Some law schools have already moved in this direction. See Christy Burke, *Winning the battle to teach legal technology and innovation at law schools*, LEGAL IT TODAY (Mar. 17, 2017), <http://burke-company.com/wp-content/uploads/2017/04/LegalITToday-Winning-the-battle-to-teach-legal-technology-and-innovation-at-law-schools.pdf>.

²⁸⁹ See Margolis & Murray, *supra* note 6, at 2 (“Lawyers from [prior] generations remember a time before technology was so ubiquitous[,] . . . They are certainly aware of technology, and use it, but are often suspicious of newer technologies and what they have to offer.”).

²⁹⁰ See RICHARD SUSSKIND & DANIEL SUSSKIND, *THE FUTURE OF PROFESSIONS: HOW TECHNOLOGY WILL TRANSFORM THE WORK OF HUMAN EXPERTS* (2015).