Corporate Insolvencies. A Comparative Analysis of the European and the U.S.A. Model with a Focus on the Liquidation vs Reorganization Dilemma and the Effects of Both in the Economy.

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A thesis submitted for the degree of

Master of Laws (LL.M.) in Transnational and European Commercial Law, Mediation, Arbitration and Energy Law

February, 2017

Thessaloniki – Greece
I hereby declare that the work submitted is mine and that where I have made use of another’s work, I have attributed the sources according to the Regulations set in the Student’s Handbook.

February, 2017

Thessaloniki – Greece
Abstract

This dissertation was written as part of the LL.M. in Transnational and European Commercial Law, Mediation, Arbitration and Energy Law, at the International Hellenic University.

Initially, the development of European Insolvency Law is presented; the harmonization attempts and some indicative national legislation examples from Germany and France. In the next chapters, the history of the relevant U.S.A. Law is cited and the dynamic role it has played in reforming other national Insolvency Law systems is underlined, as well as its important legal mechanisms for company restructuring. The chapters to follow attempt to present differences and similarities between Europe and the U.S.A. in the field of insolvency procedures through case law and more specifically by examining two cases of well-known bankruptcies. In the end, there is an effort to connect the legal aspects of the subject with the economic ones, by collecting information on the matter of how the two basic options that are offered to companies (liquidation and reorganization) affect the economy and what results do they produce.

My expectations from this dissertation are to be able to show from my limited law practice, but mainly from my research that Insolvency Law is a very fast-paced and progressively harmonized legal sector, in close relation to economy, that can actually play a significant role in reforming unsound companies and unstable economies if jurisdictions around the world follow the innovative U.S.A. model and focus on the rebuilding of companies, the reorganization of debts, the maintenance of employee positions and not on the short-term liquidation option that Europe tended to prefer some years ago.

This academic work is the result of the great collaboration I had throughout the previous months with my supervisor, Professor Pavlos Masouros, who contributed with his knowledge and useful guidance providing me with very interesting scientific articles and extremely helpful methodological advice. Furthermore, I would like to attribute acknowledgements to Professor Georgia Mpechri – Kechagioglou, whose great teaching of Insolvency Law during my bachelor’s degree years created a solid foundation for me as a starting point and inspired me to study this area of law further.
more. Last but not least, I would like to thank Professor Athanasios Kaissis for being a very supportive academic mentor and being very close to all LL.M. students, helping us with every problem we encountered through this difficult but also very fruitful period of the master’s programme.

**Keywords:** Insolvency, Bankruptcy, Reorganization, Liquidation, U.S.A. Bankruptcy Code
Preface

Being a law student and a trainee lawyer during the financial crisis years in Greece, the initiative to investigate more the challenging and always evolving legal field of corporate insolvencies came as a very natural consequence to my academic interests. As a young legal scientist, even from my bachelor’s degree years, I was fascinated by the way every country’s insolvency laws are closely connected to its policies and by the way they incorporate the general economic principles of every legal and financial system. Furthermore, the law office where I am currently doing my traineeship handles several cases of individual and corporate bankruptcies, so I usually have the chance to observe the relevant legal procedures, study the Greek laws and follow the latest developments.

The basic difficulty I encountered during my research was the studying of the American legislation and case law, as it is a common law jurisdiction and therefore an unfamiliar area for me as a civil law practitioner.

Nevertheless, my aim was to gain a complete view of the topic by studying the legal texts (the European Conventions and Regulations, national insolvency legislation from EU Member-States, the U.S.A. Bankruptcy Code etc), handling a thorough part of legal literature, searching important European and American case law and reading legal and economic researches -both academic and non-academic- and press articles (from the European Commission, INSOL Europe, GTAI, the American Bankruptcy Institute, the World Economic Outlook etc).

Closing, I would have to admit that my topic covers a very broad area, but I strongly believe in this academic idea, upon which the scientific interest has started to grow during the last years¹, and I think that I have worked on it efficiently.

Today, certain people file for bankruptcy, businesses and individuals, and it no longer has the stigma it once had. Now it’s almost considered wise, a way to regroup and come back again.

David Dinkins, American politician

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1. Introduction. Methodology, Academic Objective and Expected Contribution

This dissertation aims to highlight the different philosophies behind two classically different legal regimes in the field of Corporate Insolvency Law, which in a slow but stable way tends to be globally harmonized, as more and more companies become active worldwide. The more creditor-‘friendly’ European approach and the more debtor-‘friendly’ U.S.A. approach are stressed and a humble effort is carried out in order to indicate this in the actual competitiveness of the two markets and to show how Europe’s latest legislative reforms are on the U.S.A.’s path\(^2\).

The dissertation initially presents the evolution of European Insolvency Law, from the Istanbul Convention and the European Insolvency Regulation to the EU Recast Regulation and also some indicative national legislation. Then, the progress of U.S.A.’s Insolvency Law is cited, from the 1898 Bankruptcy Act and the 1978 Bankruptcy Reform Act to the 2005 Bankruptcy Abuse Prevention and Consumer Protection Act and the U.S.A. Bankruptcy Code of today, analyzing Chapters 7 and 11. Conclusions on the European and the American legal ‘families’ are drawn, based on their promotion of liquidation or reorganization and their procedural provisions and also some general characteristics regarding their debtor or creditor-‘friendliness’ are underlined\(^3\).

Further on, the dissertation proceeds with the presentation of two well-known corporate bankruptcies from a legal perspective, highlighting the aforementioned conclusions.

The last chapter is structured around the argument that reorganization, as found in common law regimes and especially in the U.S.A., is proven to be more beneficial for a market and for socio-economic development\(^4\).

This area of law is very challenging as, on the one hand it is an independent legal field and on the other hand it has important corporate, civil, public and criminal aspects. Furthermore, today’s approach doesn’t view corporate and insolvency law as two


\(^4\) ‘Out of Pocket. Europe’s Flawed Insolvency Regimes will Face a Severe Test in 2009’ The Economist (Paris, 30 December 2008)
completely separate legal areas, as such an approach would create more legal problems to solve. Their provisions should not be contradictory and similar legal tools should be used.

I also think that young lawyers who practice law on this field should support the view that insolvency doesn’t end commercial activity but it is a chance for a fresh and rational beginning for a company, since there are many legal tools at our disposal today. All the above are issues that are put under examination by the legal practitioners and academics of today and I hope I have handled them thoroughly.
2. History of European Insolvency Law. Efforts of Harmonization and Basic Legal Texts

The establishment of a unified legal framework for individual and corporate insolvencies in the European Union has always been crucial as the economic activities among Member-States are a common phenomenon\(^5\). Even today though, we cannot talk about a unified body of substantive and procedural laws that apply to all Member-States. The efforts towards this direction are difficult to succeed because insolvency law is a legal area that depends on various socio-economic factors; therefore, it cannot easily be harmonized, even within the Union\(^6\). The basis of all these efforts has been Article 220 of the old version of the EEC Treaty (ex Article 293 EC Treaty)\(^7\), which reads as follows: ‘The Member-States shall, so as far as is necessary, enter into negotiations with each other with a view to securing for the benefit of their nationals the simplification of formalities governing the reciprocal recognition and enforcement of judgments of courts or tribunals and of arbitration awards.’\(^8\).

On this basis, the Brussels Convention on Jurisdiction and the Enforcement of Judgments in Civil and Commercial Matters was published in 1968, excluding from its scope matters related to insolvency, as a subject requiring special treatment (Article 1)\(^9\). As the intra-Community commerce continued to grow, the Draft EEC Bankruptcy Convention was composed in 1970 and amended in 1980 based on the universality model of one legal text regulating all Member-States\(^10\) but unfortunately it was abandoned five years later. In 1987 the Commission introduced the Draft Liquidation Directive but as the national legal systems presented similarity on liquidation matters, it wasn’t adopted as well. Among its aims was also the protection of all creditors in

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\(^8\) Michael Bogdan, Concise Introduction to EU Private International Law (first published 2006, Europa Law Publishing 2012) page 88
\(^9\) Klaus Pannen, European Insolvency Regulation (De Gruyter Recht 2007) pages 8-11
cross-border investments. In 1995 the Draft EU Convention on Insolvency Proceedings was produced in Strasbourg, aiming to solve the previous problems but England refused to sign it due to political reasons, so it never came into force. This convention was following the principle of universalism too, which usually benefits creditors’ collection actions. After all these failures, the European Insolvency Convention was drafted in Istanbul in 1990 (Convention on Certain International Aspects of Bankruptcy) following the concept of modified universalism and rejecting the absolute universalism of the past. Nevertheless, it was ratified by only one country. Gradually, the idea of a Convention was abandoned and the notion of a Regulation was adopted. In 2000 the European Insolvency Convention (1346/2000) was published, based on ex Article 65 and 67 of the EC Treaty (Article 81 TFEU).

The abovementioned Regulation is a Community Act with general force on all Member-States, except Denmark, regulating intra-Community cross-border insolvency procedures. The national laws still remain distinctive, so it is basically a conflict of laws system and it is also important to notice that the negative term of ‘bankruptcy’ is abandoned. Its provisions refer to the applicable law (Articles 4, 28 etc), the recognition and enforcement of court decisions (Articles 16, 17 etc), the definition of COMI (Recital 13) etc. Among its goals are also the elimination of forum-shopping and the acceleration of the procedures, which provide the legal text with a clear pro-creditor character.

The provisions that better underline this legal text’s philosophy are the ones that refer to creditors (Articles 27-38 and 39-42). More specifically, upon the commencement of insolvency procedures the court or the trustee are obliged to notify the creditors that are in a different Member-State without any delay (Article 40.1) and

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14 Lampros E Kotsiris, Evropaiko Emporiko Dikai (first published 2003, Ekdoseis Sakkoula 2010) pages 1082-1083
the creditors, who can even be public social insurance and tax authorities (Article 39), must receive a notice with all the necessary information (Article 40.2). Furthermore a creditor, even if he has declared his notice in the main proceedings, he can declare a notice in the secondary proceedings as well (Articles 32.1, 32.2)\textsuperscript{15}. Generally, a procedure structured around creditors’ best interests is noticeable. Furthermore, pre-insolvency and voluntary procedures are left out of the Regulation’s scope.

Ten years after the Regulation’s implementation and having the advantage of many empirical examples, the legislators adopted an approach focusing on business maintenance, without of course disfavoring creditors’ claims\textsuperscript{16,17} (see the Commission’s proposal 2012/0360) and in 2015 the Regulation was reformed by the European Insolvency Regulation (Recast - 2015/848), as part of the 2020 EU Strategy on economic growth. The amendments were mainly the following: an extension of the period that is within its scope in order to include pre-insolvency proceedings, the grant of a broader meaning to the terms of ‘COMI’ and ‘establishment’ and the introduction of a new regime for insolvent group companies in order to promote cooperation between member companies and therefore, to have more possibilities of rescue\textsuperscript{18}.

In the same year the European Model Company Act (EMCA) was published as well. It is a model law statute regulating corporate law issues and introducing flexibility\textsuperscript{19,20}, as it is affected by the U.K. law.

During the last years Europe, under the pressure of the economic crisis and the U.S.A.’s example, is changing its approach to economic distress\textsuperscript{21}. Some specific

\textsuperscript{15} Lampros E Kotsiris, \textit{Evropaiko Emporika Dikaio} (first published 2003, Ekdoseis Sakkoula 2010) pages 1137-1139


\textsuperscript{17} G S Moss, I F Fletcher and S Isaacs, \textit{The EC Regulation on Insolvency Proceeding. A Commentary and Annotated Guide} (first published 2002, Oxford University Press 2009) pages 266-267


\textsuperscript{19} Marco Venturuzzo, ‘The New European Model Company Act’ (Harvard Law School Forum on Corporate Governance and Financial Regulation, 14 October 2015)


examples are the following: In 2016, the ‘Insolvency Initiative’ was launched, as an effort to develop legal mechanisms that allow viable but distressed companies to continue operating. In the same year, a conference was organized in Brussels by the Commission addressing similar subjects and the official Study on a New Approach to Business Failure and Insolvency was published, stressing the objective of more entrepreneurial chances and market stability, based on Commission’s official Recommendation (C 2014/1500\(^{22}\)). All the above are encouraging examples and prove the international dialogue that is inevitably produced by the diversity of legal systems\(^{23}\).

\(^{21}\) Deborah Ball, ‘Europe Builds Own Chapter 11. Amid Tough Times, Countries Across the Continent Are Reshaping Bankruptcy’ *The Wall Street Journal* (New York, 5 April 2013)

\(^{22}\) Lampros E Kotsiris, *Ptoxeutiko Dikaio* (first published 1998, Ekdoseis Sakkoula 2016) page 90

3. Insolvency Regimes of Today in European Union’s Member States. Indicative Examples

As mentioned above, a European Bankruptcy Code with common substantial and procedural laws doesn’t exist but there are Regulations and Directives contributing towards a common legal framework with the main objective of minimizing possible differentiations between national laws that would be problematic to the intra-EU commerce.

What is important is that national insolvency laws within the Union have similar features and in the following chapters a short analysis on the relevant laws of two Member-States is presented.
3.1. Germany. A Conservative Model Entering a Different Path?

Germany’s insolvency legislation may not be the basis for as many jurisdictions as France, but Germany is Europe’s largest economy and therefore, it affects other jurisdictions in multiple ways. Konkursordnung (KO) of 1877, amended in 1898, was the Law regulating all insolvency matters and Vergleichsordnung (VgLO) was a procedure introduced much later, in 1935, regulating a judicial settlement aiming to the viability of the company in distress. Many reform efforts had been made and in 1994 the Insolvenzordnung (InsO), amended in 2003, was introduced which is Germany’s current body of laws regarding insolvency.

The German Bankruptcy Code, is mainly focused on the collective reparation of creditors, as Article 1 InsO declares: ‘The insolvency proceedings shall serve the purpose of collective satisfaction of a debtor’s creditors by liquidation of the debtor’s assets and by distribution of the proceeds, or by reaching an arrangement in an insolvency plan, particularly in order to maintain the enterprise. Honest debtors shall be given the opportunity to achieve discharge of residual debt.’ There is a contrast in Germany being one of the largest economies and on the other hand being ‘conservative’ in this field. Insolvency in Germany carries a very negative stigma and this is underlined by the word ‘Schulden’ (debt) which also means guilt and blame. As a matter of fact, many companies moved their centre of main interests to countries such as the U.K. in order to benefit from the variety of their restructuring mechanisms.

In the general procedure, the debtor or his creditors can apply for the commencement of insolvency proceedings upon a situation of present or future insolvency (Zahlungsunfähigkeit) or over-indebtedness (Überschuldung) according to Article 13.1 InsO and the process is divided in preliminary (vorläufiges Insolvenzverfahren) and final proceedings. The first stage is supervised by a court-appointed preliminary administrator (Eigenverwaltung) and a preliminary creditors’

26 Sacha Lurken, ‘One Year Later. Germany’s Corporate Insolvency Law Reform Turns Out Success Story’ Financier Worldwide (Birmingham, May 2013)
committee (Gläubigerausschuß). These proceedings last from the filing day until the court decision is published and if it is decided that there are grounds for insolvency and that the assets are sufficient in order to cover the procedural costs, the final proceedings are opened.\(^\text{27}\)

During the final proceedings, the final administrator is appointed (80 InsO), who takes on the company’s management\(^\text{28}\) and reports on its financial situation. His role is of great significance, as he decides upon entering or terminating transactions, he proposes the dissolution or continuation of the company etc. After his report is published, the first creditors’ meeting (Gläubigerversammlung) takes place according to Article 29.1 InsO, in which the company’s liquidation or restructuring will be voted upon. The creditors’ meeting and the committee are two organs of decisive role and they decide by majority -in number and value-. More specifically, the committee represents creditor autonomy that was introduced in German Law by Konkursordnung and many powers are attributed to it, such as deciding upon the administrator (59 InsO), commenting on the administrator’s report (156 InsO), attributing to the preparation of a reorganization plan (218 InsO), requesting liquidation (233 InsO) etc.

The option of an insolvency plan (Insolvenzplan) is followed when the aim is the company’s preservation. The petition can be filed by either the debtor or the administrator and if it is approved, the creditors will receive payment according to the plan’s terms. The plan has to be approved by the court and by the majority of each creditors’ class -in number and value- (244 InsO) in order to be enforceable (231, 248 InsO). This procedure is not followed very often despite the fact that Germany’s traditional model has evolved since 1970 and that it now bears similarities to the English one\(^\text{29}\). The Insolvenzplan is available only when insolvency is already faced or there is a serious future threat, which may be late for a successful restructuring and also the preliminary creditors’ committee can very easily vote against it. It is also true that the law doesn’t necessarily declare reorganization as a plan’s aim as for example


in Chapter 11 of the U.S.A. Bankruptcy Code, so liquidation may still be followed in the end.

Self-administration (Eigenverwaltung) is another procedure, similar to U.S.A.’s debtor-in-possession regime (240 InsO), which allows the company to remain under its previous management’s control with the parallel supervision of a trustee (Sachwalter) - it can be invoked at any time if the Court judges that it will have a negative effect on creditors or if the creditors’ meeting doesn’t approve it-. Also, many of the insolvency administrator’s duties such as the challenging of contracts are transferred to the trustee and not the debtor. In fact, very detailed preparation is required, the debtor needs to gain his largest creditors’ support and sometimes to even appoint new management with restructuring experience for the success of the procedure.

For the new option of Umbrella Proceedings (Schutzschirmverfahren) an insolvency plan petition and a petition for self-administration have to be combined and the debtor is granted three months in order to prepare a plan under the supervision of a trustee and a legal expert (270.a-c InsO). A stay of individual claims is applied upon the debtor’s motion to the Court and not automatically (38, 52, 87 InsO). Another important element is that it can be followed only under the condition that the debtor is not yet illiquid. This procedure wasn’t very attractive to companies in the past, as it was slow and not really beneficial (only one percent of companies used to apply for it) and despite 2012’s reform and the positive effects of eliminating the costs and taking advantage of the company’s know-how, the courts are still reluctant to accept it.

It is also important to notice the simplicity of the creditors’ ranking system, which proves that their reparation is in the centre of the German insolvency legislation: preferential creditors are ranked first followed by secured creditors, administrative expenses, unsecured creditors, subordinated creditors and shareholders.

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Preferential claims (Massegläubiger) derive from economic activity with the administrator after the opening of the proceedings. They get satisfied before the insolvency creditors and they are granted individual enforcement rights. Secured creditors may have rights in rem or intellectual property rights and they are not considered to be insolvency creditors as well, therefore they have individual enforcement rights but only upon a specific asset. In the same category there also are creditors holding a special right on an asset, enabling them to demand preferential satisfaction from the proceeds of its sale (Absonderung). They are insolvency creditors though and any individual enforcement right they may have is under restrictions. The unsecured creditors must file their claims in order to register them and they get paid last.

Employees enjoy protection from ‘insolvency money’ (Insolvenzgeld), which covers their three-month wages. Their agreements, as long-term contracts, are usually not terminated, only possibly altered, according to a plan. On the other hand, the administrator is entitled to decide upon the continuation or not of the pending transactions and the counterparty cannot claim payment but only compensation.

Germany introduced important reforms that empowered business restructuring which had previously been a rare option (ex according to the ‘consolidation plan’ of the past, creditors should be offered at least 35% of their claims and no stay of claims was imposed). In 2009 the suspension of enforcement actions against insolvency assets that are necessary to the debtor’s company was allowed by law and in 2010 the Act on the Implementation of Measures to Stabilize the Financial Market (Finanzmarktstabilisierungsgesetz) was introduced, according to which it wasn’t obligatory anymore for viable companies to file for insolvency in cases of overindebtedness. In 2012 a legislative effort for the reform of business rehabilitation was presented (Gesetz zur weiteren Erleichterung der Sanierung von Unternehmen, ESUG-InsO) which also aimed to the protection of shareholders’ rights, the trustee’s

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independency, the strengthening of the creditors’ role in reorganization, the harmonization of insolvency and corporate law, the institution of a protective process for companies which still have liquidity, the enhancement of employees’ voting rights and more\textsuperscript{36,37}. Another improvement of 2012 was the law on the restructuring of financial institutions (Gesetz zur Restrukturierung und geordneten Abwicklung von Kreditinstituten, zur Errichtung eines Restrukturierungsfonds fur Kreditinstitute und zur Verlangerung der Verjahrungsfrist der aktienrechtlichen Organhaftung-Restrukturierungsgesetz) which introduced special restructuring proceedings, the establishment of a restructuring fund etc\textsuperscript{38}. Such reforms provide the legislator with more mechanisms and bring German Insolvency Law closer to U.S.A.’s Chapter 11\textsuperscript{39}.

Other changes brought by the latest reforms were the creditors’ right to take part in the process earlier than before increasing the possibilities of an effective reorganization—\textemdash but still keeping them in the centre of the procedure—\textemdash or the variety of options offered by a plan such as: to converse creditors’ claims into equity (debt-to-equity-swaps)\textsuperscript{40}, reduce the company’s capital etc. More flexibility was granted to insolvency participants and even pre-insolvency proceedings were introduced. In 2013 a new law regulated the strengthening of creditors’ position. The general comments from the German practice were positive though, as it created an environment of uniformity for creditors\textsuperscript{41}.

It is supported that the efforts of reforming German law weren’t really successful, as it still is a unified system leading either to reorganization or liquidation (233 InsO) rather than two clearly different options, something that can only benefit the creditors and the reorganization plan is still in their hands. Attention should also be paid to Article 15 InsO according to which directors are held liable if they don’t file for insolvency three weeks after cash-flow or sheet imbalance, which is a time limit

\textsuperscript{36} Lampros E Kotsiris, Ptoxeutiko Dikaiio (first published 1998, Ekdoseis Sakkoula 2016) pages 53-54
\textsuperscript{37} ‘Bankruptcy Procedures in Germany’ (LawyersGermany, 14 September 2015)
\textsuperscript{38} Adam Gallagher, ‘Germany’s Insolvency Law Expected to Be Modernized in Reaction to the Financial Crisis’ (2011) January 2011 American Bankruptcy Institute Journal
\textsuperscript{39} Bo Xie, Comparative Insolvency Law. The Pre-pack Approach in Corporate Rescue (Edward Elgar Publishing, 2016) pages 156-159
\textsuperscript{40} Latham and Watkins LLP. Finance Department, New Options for Creditors in German Insolvency Proceedings (Client Alert Number 1257, 2011) page 3
\textsuperscript{41} H Philipp Esser, ‘Insolvency Law under Discussion in Germany and Europe’ (2013) May 2013 American Bankruptcy Institute Journal
objectively belated in order to draft an efficient restructuring plan. It is also accepted that liquidation and the natural consequence of the stronger companies eliminating the weaker ones\textsuperscript{42} is promoted by Insolvenzordnung’s provisions. For example, in 2010 there were 136,000 filings for insolvency procedures and only 2,000 of them resulted to business continuation. Furthermore, the German Insolvency Law still has a long way to go as many of its critics support that group insolvency legislation needs to be developed following U.S.A.’s path and that an English-style ‘Scheme of Arrangement’ needs to be regulated. It is also the jurisdiction providing the most protection to security creditors, without publicity and registration being required and their securities are fully enforceable\textsuperscript{43}. These are some of the reasons why out-of-court negotiation procedures are still a popular option in the German business world, with 20-30% of insolvent companies trying this solution before anything else.

The distinction between pro-creditor and pro-debtor systems may be gradually fading today as the effect of U.S.A.’s Chapter 11 is obvious in all European legislations but it cannot be denied that even though restructuring gained importance in Germany, the leading roles still belong to the administrator and the creditors. The negative approach towards insolvency also needs to change in order to gain every positive result the new laws can offer, as it is common for companies to avoid even the very helpful Umbrella Proceedings under the fear of negative publicity\textsuperscript{44}.

\textsuperscript{43} J L Westbrook, C D Booth, C G Paulus and H Rajak, \textit{A Global View of Business Insolvency Systems} (Martinus Nijhoff Publishers 2010) pages 12-24  
\textsuperscript{44} J Englert, A Tashiro and A Lehmann, ‘New German Insolvency Code’ \textit{Financier Worldwide} (Birmingham, June 2010)
3.2. France. Europe’s Rebel Drawing Back?

Ordonnance de Commerce (1673) was France’s first unified commercial code. Chapter 11 of this code formed the basis on which the codes of 1807 and 1838 were founded and some of their elements are still reflected in various national insolvency systems\(^{45}\). Articles L610.1–L680.7 of the French Commercial Code refer to insolvency and with the laws of 1967, 1984, 2005, 2010 and 2015 great reforms were introduced\(^{46}\).

A variety of procedural options, aiming to business rescue and mainly focused on an early stage of recession is offered to merchants in economic distress. More specifically, there are court-assisted (conciliation and mediation) and court-driven (safeguard proceedings, accelerated financial safeguard proceedings, accelerated safeguard proceedings, judicial settlement-reorganization and liquidation) procedures.

In more detail, conciliation (procedure de conciliation – L611.1-L611.16) is a procedure offered to companies facing financial problems for not more than forty-five days and it can have a maximum duration of five months. The debtor confidentially negotiates his debts with the assistance of a conciliator and any agreement reached must be ratified by the relevant Commercial Court. The important element is that the management remains in the debtor’s hands. Mediation (mandat ad hoc – R611.18-R611.21.1) is an informal and flexible procedure without time limits, according to which the court appoints a mediator as an advisor after the debtor’s request. It solves specific problems and not a general financial distress, with the only prerequisite being the company’s solvency\(^{47}\). Of course, during both procedures creditors can independently act in order to receive repayment. In the safeguard proceedings (sauvegarde – L620.1-L627.4) there is a solvent debtor focused on restructuring his commercial activity under the condition that creditors’ majority -in number and value-


approves his plan. After 2014 the creditors’ position improved and each of them can propose a plan as well. They cannot enforce individual enforcement measures in order to satisfy their claims though for a period of six to eighteen months and during this period an administrator is in control of the property. It is claimed that a balance is gained between judicial control and personal negotiations in this solution. Accelerated financial safeguard proceedings (sauvegarde financière accélérée - L.628.1-L.628.7) are influenced by U.S.A.’s Chapter 11 and they also bear many similarities to the abovementioned procedures but they are imposed only on large firms and in shorter time frames (duration of maximum two months), implementing already agreed-upon restructuring plans and a conciliation procedure is compulsory to have taken place before. The accelerated safeguard proceedings (sauvegarde accélérée - L.233.16) bear many similarities to the aforementioned ones as well (the creditor’s majority has to approve the proposed plan, prior conciliation is compulsory etc) with the difference that they can be applied on insolvent - for a period no longer than forty-five days- debtors too. Reorganization (adressement judiciaire – L631.1-L631.22) is the least amended procedure but its significance is being questioned during the last years since it tends not to be preferred by companies in distress. The rules regarding the plan’s acceptance are the same as in the abovementioned procedures but it is slower and court-driven, with the administrator mainly controlling the process. Lastly, liquidation (liquidation judicaire - L640.1-L640.6) is initiated by the debtor, his creditors, the district attorney or the court and during this procedure the


49 Conseil d’ Analyse Economique, Reforming French Bankruptcy Law (Les Notes du Conseil d’ Analyse Economique no 7, 2013) page 3


debtor isn’t of course in charge of his property.\textsuperscript{54} The assets or the whole company are sold in order to satisfy the creditors, always according to the order of priority\textsuperscript{55}.

From the above short presentation, a rough conclusion that can be drawn is that the French system is a pro-debtor system offering a variety of options, a characteristic that was enhanced by the 2005 reform which aimed to create a legal environment similar to U.S.A.’s Chapter 11\textsuperscript{56}. Nevertheless in 2014 another reform took place, promoting pro-creditor elements\textsuperscript{57} (such elements were presented even from the 1994 reform), such as the creditors’ right to present a restructuring plan for the in-debt company.

Roughly, the entities having a role in French insolvency proceedings are the following: during safeguard and reorganization proceedings there is a preliminary (juge commis) and a supervisory judge (juge commissaire), a creditors’ representative (mandataire judiciaire) and an administrator (administrateur judiciaire), who are legal experts, and the commissioner of the plan, who can either be the creditors’ representative or the administrator. Regarding stakeholders, not all categories of them are represented during the proceedings. The legislator regulates for the controllers who assist the administrator and the supervisory judge, the creditors’ committees -usually in large corporate insolvencies- and the employees’ representative. During liquidation proceedings, and since there isn’t a rescue possibility, the creditors’ committees don’t take part, nor does an administrator exist and the debtor is represented by a liquidator who can be a former creditors’ representative\textsuperscript{58}. A reference should also be made to some other ‘key players’ that have a specific role, for example public officers (notaries, auctioneers etc) and scientific experts.

Regarding creditors in collective proceedings, they generally must file their claims. The creditors’ representative organizes a list of claims that has to be approved by the supervisory judge and any interested party can appeal within thirty days from the

\textsuperscript{55} Donald S Bernstein, *The International Insolvency Review* (Law Business Research Ltd 2013) page 150
insolvency decision’s publication. The debtor has to propose a settlement of payments and despite the fact that reduction of liabilities is always the aim, it is difficult to be met in practice and only in special circumstances, such as the creditor being a public authority or the parent company, can such a result be achieved. In the case of a plan, creditors receive partial payments for the whole period that it covers. The first payment can be submitted within a year from the plan’s ratification and there is no mandatory minimum amount for it, something that is unusual and really beneficial for the debtor. Of course, the principle of creditor equality has to be respected\(^5\). 

Even though liquidation is rarely followed directly, without reorganization or safeguard proceedings having previously failed, it remains a harsh condition according to which creditors must be compensated from the sale of assets or even of the whole company, the claims are accelerated and become immediately payable and the priority of them is fixed (pre-insolvency employee wages\(^6\), legal costs, post-insolvency debts, pre-insolvency claims guaranteed by security over real property, post-insolvency employee wages, current contract claims, pre-insolvency claims secured by general liens, unsecured creditors). It is important to mention the category of creditors that can claim their property back within three months from the publication of the insolvency decision, as owners of personal property that is in the debtor’s hands and if this is not possible, they can seek payment from a third party.

Employees also hold a significant position in French law. They are considered to be creditors for their wages and compensation and they are not required to file their claims as they have a general lien over the debtor’s property which stands for their last six months of work. Since 1973 a priority right has been founded which puts employees first, even above the secured creditors, and it stands for the last sixty days of their work. All the above though aren’t easily fulfilled, as during safeguard proceedings it has to be proved that the debtor is not in a cessation of payments situation and on the other hand, during reorganization or liquidation the debtor is in such a harsh economic condition that the necessary amounts cannot be released. Another aspect is that employees also are a ‘disposable work force’ and in situations of


economic distress, mass redundancies can be observed. According to Labour Law though, an employee safeguard plan must be conducted, protecting them from possible law infringements. Its terms differ depending on whether the debtor has applied for safeguard proceedings, reorganization or liquidation but in general they own a well-protected position.

Guarantors cannot deny the satisfaction of individual claims that are secured by a guarantee on the sole legal basis of the commencement of insolvency proceedings. This rule though is subject to several exceptions in the cases of conciliation, safeguard proceedings or reorganization, allowing the guarantor to benefit from any possible beneficial terms that the debtor and his creditors have agreed upon. Only in the case of liquidation the guarantee is subject to stricter conditions and it has to be paid without any alterations. The guarantor can always demand repayment from the debtor at a later stage; a condition which is rarely satisfied though61.

Another important aspect of insolvency is the liability of directors of legal entities for actions that led to economic distress. Criminal sanctions and financial penalties are imposed on them if fault (L651.1-L651.4)62 or fraud are detected. The important element is the casual link between fault and loss63. The provisions aren’t as harsh as for example the relevant German provisions, leading the managers to usually violate the short fifteen-day-from-the-occurrence-of-insolvency filling period.

It is supported that one of the 2014 reform’s aims was to make French law more creditor-‘friendly’, since it used to be too ‘socially oriented’, focused on business reorganization and employment maintenance, something that discouraged creditors from taking part in court-driven insolvency proceedings64. For example, a pro-creditor provision declaring valid any claims that occurred before the insolvency decision and that were not submitted in due time and a provision that doesn’t declare liable creditors for any losses caused to the estate from the extension of their claims are

indicative examples of this change in strategy. Other examples are the creditors’ right in judicial safeguard proceedings to submit a plan to the creditors’ committees and the court or that the debtor’s plan cannot include debt reductions and contract alterations but only renegotiations of claims. Furthermore, creditors’ approval wasn’t needed for a plan to be accepted in the past, a situation that has changed today. Regarding liquidation, the procedure is accelerated which is beneficial for creditors; for example, it can be closed even if litigation is still evolving or even if some assets remain. Also, a simpler system for filing was adopted, according to which if the debtor has listed a creditor’s claim the creditor doesn’t have to file it too in order to include it in the process, as was the case before.

It could be supported that French legislation, having a strong Labour and Trade Law tradition and due to socio-political reasons such as high unemployment, wasn’t favouring creditors. In fact, a past survey had ranked France with the score of zero regarding creditor protection, whereas Germany had 3 and the U.K. 4. Another survey about creditor recovery ranked France twelve points lower than Germany and twenty points lower than the U.K. On this basis, the latest reforms added some pro-creditor elements to one of Europe’s most debtor-‘friendly’ Insolvency Codes under the pressure of not corresponding to the economic crisis and the market’s needs for investments. Nevertheless, even if it has a long way to go from its strong court-driven character before reaching U.S.A’s debtor-controlled system, it still is a legislation promoting business continuation and it is very important that the 2005 reform was introduced before the global economic crisis occurred, providing French economy with important recession ‘antidotes’.

67 Conseil d’ Analyse Economique, Reforming French Bankruptcy Law (Les Notes du Conseil d’ Analyse Economique no 7, 2013)

The legislators of U.S.A.’s Constitution (1787) declared their right to draft unified insolvency laws (Article 1) but since many states already had their own relative laws, only one law was instituted in 1800 having its roots in English legislation with harsh treatment towards debtors, even imposing the penalty of imprisonment. Nevertheless, there still was a necessity for unified legislation since most states’ laws were discriminatory against foreign debtors, creating barriers for inter-state commerce but only some sporadic federal insolvency laws were introduced by the Congress during the period of 1800-1878. Eventually, in 1898 permanent federal legislation was introduced. In the next paragraphs, the evolution is presented in detail.

During the period of 1792-1797 there was pressure in order to produce a common legal framework as economic distress had led debtors to imprisonment so in 1800 a Bankruptcy Act, similar to the 1732 English Act, was introduced. It was a strict pro-creditor text though with a few debtor-positive elements (ex cooperative debtors could be granted debt discharge if the creditors’ majority approved it or the fact that even though fraudulent bankruptcy was a criminal offence, it was not punished by death penalty). In the nineteenth century, financial problems occurred to the railroad sector so equity receivership was introduced enabling a receiver to take control of the company after the debtor’s petition and to find buyers. In this way employee positions were maintained and a higher price could be achieved as well but in practice this legal tool was much abused.

In the following period imprisonment was minimized and it finally stopped by federal legislation in 1833 -today it is permitted only if fraud is detected-. In 1841 the second Bankruptcy Act was published, which was the first modern insolvency law and for the first time both merchant and non-merchant debtors could voluntarily initiate

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73 Charles Warren, Bankruptcy in United States History (Harvard University Press 1935) pages 49-52
proceedings and be granted a discharge. Even though the Act’s application produced results, creditor protection was eliminated and the procedure was mainly court-driven. Eventually it was abandoned two years later. In the following years of economic growth no important legislative efforts were made except from the 1867 Bankruptcy Act which was abandoned in 1878 due to low creditor protection and difficulties in the grant of debt discharge, even though many of its provisions were similar to the ones that are in force today.

In 1874 a great step forward was taken with the composition agreement, the modern reorganization plan’s predecessor, according to which the debtor could pay only a percentage of his debts over a certain period of time if the creditors’ majority approved so. The period of the next twenty years was the last one without permanent federal insolvency law, as the financial distress of 1884 and 1893 indicated once again the need to institute unified legislation.

The Bankruptcy Act of 1898 that followed was the beginning of permanent and ‘liberal’ federal legislation even though it was difficult to overcome the scepticism against federalism after the Act of 1867\textsuperscript{75} and the controversy on the matter of whether insolvency legislation should have a permanent or a temporary character. The legal text provided an easier grant of debt discharge and provisions regarding partnership insolvency\textsuperscript{76}.

From the beginning of the twentieth century Congress’s objective was to eliminate the strong pro-debtor orientation of the Act but the Depression of 1920 and the fear of debtor abuse produced the opposite results. Especially during the period of 1933-1938 many reorganization laws were voted with the most important one being the Chandler Act of 1938. In 1978 the Bankruptcy Reform Act resulted to the U.S.A. Bankruptcy Code of today, replacing the previous Act. It is noteworthy that these actions weren’t an abrupt response to a crisis but a stable evolution, contrary to the reasons that usually prompt legislative action in the EU. Administration matters were improved,


\textsuperscript{76} David A Skeel Jr, ‘The Genius of the 1898 Bankruptcy Act’ (University of Pennsylvania Legal Scholarship Repository, 1 January 1999) \url{http://scholarship.law.upenn.edu/cgi/viewcontent.cgi?article=1719&context=faculty_scholarship} accessed 1 November 2015 pages 323-328
Chapter 13 was promoted (readjustment of individual debts) and a balance between creditors’ and debtors’ interests was attempted.

In the following years, laws of minor importance were voted such as the 1984 Bankruptcy Amendments and Federal Judgeship Act (BAFJA) which was a jurisdictional law of doubted value\(^{77}\) or the 1986 Bankruptcy Judges, United States Trustees and Family Farmer Bankruptcy Act which created the Code’s Chapter 12. In the period of 1990-1992 laws regarding ‘pre-packaged’ filings were voted\(^{78}\) and 1994 also brought minor substantive changes regarding the use of Chapter 13 instead of Chapter 7.

In 2005 President George W. Bush signed the Bankruptcy Abuse Prevention and Consumer Protection Act (BAPCA), mainly regulating individual bankruptcies. According to it, debtors who still had the ability to pay should pay a certain amount of their debts immediately -with the exception of those that their income was lower than the average- and they would be discharged of their remaining debts. Matters also addressed by it were creditor protection, abusive filings, elimination of forum-shopping, establishment of a balance between Chapters 7 and 13\(^{79}\) and the amendment of Chapter 11. It is also supported that creditors gained advantages (ex by the increased requirements in order to file for insolvency or to be granted a discharge, by limiting reorganization rights etc).

In 2007 amendments to the Federal Rules of Bankruptcy Procedure were voted and three years later the Federal Rule on Bankruptcy Procedure 2019 came in force regulating procedural matters and promoting reorganization\(^{80}\).

As American law’s historic progress shows, debtor relief had been in the centre of legislative activity even from the early years and, as it will be presented in the followings chapters, the American laws and especially the Code’s Chapter 11 have

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influenced many legal systems worldwide as they try to promote entrepreneurship; an approach that derives from the capitalistic structure of U.S.A.’s economy.

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5. U.S.A.’s Insolvency Law and its Role in Reforming Other National Legal Regimes

As mentioned in the previous chapter U.S.A.’s Bankruptcy Code of 1978 (title 11 of the United States Code) is a unified legislation governing all insolvency filings in the country. The Federal Rules of Bankruptcy Procedure, introduced by the Supreme Court, and the state rules of every court govern the relevant procedural aspects. Chapters 1, 3 and 5 of the Bankruptcy Code have general provisions regulating all cases, whereas the rest of the chapters regulate special aspects of insolvency.

Chapter 1 provides definitions. Article 101 BC declares that insolvency isn’t a prerequisite in order to file for the Code’s protection and for a company aiming to be rescued it is crucial to be able to file at an early stage. Chapter 3 regulates administrative matters. An important provision is Article 327 BC that refers to lawyers handling such cases and declares that they must submit documents certifying their disinterest in them. Even if a lawyer isn’t directly connected to the parties he has to prove that his partners aren’t connected either. Such rules ensure a fair procedure. Chapter 5 has provisions about accurately identifying the debtor’s assets and liabilities.

Chapter 7 describes the liquidation process in which, as in the European examples mentioned above, a trustee dissolves the insolvency estate and distributes the proceeds to the creditors according to their claims’ priority. Any individual unable to comply with his financial obligations and any business entity wanting to terminate its activity can opt for this but only individuals can receive a debt discharge under Article 727 BC. The entities excepted from the Code are banking and insurance institutions, entities having no property in the U.S.A. and governmental units (109 BC). Liquidation’s advantages are speed and simplicity and they are the reasons it remains a popular option despite the various alternatives the law offers. The truth is that the Code doesn’t promote Chapter 7 for companies. A company must face severe problems in order to apply for it and it usually does so only after Chapter 11’s procedure has failed (1112 BC).

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According to Articles 301 and 303 the debtor or his creditors - three creditors with ‘bona fide’ and total claims of minimum 5,000 dollars - file an insolvency petition to the competent court of the district where the creditor has his principal place of business, which ceases individual enforcement actions against him (362 BC). A list of assets and liabilities, a document certifying his income and a list of contracts and tax return transcripts have to be submitted as well (521 BC, 1007. b Fed. R. of B. Pr.) and a trustee is appointed having the responsibility of keeping the procedure evolving. The company operates under his control only for the necessary liquidation actions. Between days 21-40 after the filing, the trustee will call a creditors’ meeting and if there are non-exempt assets in order to proceed, the creditors file their claims in a ninety-day period after their first meeting (502 BC). The trustee can annul preferential transfers made to creditors within a ninety-day period prior to the filing (548 BC) and transfers made to partners or relatives during a one-year period prior to the filing (101.31, 101.54, 547, 548 BC).

The proceeds from the liquidation of assets or the company as a going concern are distributed to the six classes of claims according to Article 726 BC85 (secured claims, super-priority claims, administrative claims, unsecured claims with priority, subordinated claims and equity interests). Each class must be paid in full before the next class is satisfied. Regarding secured creditors, they are paid first, having claims supported by collaterals, and their payment doesn’t derive from the estate but from their security. It is also important to note that if the collateral’s value is not enough in order to repay them in full, then for the rest of the value the amount is ranked as an unsecured claim; it is never annulled. Any remaining assets will satisfy the unsecured claims. Liquidation doesn’t differentiate significantly from foreign jurisdictions.

5.1. Getting to Know Chapter 11

On the other hand Chapter 11 focuses on the debtor, without of course disfavouring creditors, and it could be said that it is the centre of the American insolvency heritage. Almost any individual and business entity can file for Chapter 11 as well, which has many ‘success stories’ in its history as it has restructured important areas of the American economy (ex airlines, healthcare, telecommunications etc). Protecting companies as a whole, debt restructuring and creation of equity are within its goals.

In reorganisation usually a debtor-in-possession continues to manage the company filing monthly reports to the court (1101, 1106, 1107 BC) and not a trustee. A trustee is appointed only in the case of fraud, dishonesty or mismanagement from the debtor (1104.a BC). After the insolvency filing the debtor owns the exclusive right to propose a plan for the first 120 days, which can be extended for eighteen months (1121.b-d BC) and upon proposal there is a 180-day period -extendable for twenty months- for it to be accepted (1129 BC). According to Article 363 BC the company can operate during the restructuring period without special court permission; however, actions that are not part of its usual activity are not permitted. Furthermore, there is flexibility regarding transactions which means that according to Article 365 BC the debtor can decide upon the fulfilment or not of almost any executor contract.

The debtor’s plan must present each class’s repayment and the majority of each class -in number and value- must vote in favour of it and at least one impaired class. Administrative creditors are specially addressed, as they must be paid in cash and they also have the right to enter into negotiations with the debtor and alter their claims. The ‘Absolute Priority Rule’ has to be followed although Articles 1122 and 1123 BC provide flexibility to the debtor. The law only declares that similar claims must form one class, which allows the debtor to usually create one class for all unsecured creditors -disfavouring some of them-, whereas each secured claim belongs to a separate class. The court confirms the plan if the abovementioned principle and the ‘Best Interests of Creditors Test’ are satisfied. It is mandatory for the plan to include an

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introduction with information on the financial situation and provisions regarding classification, voting and distribution. There also is the option of ‘pre-packaged plans’, which are agreed upon by the debtor and his creditors before the official filing. If the restructuring option is abandoned whatsoever, it is important that only the debtor can decide the alteration to Chapter 7.

As mentioned above, Article 362 BC introduces the automatic stay which is decisive in reorganization, as creditors’ prepetition claims are ceased in order to proceed to an effective reform—with the exceptions of governmental, environmental and other claims.\textsuperscript{87,88} Court decisions, set-offs, liens are all ceased, facilitating the reform. Relief from the stay can be granted if a creditor’s collateral is at risk of being damaged.\textsuperscript{89} Article 362 BC doesn’t apply on guarantors.

Regarding creditors, any creditor whose claim is not listed by the debtor or it is characterized as disputed must file a ‘proof of claim’ and attach supporting evidence (1111 BC, 3003.c.2 Fed. R. of B. Pr.). Furthermore, under Article 554 BC the debtor can deny a secured creditor’s right if the creditor hasn’t secured it as the law requires (the debtor’s ‘strong-arm powers’). Other important provisions regarding creditors are Articles 361 and 363 BC which declare that if ‘cash collateral’ is spent, secured creditors are entitled to additional ‘adequate’ protection, according to which the debtor can make periodic payments or provide additional liens.

Important organs of Chapter 11 are also the U.S.A. Trustee and the bankruptcy examiner who have similar supervisory roles and the creditors’ committee which is formed by the seven largest unsecured creditors, bearing an advisory role (1102, 1103 BC).

\textsuperscript{87} M Kardas-Nelson, L Nelson and A Fischel, ‘Bankruptcy as Corporate Makeover’ \textit{Dollars and Sense. Real World Economics} (Boston, June 2010)
\textsuperscript{88} K R Huennekens and N Kramer, ‘Bankruptcy Law’ (2015) 50 University of Richmond Law Review pages 13-16
\textsuperscript{89} Douglas G Baird, \textit{Elements of Bankruptcy} (first published 2006, Foundation Press 2014) page 217
5.2. The Criticism

Chapter 11 has also received severe critique. Contrary to the legislator’s approach who is giving incentives for all companies to apply for the chapter’s protection, some academics supported that a company should apply for it only under the condition that it has strong possibilities of viability otherwise the restructuring isn’t worthy of the time and effort and it is indicative of judicial irresponsibility, since the market’s competition and corruption are not taken under consideration. It is supported that judges should only confirm a plan if it is not likely to be followed by further reorganization or liquidation, a common scenario in the American practice\(^90\). As a scientific symposium of 2013 confirmed\(^91\), fifteen percent of companies undergoing a reorganization of Chapter 11 will file for protection again. Feasibility should form an implicit element of restructuring.

Even though Chapter 11 continues to have a significant role in the economy, other roles have been attributed to it as well, as the economy evolves and this may create problems\(^92\); for example the reform of a company at a level that it entirely changes its object (ex Borders and Blockbuster altering its activity from rental stores into online streaming services). In this way the market may be kept active but on the other hand a company like Blockbuster for example, with 1 billion dollars debt at the time of filing, completely changing its object in order to survive is a dangerous practice.

Another criticised use of Chapter 11 is using it as a mechanism in order to ensure that the assets will be sold at their highest price. Companies may even sell the assets before the procedure is over so Chapter 11 only offers a confirmation. In 2002 eight of the ten largest corporate filings used Chapter 11 in this way.

From 2000 the use of Chapter 11 as a mechanism in order to sell a company as a going concern, something that had only been a theoretical idea in the past, increased.

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In fact, half of 2002 Chapter 11 cases were company sales\textsuperscript{93} and in 2014 twenty-one large companies filed for it, with sixteen of them being sold as a going concern, altering the chapter’s philosophy\textsuperscript{94}.

Another aspect of the issue is that plans are not always debtor-oriented as they may impose strict terms. For example the workforce may be reduced, the management may be replaced, a merger may take place or unprofitable assets and sectors may be abandoned. So the election of Chapter 11 over Chapter 7 doesn’t always equal prosperity for a company.

Serious critique has also been expressed about the result of reorganization not being selected by as many companies as the legislator would wish\textsuperscript{95}. More than 500.000 companies become insolvent every year in the U.S.A. and it is noteworthy that approximately only 10.000 file for Chapter 11; the majority of them being relatively small with asset value less than 100.000 dollars, something that doesn’t reflect the legislator’s basic objective, as in these cases the aim is usually not business rescue but to help the management restructure the company’s finance. Small companies often apply abusively and empirical evidence shows that half of these plans are not successful.

Remaining on the subject of small companies, it is true that the Code imposes stricter provisions upon small-business debtors, as is the case for individuals as well; for example regarding filing (109.g, 111, 362.d-e BC) or the extra documents which need to be submitted (302.1, 521 BC). Such debtors must make several filings to the court concerning their feasibility (308, 1116 BC) and they are also subject to additional supervision by the U.S.A. Trustee (586.a.7 BC). As it is supported, American law promotes trade and therefore it is more protective upon large companies, which is a problematic element indicating that maybe the legislator hasn’t seen Chapter 11’s

\textsuperscript{94} Douglas G Baird, Elements of Bankruptcy (first published 2006, Foundation Press 2014) page 12
\textsuperscript{95} Jose L Carmona, ‘Another 180 Bankruptcies Files During Third Week of May. Chapter 13 Repayment Cases Made Up 60% of All Filings’ Carribean Bussines (San Juan, 5 June 2014) page 23
actual power. In small-company cases the court is more active as creditors prefer not to hold an active role and the deadlines are more realistic and achievable⁹⁶.

Lastly, the legal changes in creditor control over a company that occurred in 1998 shouldn’t be overlooked, as they allowed investor groups to gain important collaterals on assets and, therefore, to control the company’s access to money and pressure it. This phenomenon of creditors not aiming to establish cooperation and having goals that oppose to the debtor company’s goals is common during the recent years⁹⁷.

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5.3. The Reform

On the other hand it is supported that criticism on this chapter is not justified, as many surveys prove its positive economic results. For example data collected during the period of 1994-2002 indicates that the majority of insolvent companies opted for a Chapter 11 reorganization and in less than twelve months they were profitable again.

Nevertheless in 2014, when the American Bankruptcy Institute (ABI) presented the Final Report and Recommendations on the Reform of Chapter 11 it was obvious that after approximately thirty years the American laws needed to reform as well.

Some of the suggested reforms were the appointment of the estate neutral, a person appropriate to solve any disputes arising, and the impose of a sixty-day period during which asset sales are forbidden in order to allow the debtor to examine his restructuring options and not fall victim of bad market conditions. The Commission also suggested the courts to follow the ‘broad’ and not the ‘narrow’ view in the examination of assets, an approach leading to more property being included in the procedures and to the enhancement of the company’s value. Another important reform was the grant of more flexibility to the debtor regarding the abidance by the ‘Absolute Priority Rule’ on the thought that an insolvent company needs financing, which parties outside of the procedure are more unwilling to provide –of course, always under the ‘Reasonable Markets Test’-. Last but not least, the grant of a ‘guarantee’ to unsecured creditors who were just below the last class that received payment (‘immediately junior class’) was introduced.

American insolvency law continues to develop by enhancing the fair procedure’s, the debtor’s and the creditors’ protection.

5.4. The Alternatives and the ‘Restitution’

Even though American Insolvency Law mainly focuses on the procedures regulated by the Bankruptcy Code, there are alternatives to Chapters 7 and 11 (305 BC). In U.S.A. the debtor is not obliged to follow the formal court procedures contrary to most European legislations where only non-insolvent debtors are allowed to follow the informal ones. These procedures are under the general category of ‘rehabilitation’.

These voluntary procedures are known as ‘work-out’ settlements and they can be initiated by either the debtor or his creditors, who will form a ‘steering committee’. They produce ‘forbearance agreements’ which are contracts between the debtor company and its creditors, bound to each state’s laws. Usually though only financial creditors are invited to the negotiations whereas suppliers, employees etc continue to be paid. They are divided into ‘composition’ and ‘extension agreements’. In the first case the debt is reduced whereas in an extension agreement the debt’s maturity is extended\textsuperscript{100}.

The usual ‘forbearance period’ lasts for a maximum of three weeks, extendable for thirty days, and it is automatically terminated if a creditor takes action in order to enforce his rights against the debtor.

Among their benefits are: less time and costs, less disruption of the company’s activities, no elimination of workforce, maintenance of the company’s management, maintenance of stability in order to negotiate, the company can proceed to actions that go beyond its common course, flexibility, avoidance of reputational damage etc. However there still are negative features such as no protection against creditors who want to follow their previous written agreements with the debtor, no legal method to oblige dissenting creditors to cooperate, difficulties in the case of many creditors and low liquidity, threat of abuse by participants, acceleration of payments, no tax reductions, etc\textsuperscript{101,102}. A survey sample of 174 insolvent firms over a three-year period

\textsuperscript{101} International Monetary Fund. Legal Department, \textit{Orderly and Effective Insolvency Procedures. Key Issues} (International Monetary Fund 1999) Forword
underlined that it is difficult to foresee the success or not in such cases which are subject to wide flexibility\textsuperscript{103}. The American Code provides debtor-oriented legislation, which can be even more beneficial to companies in distress than out-of-court pre-insolvency procedures are and this is the reason for such procedures being at low levels in the U.S.A.\textsuperscript{104,105}. The Code’s provisions provide creditors with incentives to finance the debtor (DIP financing), allow for a second Chapter 11 filing (‘Chapter 22’) and a ‘cramdown’ on dissenting creditors making the acceptance of the plan more possible to succeed etc. Generally, it is an innovative system of law, following closely the economy’s needs.


\textsuperscript{103} Keven Edward Yost, ‘The Choice Among Traditional Chapter 11, Prepackaged Bankruptcy and Out-of-Court Restructuring’ (\textit{Purdue University. Purdue E-Pubs}, 2002) http://docs.lib.purdue.edu/dissertations/AAI3105057/ accessed 7 December 2016 page 25

\textsuperscript{104} James B Shein, \textit{Reversing the Slide} (Jossey-Bass 2011) pages 166-167

6. Indicative Case Law

As Professor James Shein has written, corporate insolvency is a ‘tool’ that can either be used by companies as a shield in order to defend themselves from excessive debt or as a sword in order to dynamically terminate unbeneﬁtable commercial relationships and to create a fresh start. Every insolvency and restructuring story is different and it is connected to factors such as its causes and aims, but the way it will evolve mainly depends on the relevant legislation of every jurisdiction. By the presentation of two examples I will try to compare U.S.A.’s and Germany’s latest restructuring laws and to draw conclusions on their efﬁciency. The comparison of other options such as liquidation wasn’t thought to be necessary, as the tendency worldwide is the legislative promotion of business continuation.

106 James B Shein, Reversing the Slide (Jossey-Bass 2011) pages 152-153

General Motors Corporation was founded in 1908 as a car manufacturing company and had always been one of the leading powers in American commerce. In 2000 U.S.A.’s central banking system’s intervention in the stock market led to a recession which in turn created pressure on companies having to deal with excessive pension funds, such as GM. Furthermore a 10.6 billion-dollar capital loss in 2005, a great labor strike in 2007, the automotive crisis of 2008, high oil prices and the global financial crisis urged GM’s management to file for a Chapter 11 solution in 2009, aiming to benefit from its multi-utility and its aim of enhancing business value. By that time its debt was 172.81 billion dollars and its asset value only 82.29 billions.

GM’s debtor-in-possession filing aimed at a government-assisted reorganization, a common practice of large American companies. The first-day motions they filed to the court (Article 365 BC) were about employee payments and the sale of the company’s jets. According to the submitted plan they would also receive fifteen billion dollars from the United States Treasury - it was stated that the only alternative to that would have been liquidation- and a sale according to Article 363 BC would follow.\(^\text{107}\)

According to the plan NGMCO Inc., a company owned by unsecured GM bondholders, worker funds and governments, purchased GM’s assets, trademark and operations, changing its name to ‘General Motors Company LLC‘. This of course was a pre-packaged agreement, as the approval was obtained prior to the submission of the plan, a common scenario in companies with complex branding. The ‘new GM’ had a separate legal personality from the ‘old’ one and it also stopped placing the GM brand on all of its brands, adopting the structure of a multiple-brand company. Furthermore it retained only four of the previous brands (Chevrolet, Cadillac, GMC and Buick) and it reduced its contractual agreements, factories and employees.

The ‘old’ GM was renamed ‘Motors Liquidation Company’. Regarding the sales of its multiple brands according to the plan’s terms, Hummer and Saturn failed to be sold, as sales as an insolvency measure aren’t easily achieved, so their manufacturing was

abandoned whereas Saab was sold delivering profits to the pre-petition creditors. The company continued the insolvency proceedings and it was divided into four trusts.

This is a good example of a flexible restructuring that used a variety of legal mechanisms, loyal to the tradition of American companies that refuse to ‘give up’ to liquidation. Even though the case needed complex handling, its negative results in the economy were controllable (ex activities outside of the U.S.A. and the normal operating activities remained untouched). Generally it was a pluralistic procedure that included a ‘pre-packaged’ plan, debtor-in-possession management, state funding, sales of assets (partial liquidation), multiple reductions, alteration of the previous approach to commercial activity and even a leasing of the company’s commercial identity, trademark and intellectual property rights (partial dissolution\(^{108}\)). Today both ‘GMs’ as well as their subsidiaries operate profitably, as a constant proof of the American insolvency law system’s efficiency.

6.2. The IVG Immobilien AG Case. A Hesitant but Promising Effort

IVG Immobilien AG was founded in 1916 as a coal and steel company, converting its services mainly to real estate in 1997. In 2013 the severe threat of bankruptcy occurred due to a decrease of demand for its buildings and to expensive constructions such as the ‘Squaire’ building\textsuperscript{109}. During the same year the company filed a court petition for reorganization under self-administration, with its debt being 4,2 billion euros and its asset value 20 billions.

The plan proposed by the company was approved by the creditors who were powerful hedge funds such as Cerberus Capital Management, Marathon Asset Management, Morgan Stanley etc\textsuperscript{101,111}, as its terms were beneficial for them. They would be repaid through debt-to-equity swaps granting them shares with total value of 1,4 billion euros and making them IVG’s new owners with great controlling powers\textsuperscript{112} and even unsecured creditors would receive a repayment of approximately sixty percent. Furthermore, the plan provided for asset sales such as the company’s 50% stake in London Gherkin tower which offered to the company 12 billion euros, management replacement, a 2,2 billion-euro debt reduction\textsuperscript{113}, capital increase\textsuperscript{114}, reduction of workforce and the separation of the company into three independent sub-companies (one for real estate, one for institutional funds and a third one for caverns). The basic criterion for the plan’s acceptance was the better compensation of creditors compared to the compensation they would have received under liquidation.

\textsuperscript{112} A Mechele Dickerson, ‘The Many Faces of Chapter 11. A Reply to Professor Baird’ (2004) 833 College of William and Mary Law School Scholarship Repository page 121
The company’s plan made good use of Article 240 of the German Rules of Civil Procedure regarding the automatic stay, Article 245 allowing the cram-down of some creditors’ classes’ claims and Article 103 providing debtors the right to terminate contracts. In September 2014 the company successfully emerged free of debt obligations having restructured approximately 4 billion euros of debt\textsuperscript{115}. IVG was saved but it was forced to proceed to tremendous changes. Creditor repayment was in the centre of reorganization leaving the company’s best interests second and causing disruption in the market.

IVG’s restructuring obviously benefited from the 2012 law reform\textsuperscript{116} that minimized the administrator’s role, enhanced creditor participation, promoted self-administration and provided more negotiating freedom to the parties involved. These were all changes that allowed German law to handle complex cases even though it still lacks the speed and flexibility of the American and the English relevant legislation\textsuperscript{117}. The most important aspect besides law reform though is the slow change in judicial approach as the courts started to become more receptive towards second corporate chances. At this time not many large restructurings had taken place and Bonn’s (IVG case), Offenburg’s and Düsseldorff’s courts took some brave steps towards the confrontation of judicial ‘conservatism’ through financial and operational restructurings of companies.

Even though today the German and the European economy face the same difficulties as the American, Europe’s law and practice are still far from being able to provide the same solutions. Nevertheless, it is positive that as time goes by legislators seem to be on the same path and it depends on the judicial forces to be in harmony from now on.

\textsuperscript{117} C Pickerill and W Prusko, ‘What’s So Special About German Corporate Bankruptcy Cases Three Years After ESUG Reform?’ \textit{Financier Worldwide} (Birmingham, March 2015)
7. The Economic Perspective of the Liquidation vs Reorganization Dilemma and the Effects of Both Options in the Market

Corporate insolvencies are a dynamic phenomenon affecting societies in multiple ways causing increase of unemployment rates, decrease of consumers’ purchasing power and market inactivity. Many bankruptcies taking place during the same period of time may even cause an economic crisis and since such phenomena are often today internationally, it would be interesting to investigate which legislative approach on insolvency benefits the economy more.

Unfortunately, not many articles have been written on this matter and the majority of them refers to the internal effects on the procedure and not the external ones on the economy\textsuperscript{118,119}. Furthermore there is a disproportionate majority of American literature compared to the European available so it is not easy to gain a complete view on the matter of which jurisdiction follows the ‘wiser’ path. Insolvency systems need to be in the right direction, as entrepreneurs need second chances in order to take incentives but also their creditors need the safety that they will collect their claims in the best possible way.

A company filing for insolvency and opting for the solution of liquidation will stop operating and its assets will be distributed to various creditors. On the other hand under reorganization it will continue to operate and it will be restructured but it may still proceed to dismissals according to the plan.

From the previous chapters’ analysis it was shown that the second option offers reallocation of contractual obligations\textsuperscript{120}, continuation of commerce, possible production of wealth and avoidance of market panic\textsuperscript{121}. A dilemma often expressed is ‘employment maintenance (reorganization) vs efficient use of assets (liquidation)’ but


\textsuperscript{119} Kevin J Delaney, \textit{Strategic Bankruptcy. How Corporations and Creditors Use Chapter 11 to Their Advantage} (University of California Press, 1992) page 185

\textsuperscript{120} Barry E Adler, ‘Bankruptcy and Risk Allocation’ (1992) 77 Cornell Law Review page 446

successful reorganizations include both aims. Furthermore, a principle often met in scientific literature is that if the assets still operate and have value together, they should be kept together. Surveys have also proved that companies having undergone reorganization are more profitable and benefit the economy more, compared to companies that have never been subject to such procedures. On the contrary, liquidation of assets can be noticed even in non-insolvency situations. The latest insolvency laws though, with the variety of their reorganizational ‘tools’, aim at turning a company’s pathogenic elements into knowledge.

An example underlining this chapter’s point comes from the American academia. A survey showed that in cases filed under Chapter 11 the companies preserve 75% more of their financial value than they would have preserved under a Chapter 7 filing. It also showed that the full recovery rate for secured creditors was 72% in the first case and only 32% to 51% in the second case. Furthermore, according to the study in 95% of Chapter 7 cases the unsecured creditors receive nothing whereas under Chapter 11 52% of them will receive repayment. Even though it refers to internal insolvency results, it is indicative of reorganization’s advantages.

Individual bankruptcies can present another accurate example: One of the changes brought by the BAPCA law (2005) were the additional barriers for debtors in order to achieve a debt discharge in an effort to halt the Code’s strong pro-debtor approach. Consequently, debtors had to submit strict monthly repayments in a way that prevented them from returning to a normal circulation of earning and spending, causing an economic recess domino.

Of course it is also important to note that reorganization shall and can benefit creditors as well, as they have the option of voting against an unfair plan and alternatively if they believe in its success, they also believe that they will gain profit too in the future; and practice has shown that creditors do have the power to impose their

own terms\textsuperscript{125}. Creditor protection should never be overlooked, as their recovery is a decisive factor helping companies to have access to stable financing\textsuperscript{126}.

The answer to the title’s question has to be based on other factors as well, such as the costs of both options and who will have to bear them – unfortunately though, most studies include only the legal costs\textsuperscript{127}. Reorganization procedures have often been accused as being expensive (approximately 4,6 of the company’s market value) and hiding indirect costs\textsuperscript{128}\textsuperscript{129}. Economist Dean Meckling’s firm thesis is that a reorganization system must not be costly in order to be able to meet its goals\textsuperscript{130} and practice has shown that usually the costs are much lower than some support, at least in cases involving small firms\textsuperscript{131}\textsuperscript{132}. Furthermore reorganization procedures have also been characterized as time-consuming (1 to 2,8 years), especially in cases of complex capital structure but the majority of companies returns to full operation within a year\textsuperscript{133}. It has also been claimed that reorganization in some jurisdictions does not protect small companies but the market’s rules show that usually in such cases, the company’s major ‘asset’ is its personal contact with customers; an ‘asset’ that is difficult to be ‘preserved’ in insolvency.\textsuperscript{134}

A research from the University of Cantabria confirmed that in creditor-oriented insolvency systems there is greater loss of share value in firms, in comparison to


\textsuperscript{128} J S Bhandari and L A Weiss, Corporate Bankruptcy. Economic and Legal Perspectives (Cambridge University Press 1996) page 193


systems which promote business rescue, by examining firms facing the threat of insolvency in France, Germany, Spain and the U.K. during the period of 1990-2002\textsuperscript{135}. Furthermore the last twenty years have shown that even the rescue of companies in harsh distress can benefit an economy battling with high unemployment rates\textsuperscript{136}.

European justice is still reluctant in this field though and an example from the German market and the solar energy sector is indicative of this: Even though energy is a crucial branch of German commercial services and even though many of its major companies were battling with insolvency, most of them closed down, unable to benefit from the relevant legislation\textsuperscript{137,138}.

The answer to this subject is complex as it has to take into consideration each national economy’s needs and the solution that will be preferred is always relative to the causes of the distress. However, economic and legal surveys addressing the issue demonstrate reorganization mechanisms’ dynamic to benefit distressed companies, their creditors and national markets in the long term.


\textsuperscript{138} Stefan Schultz, 'Bankruptcies Have German Solar on the Ropes' Spiegel (Hamburg, 3 April 2012)
8. Conclusions

During the last years the interest in comparative corporate insolvency law has increased, as law’s connection to entrepreneurship is acknowledged more and more. This dissertation examined jurisdictions of very different legal traditions and what could be underlined as one of its major outcomes is the recent years’ international tendency towards pre-insolvency proceedings, reorganization and the provision of second chances to companies; a result also abetted by globalization that leads the national legal systems to converge and harmonize.

Conclusions are hard to be drawn as the economic factors that prompt legislative activity on this field are constantly changing and it is important to consider that insolvency law usually changes corresponding to the economy. My research shows that the ‘conservative’ legal system of Germany is slowly moving towards more debtor protection, introducing new procedures influenced by U.S.A.’s Bankruptcy Code and that France is trying to eliminate its previous strong debtor inclination with its latest reforms in order to walk in the same pace with the rest of Europe. On the other hand the U.S.A., enjoying an already complete and innovative legislation, hasn’t undergone many reforms during the recent years, continuing to be in the centre of the international insolvency ‘laboratory’ and to set the example for other jurisdictions to follow since the active American market helps it evolve and become more efficient.

In order to better estimate what makes an insolvency system more successful than others it is essential to evince its effect in the economy and to do so, besides an empirical research, it is necessary to proceed to an economic analysis of the legal rules -as it was done in the previous chapter-, a difficult venturing whatsoever for a legal scientist. It is supported that legislations with clear economic goals benefit a

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140 Enoch K Beraho, ‘A Comparative Review of Bankruptcy Reforms in the USA, the UK, China and Malaysia’ (2011) 9 Problems and Perspectives in Management pages 15-17
society’s economy more\textsuperscript{143}. The elements that shall be studied and were actually studied for this question are the issue of who controls the procedures, the provisions referring to debtor and creditor protection, the ranking of creditor claims, the maximization or not of the distressed company’s value etc.

Of course the perfect insolvency system doesn’t exist but from the above analysis the American system was presented as the most ‘mature’ one, offering the ‘safe harbors’ creditors may need, but mainly focusing on the continuation of commercial activity by creating a legal environment that provides second chances to struggling entrepreneurs\textsuperscript{144}; a result that can be certified by its robust economy. The civil law systems, even though they may vary on several aspects, generally refuse to leave creditors without significant protection\textsuperscript{145}. It has also been observed that countries with weak judicial proceedings usually offer strong creditor protection as a ‘counterweight’ for the uncertainty.

Insolvency law is a law of obligations with the difficult dual purpose of satisfying the debtor and his creditors in order to encourage business risk. As the economic crisis deepens the challenges upon this legal field multiply; nevertheless nowadays, as the above analysis demonstrated, merchants and lawyers have at their disposal sufficient legal mechanisms.


\textsuperscript{144} D Druin and M Allgrunn, ‘The Economic Impact of Chapter 11 Reorganization Versus Chapter 7 Liquidation’ (2014) 2 Journal of Criminal Justice and Legal Issues pages 1-4

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