The Globalisation of Insolvency Reform

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The globalisation of finance and trade has stimulated a wave of proposed law reform in the field of insolvency (bankruptcy) around the world. This paper summarises the central functions of insolvency law in a modern economy and the relationship between liquidation and reorganisation in fulfilling those functions. It then discusses some key issues in the current reform debate: 1) Who should benefit from the increased values obtained in a successful reorganisation? 2) What is the best method of managing a reorganisation effort? 3) What priorities in distribution should be retained? and 4) What are the best approaches to multinational (cross-border) insolvencies?

The next Part of the Review will contain an article by Paul Heath QC examining the proper role of the state in insolvency law in New Zealand.

An Era of Insolvency Reform

Insolvency (bankruptcy) reform[1] became a global preoccupation in the nineties. All over the world, ministries, commissions, and legislatures have been considering and adopting new insolvency laws. Germany adopted a completely new

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1 I use "insolvency" to describe insolvency proceedings of all kinds, including those applicable to consumers and to businesses, and to natural as well as legal persons, as long as the proceeding is a collective one directed at the circumstance of general default. See, eg, *Guide to Enactment of the UNCITRAL Model Law on Cross-Border Insolvency*, UN General Assembly, Doc A/CN.9/442, 19 December 1997 (hereafter "*Guide to Model Law*") para 50. However, the central concern of this paper is business insolvency. I would have a different emphasis on a somewhat different set of facts and issues if consumer insolvency were my primary subject. As to terminology, many in the English-speaking world use "insolvency" to refer to enterprise cases and "bankruptcy" to refer to cases involving natural persons. Here I use "insolvency" to refer to both. The North American practice is to use "bankruptcy" to refer to both types of cases.

insolvency law, effective this year.[2] Canada revamped its insolvency laws in 1992 and then adopted substantial amendments last year.[3] Most of the countries of Eastern Europe have created new insolvency laws since the fall of the Wall. Russia and China have had at least two new laws each.[4] Japan has had an insolvency reform commission at work for several years now and the commission has recently been told to speed up its work. The United States adopted some significant revisions to its insolvency laws in 1994 and established a commission to consider more extensive changes. That commission reported[5] in 1997 and the United States Congress came very close to passing much more substantial changes last year.[6] Closing the circle, the United Kingdom, which really began the recent international reform parade,[7] is actively considering further changes to its Insolvency Act.

The great interest in reform of domestic insolvency law has been more than matched by efforts to address multinational insolvencies. Several countries have added new provisions specifically addressing cross-border issues to their domestic insolvency laws. Notable examples are Australia, Germany, and the United Kingdom.[8] On a multilateral level, three efforts are potentially of the greatest importance: the European Convention, the UNCITRAL Model Law, and the American Law Institute Transnational Insolvency Project for NAFTA.[9]

These various efforts, domestic and transnational, are being supported by several of the major international organisations, some of which have made or will make recommendations for reform to member nations.[10] Thus reform activity in the developed countries is apt to be matched by increasing interest in insolvency law reform in the developing world as well.

Why has this wave of interest in insolvency law arisen around the world? It is not enough to say that it results from the current economic crisis in Asia, because

2 Insolvenzordnung [Insolvency Law], art 102. See Balz, "Market Conformity of Insolvency Proceedings: Policy Issues of the German Insolvency Law" (1997) 23 Brook J Int L 167; Kamlah, "The New German Insolvency Act: Insolvenzordnung" (1996) 70 Am Bankr LJ 417.

3 American Law Institute, Transnational Insolvency Project, *International Statement of Canadian Bankruptcy Law* (Tentative Draft 15 April 1997)(final approval, May 1997; awaiting translation) 5 [hereafter "*Statement of Canadian Bankruptcy Law*"].

4 China: *Supplementary Notices on Issues Concerning the Trial Implementation in Several Cities of State-Owned Enterprise Bankruptcy and Reemployment of Staff and Workers*, 2 March 1997; *People's Republic of China Enterprise Bankruptcy Law*, enacted 2 December 1986, effective 1 November 1988. Russia: *Federal Law – Insolvency*, effective 1 March 1998, replacing *Law on Enterprise Bankruptcy*, effective 1 March 1993.

5 National Bankruptcy Review Commission, *Bankruptcy: The Next Twenty Years, Final Report* (1997).

6 That legislation has already been reintroduced this year. It contains important changes to business insolvency provisions, although its central thrust is change on the consumer side. Further legislation to consider more fundamental business law changes may follow.

7 Insolvency Act 1986.

8 Australia: Corporations Act 1989, s 581; Germany: Insolvenzordnung [Insolvency Law], art 102; United Kingdom: Insolvency Act 1986, s 436.

9 See generally American Law Institute, Transnational Insolvency Project, *International Statement of United States Bankruptcy Law* (Tentative Draft, 15 April 1997) (final approval, May 1997; awaiting translation).

10 See, eg, International Monetary Fund, *Orderly and Effective Insolvency Procedures: Key Issues* (1999). The World Bank is conducting a series of meetings looking to develop guidelines for the use of client countries.

major reform began before that crisis appeared and has been notable in Europe and North America.

Part of the answer lies simply in the passage of time. The last great reworking of insolvency laws around the world took place just over one hundred years ago, before the turn of this century.[11] That was, for the most part, a time of general prosperity.[12] The Great Depression naturally occasioned revisions to insolvency laws in many countries, but in very few did it lead to fundamental changes. By the nineties, the twentieth century had happened since the last time most insolvency laws were rewritten and that would have been reason enough to reconsider them.[13]

Yet there is more to the matter than that. Although the full explanation is no doubt multifaceted, I suspect that two important triggers for the renewed interest in insolvency law were de-governmentalisation and globalisation. I offer the somewhat awkward coinage, de-governmentalisation, to comprise both deregulation and privatisation, trends that have dominated government policy around the world in the last decade. One explanation for the fact that the Depression produced revision but not fundamental reform in most insolvency laws is that the thrust of government policy in most countries in the thirties was regulation and nationalisation, both of which were meant to eliminate the possibility of general default by an economic enterprise. When those policies were reversed and the market became the favourite tool of policy makers, laws were required that met the needs of the marketplace, from transparency (providing necessary information to the market) to insolvency (providing a mechanism for reacting to the inevitability of default in a system based on competition and risk).

Globalisation has contributed because it has the potential to exaggerate the impact of economic trends. The massive and sudden flows of investment in and out of Pacific Rim countries in the last thirty-six months have revealed the size of the economic waves generated by a global financial system. The risks of great and pervasive financial distress, as opposed to particular casualties of ordinary economic competition, have pointed attention at insolvency law, especially mechanisms aimed at the rescue of fundamentally sound enterprises. Just as with mergers and acquisitions (which are themselves a prominent part of the "rescue culture"), the nineties have produced considerable evidence of the need in a globalising economy for a constant reshuffling and readaptation of economic

11 Notable examples were Germany (1877), the United Kingdom (1883), Japan (1892), and the United States (1898).

12 Of course, there were "panics" during that period, including the Panic of 1885 in the United States and the troubles surrounding the rescue of Baring Bank in 1890. But on the whole it was a prosperous period.

13 For whatever reason, the United States was a bit ahead of this trend, adopting a completely rewritten insolvency law effective in 1979. Although that law, especially Chapter 11, has substantially influenced subsequent reform, it certainly did not produce any groundswell for change in most countries during the eighties. The notable exception was the Insolvency Act 1986 in the United Kingdom.

enterprises. When those changes come in the context of financial distress, as they often do, insolvency reorganisation is the natural tool for the job.

There has been a small countertrend of sorts in the academy, with several theorists proposing to eliminate or dramatically reduce the role of insolvency laws, especially reorganisation regimes, by using a variety of market-oriented devices.[14] Interesting as it would be to explore these notions, it would not greatly advance the purposes of this paper. These ideas have no empirical support and have attracted little interest from governments or commercial constituencies.

With particular reference to the insolvencies of businesses, the dominant issue has been reorganisation or rescue. There are substantially different views about the details, but most of the reform efforts of the nineties have focused on the restructuring of distressed businesses. Generally, legislation and proposals have only tinkered with liquidation provisions, including the important avoiding powers (for example, fraudulent conveyance and preference provisions). If there is a second place — a distant second — in reform prominence, it has been to narrow priority provisions as applied in both liquidation and reorganisation. Reformers have tried to eliminate as many priorities as possible, except for the big two: security interests and employees' preferences.

The third reform trend, just emerging in the last couple of years, has been a greatly heightened interest in the problem of cross-border insolvency, especially the rescue of multinational corporations.

To put these trends in perspective, and then to examine some of the key issues being discussed, it will be best to start with a summary of the functions insolvency law serves in various societies around the world.

Social and Economic Functions

The traditional functions of insolvency law are liquidation and reorganisation. The first involves assembly of the debtor's property (including avoidance of certain pre-insolvency transfers), selling the property, and distributing the proceeds according to legal entitlements. The second involves attempting to continue the business for the benefit of the beneficiaries designated in the law. As insolvency law grows more sophisticated, the line between these two traditional functions blurs and realigns, but it is always helpful to start with them. The economic and social functions described below are generally part of both traditional legal functions, although perhaps with an emphasis on one or the other.

We must start with the circumstances under which insolvency law, as such, is applied. Regardless of the definition of "insolvency", insolvency law is the law

14 See, eg, Gertner & Scharfstein, "A Theory of Workouts and the Effects of Reorganization Law" (1991) 46 J Fin 1189, 1196; Jensen, "Corporate Control and the Politics of Finance" (1991) 4 J App Corp Fin 13; Adler, "Financial and Political Theories of American Corporate Bankruptcy" (1993) 45 Stan L Rev 311, 323-333; Weiss, "Bankruptcy Resolution: Direct Costs and Violation of Priority of Claims" (1990) 27 J Fin Econ 285, 300 (delivering the company into the hands of its creditors as a means to avoid collection costs); Bebchuk, "A New Approach to Corporate Reorganizations" (1988) 101 Harv L Rev 775.

applied when an economic enterprise is in general default of its obligations.[15] A number of other laws relating to dispute resolution and asset seizure are invoked with respect to default on less-than-most obligations. Insolvency law reflects a recognition that different approaches are necessary when a debtor's default is general.

As with other sorts of laws, insolvency law becomes more important when a society adopts a market economy and faces the concomitant problems created by market risk, if the market is too large to permit resolution of those problems through social accommodation among persons well known to each other. Insolvency law is not necessary to impose the discipline of economic failure. The market does that without assistance. Insolvency law is important, however, to allocating the costs of failure fairly in relationship to the economic responsibility of each actor and to avoiding the fraudulent shifting of consequences from those upon whom the market risk should fall. That discipline contributes importantly to the long-term strength of the market.

A *Order and social control*

General default creates a crisis for all concerned — debtors, creditors, customers, suppliers, and employees, among others. History, including recent history, attests to the many serious threats to social order that may result. General default may also precipitate panic in the relevant markets and lead to a "cascade" effect of plummeting prices and widespread collapse. These effects can destroy in minutes values built over a generation and can terminate businesses despite their inherent soundness.

Therefore the first job of insolvency law is to impose social order and do so rapidly. Although under some circumstances this role can be played by a private agency (for example, a market supervisor), it generally requires state intervention. The intervention must calm panic and control debtors and creditors to preserve values and to protect markets. Indeed, the latter goal may have primacy in a particular situation, if markets are seriously threatened. A recent non-judicial example in the United States was the threatened default of the giant hedge fund, Long Term Capital Management (LTCM). The Federal Reserve informally, but forcefully, intervened to protect capital markets in that case, influencing creditors to make further investments to protect the markets.

Especially in liquidation, insolvency laws provide a measure of social control and reassurance that matters will be resolved in an orderly and fair way. A liquidator can, for example, issue statements that calm markets in a way that some other official cannot credibly do. A company filing for "reorganisation" is likely to produce less fear than a "bankruptcy". The current turmoil in a number of Asian societies, and deep concern about the prospect of similar difficulties

15 General default should be understood to include the threat or risk of general default. See the related point with respect to "insolvency" in the Model Law: *Guide to Model Law*, above note 1, at para 71.

elsewhere, have emphasised the function of insolvency laws in calming panic and keeping markets as orderly as conditions permit.

Although the Federal Reserve's intervention in LTCM was apparently successful, many would argue that it establishes a bad precedent. Ad hoc governmental intervention has a substantial price. We would not want to see it often done. Necessarily it involves picking one company to save while many others are let go. To some extent, the rescued company may be rewarded for having been more reckless, on a larger scale, than those who are permitted to fail. Although I know of no reason to suspect a political motive with LTCM, there is always a suspicion of favouritism in such situations. LTCM was not a bail-out in the usual sense, because public money was not involved, but public power was exercised. The application of public power on an ad hoc basis can quickly become corrosive of trust or even become corrupt.[16]

The need for intervention in the LTCM matter arose because its assets were largely financial instruments essentially exempted from the operation of the ordinary insolvency laws in the United States. Assuming that hedge funds will continue to be unregulated, the absence of an effective insolvency regime to deal with instances of their financial distress will leave public agencies with no choice but to intervene. That fact illustrates one of the greatest benefits of a comprehensive insolvency law: the legalisation – and therefore the de-politicisation – of the public response to financial crisis. Of course, hedge funds, like other essentially financial companies, may require a specialised insolvency regime, such as many countries have established for banks, but their special characteristics do not exempt them from financial crisis and therefore from the need for a collective, public response to such crisis.

This first role of insolvency laws, the imposition of social order and the prevention of anarchistic action, is often stated as an aspect of value maximisation.[17] It has that important purpose, but its function is broader, as indicated. Each of the goals that follow in this discussion depends upon this one.

B *Predictability*

Risk, along with profit, are the essence of a market economy. While no law can eliminate risk, commercial laws should attempt to make outcomes as predictable as possible, without unnecessarily sacrificing flexibility.[18] Individual collection actions are not only chaotic and costly in the context of general default, but they necessarily produce unpredictable results.[19] To the extent that insolvency law

16 See, eg, "Partial Exonerations in South Korea" *New York Times*, 21 August 1999, p C2 (two South Korean "top economic officials" convicted of pressing "banks to extend preferential loans to cash-short companies").

17 Jackson, *The Logic and Limits of Bankruptcy Law* (1986).

18 See text, below note 23.

19 Of course, that statement is least true where collection is by a single debenture-holder with complete liquidation authority via a receiver. It is in that circumstance that insolvency becomes unimportant almost to irrelevance, except insofar as it polices the receiver or deals with a rare surplus. Thus the text is concerned with other sorts of actions by secured or unsecured creditors.

can produce predictable outcomes following general default, it stimulates investment and reduces transaction costs.

C *Value maximisation*

Any forced sale sharply reduces value. Forced sales by creditors under legal deadlines and procedures are especially destructive of value. This consequence arises directly from the legal process of forced sales. One important weakness in that process is that it often requires a quick sale. A seller who can wait for the right moment or the right buyer will get a higher price. That weakness is exacerbated in a time of economic crisis. General defaults not uncommonly occur during a time of market decline and turbulence, when a delay in sale, together with a marketing effort, can preserve substantial value, as well as protect the market itself from panic selling.

Value maximisation has several levels. An auction on the courthouse steps is the worst way to sell anything. A negotiated sale after marketing is better, even if assets are sold piecemeal. Better still is a sale of a package of assets. And in at least some circumstances it is possible to sell the on-going business as an operating entity, thus capturing the "going concern" value.

The primary reason that reorganisation is highly favoured by many creditors, as well as by debtors, is the grim prospect of recovery in liquidation, even under modern insolvency procedures.[20] The willingness of creditors to tolerate a substantial failure rate in reorganisation arises from contemplation of the alternative.

In a reorganisation, the business may be sold, making the proceeding simply a specialised form of liquidation conducted under the provisions of a consensual "plan" or "scheme" rather than specific statutory rules, although it will still be within a statutory framework. It should be emphasised that sale under a "plan" is often preferred to ordinary liquidation not only because it may permit sale at a higher liquidation level (up to going concern), but also because insolvency laws frequently permit greater flexibility in a "plan" sale than under traditional liquidation procedures.[21]

A modern insolvency law provides a structure within which creditors (and other interested parties) can act collectively, for the common good. Creditors often feel instinctively the need to take such action, but absent a workable law they may lack the vehicle for doing so. A strong thread of modern insolvency theory holds that this need for collective action, primarily to achieve value maximisation, is the central function of insolvency law.[22] Although other views are gaining currency

20 For the United States, as an example, see Herbert & Pacitti, "Down and Out in Richmond, Virginia: The Distribution of Assets in Chapter 7 Bankruptcy Proceedings Closed During 1984–1987" (1988) 22 U Rich L Rev 303.

21 The German reform, under the influence of the distinguished German lawyer Dr Manfred Balz, rests heavily on the notion of a "plan versus non-plan" procedure, rather than liquidation versus reorganisation: Balz, above note 2, at 168.

22 Jackson, above note 17.

and providing balance,[23] certainly one important function of insolvency law is to solve the "common pool" problem by collective creditor action to maximise value.

On the other hand, it is less often acknowledged that the goal of maximisation is in significant tension with the goal of predictability. The conflict is most evident in reorganisation, but is present to a significant degree in liquidation as well. The maximisation goal also tends to ignore the serious conflicts of interest among creditors, discussed below.[24]

D *Disclosure and fraud*

Central to the whole problem of credit, which is in turn central to modern economies, is the problem of information asymmetry. Debtors always know much more about their enterprises than do their creditors, even large creditors who exercise close scrutiny.[25] Rapidly growing markets—especially those moving from small, closely knit credit relationships to larger, more impersonal ones—often have particularly undeveloped rules and customs concerning disclosure, leaving creditors even less informed than in more mature markets. The whole notion of "due diligence" in the most advanced economies arises from this fundamental problem, but even the most "diligent" lender or investor knows that there will be important information that simply cannot be obtained.

Insolvency has always employed incentives and sanctions designed to force debtors to make full disclosure of their assets, liabilities, and affairs. A basic social and legal function of insolvency law is to obtain the maximum information for all interested parties.

Beyond disclosure, insolvency laws must deal with fraud. The fact of general default routinely gives rise to suspicions, all too often justified, of fraud and favouritism. Because many frauds are particular in form and consequence to insolvency, this function cannot be left to general enforcement mechanisms, but should be an integral part of insolvency law.

E *Promotion of entrepreneurship*

In many societies entrepreneurial investment is given at least equal status with debt investment. In these societies there is a recognition of the important social and economic role of entrepreneurs and of the fact that such persons invest time and talent, as well as money, in their firms. In those societies insolvency laws have as one goal giving the entrepreneur the maximum opportunity to recover from economic reversals. At least one rationale for that goal is to encourage people to take entrepreneurial risks.[26]

23 See, eg, Warren, "Bankruptcy Policy" (1987) 54 U Chi L Rev 775.
24 See section F.
25 In truth, some debtors do not, but their economic failure is generally swift and certain.
26 I include in entrepreneurial risk-takers the interests of venture capitalists who back entrepreneurs.

This aspect of insolvency law has risen to policy prominence recently in the United Kingdom and the Netherlands, among other countries.[27] It has long been an important element in insolvency policy in the United States.

F *Reflection of other social and economic goals*

Some commentators have suggested that insolvency law should be an empty vessel normatively, leaving all social and economic goals to other laws.[28] At the extreme, insolvency law would have a narrow focus on disposal of economic rubbish. That view has been seen as unrealistic and overly rigid by others, including myself.[29] The question presented by this disagreement can be posed as follows: when should insolvency law change the rights and consequences established by non-insolvency law? That question is inherently misleading, because insolvency law will inevitably change results simply because the context is general default and collective action. Nonetheless, the question provides a basis for discussion.

The most common and important respect in which this issue arises is in choosing among creditors. Secured creditors, priority (preferred) unsecured creditors, and general unsecured creditors have seriously conflicting interests, between and within these classes. Most insolvency laws affect their substantive rights in various ways. For example, employees who may have no special rights as creditors outside of insolvency are often given priority in insolvency distribution. On the other hand, landlords in some countries have restricted rights in insolvency as compared to non-insolvency situations. Of course, the largest conflict is between secured creditors and all of the other interested parties. Increasingly, insolvency laws around the world have restricted the collection rights secured creditors would enjoy outside insolvency, while generally respecting their distribution rights.[30]

Sometimes this debate is phrased in terms of "redistribution", invoking the terms of some of the debates about progressive taxation. The idea is that each creditor has won a bargain in the marketplace and any change in that bargain represents a "redistribution" in favour of others that must be justified.[31] That cast of the issue is useful, but is often stretched too far. The laws outside of insolvency also restrict the bargains in the marketplace, even among commercial enterprises, in various ways: the law says the parties may agree on A, B, or C, but not X, Y, or Z. The "pound of flesh" aside, a classic example is self-help repossession by a secured creditor in the United States. The law permits such creditor action only

27 United Kingdom: "Mandelson aims to ease bankruptcy laws" *The Times*, 14 October 1998, p 2 (Trade and Industry Secretary intends reforms to ensure that insolvency laws "did not needlessly deter risk-takers"). The Netherlands government has commissioned at least two studies of the relationship between insolvency laws and the encouragement of entrepreneurship.

28 See, eg, Baird, "Loss Distribution, Forum Shopping, and Bankruptcy: A Reply to Warren" (1987) 54 U Chi L Rev 815, 818.

29 See, eg, Warren, above note 23.

30 Balz, above note 2, at 173.

31 See, eg, Baird, above note 28.

where it does not lead to a breach of the peace. Debtors are not allowed to bargain away that community right.[32] Debtors are also forbidden to bargain away in advance their own right to notice of sale following repossession.[33]

Thus the question is not whether constraints and requirements should be imposed on permissible bargains, but whether the constraints and requirements applied following general default should be the same as those imposed in other commercial situations.

Aside from entitlements among creditors—and other interested parties—insolvency laws often reflect other social values. For example, they may have a component of concern for competition, a value tending to favour maintaining an enterprise as a separate entity in the face of an attractive purchase offer from a competitor. Many other social values are put into issue in business insolvency proceedings and are given more or less weight in various societies.

Issues

It would be too great a task to summarise the reform proposals and debates taking place around the world, but it may be useful to highlight some of the central issues.

A *Reorganisation*

The two largest questions in the reform of rescue provisions are: a) who should be beneficiaries? and b) who should direct the rescue?

(a) Debtors as beneficiaries

If the business can be continued as a going concern, who should get the resulting value? In some societies, it seems self-evident that any value, up to the exceedingly rare payment of one hundred percent with interest, should go to creditors. In others, it is axiomatic that the owners, employees, and other parties have important interests and that all interested parties should share in the losses and gains of the insolvency process. The United Kingdom has traditionally represented the creditors-only end of this spectrum and the United States the other end.

The extent to which the owners of the business are counted among the beneficiaries of reorganisation depends upon the weight given to social and economic goals outside of collection law as such. As noted above, in some countries entrepreneurs are highly valued—and lenders may be viewed with suspicion—so that the primary justification for reorganisation is protection and encouragement of debtors willing to invest time and talent, along with money, in

32 Uniform Commercial Code, s 9-501(3), 503 (1998). The UCC Article 9 has recently been extensively revised, but the revision will not be effective anywhere before July 2001.

33 Uniform Commercial Code, s 9-501(3), 504 (1998).

start-up businesses. It has been justly argued that such a rationale has little weight as to large, mature public companies,[34] although that argument is sometimes countered with the claim that public shareholders require special protection from a conspiracy of promoters and lenders.

Aside from entrepreneurship, the debtor's interest seems often to stand proxy for other values. These include the interests of employees, the importance of maintaining competition, and the stability of communities. The concern is that the sale of a business, even as a going concern, often leads to mass layoffs or even the closing of the business, while rescuing the business for the owners may be more likely to provide stability. One suspects that the right answer as to these values may lie somewhere between the economist who dismisses any question of social disruption—usually from a tenured chair—and the sentimentalist who imagines that economic life can be frozen in amber.

Finally, the debtor-beneficiary approach may be supported by the argument of early initiation, discussed below.

(b) Who is in charge?

Whoever might benefit from a reorganisation, someone has to attempt it. The choices seem to be the existing management, a trustee, existing management plus a trustee, or the creditors and a trustee. These are all points on a continuum of possible approaches.[35]

The United States and a number of other countries use a debtor in possession concept.[36] Existing management is retained, generally with a good deal of court control and supervision, at least in theory. The United States Chapter 11 differs from most of these regimes, however, in that most other laws have fairly rigid time limits for approving a plan and often strict minimum-payment requirements.[37] Other countries prefer management by a court-appointed trustee,[38] or by a trustee controlled by creditors.[39] Canada has adopted a hybrid system, with a trustee combining with existing management.[40]

34 See generally, LoPucki & Whitford, "Bargaining Over Equity's Share in the Bankruptcy Reorganization of Large, Publicly Held Companies" (1990) 139 U Pa L Rev 125; LoPucki & Whitford, "Corporate Governance in the Bankruptcy Reorganization of Large, Publicly Held Companies" (1993) 141 U Pa L Rev 669, 722 note 184.

35 There is a further alternative, namely reorganisation by a secured creditor. Although many have thought of the debenture-receiver system in the United Kingdom and elsewhere as a liquidation device, the Cork Report popularised the notion that it could serve to reorganise as well: *Insolvency Law and Practice: Report of the Review Committee* Cmnd 8558, 1982. However, that notion has not caught fire in reorganisation reform discussions in most countries.

36 Called the "suspenso" in many Spanish-speaking countries.

37 The old German law, which was followed in many countries, is exemplary. See Kamlah, "Vergleichsverfahren: a German Reorganisation Procedure" in Rajak (ed), *Insolvency Law: Theory and Practice* (1993) 251.

38 United Kingdom: Insolvency Act 1986, s 14.

39 Germany: Kamlah, above note 2, at notes 76, 84.

40 *Statement of Canadian Bankruptcy Law*, above note 3, at 58. However, under the Companies' Creditors Arrangement Act 1985, no trustee is appointed and the prior management remains in control. Ibid at 67.

To oversimplify grossly, the debate centres on which of two mistakes to make: to put a desperately struggling company under a new, unknowledgeable management often viewed with suspicion and hostility by existing employees, or to leave the fox (or the lout) in charge of the henhouse.

(c) Early initiation

Although the choice of reorganisation manager is often put into terms of "pro-debtor" versus "pro-creditor", it also reflects a conflict between classes of creditors. In particular, because unsecured creditors so often get little or nothing in liquidation, they are among those most anxious to attempt reorganisation in the hope of winning both a larger distribution on account of prior debts and preservation of an on-going customer.[41] Because they have little to lose, they are apt to be more ready to take the chance of reorganisation and are perhaps more willing to risk continuation of existing management, with which they have relationships. However, the most important reason that their interests may combine with those of debtors is the benefit of early initiation.

One of the items on which virtually all observers agree is that insolvency is usually invoked too late, after value has nearly disappeared. Every modern reform has had early initiation as a major objective. However, as noted above,[42] lack of information is a central problem in debtor-creditor relations: creditors do not have the key information necessary to initiate legal proceedings, and relaxation of the requirements for insolvency proceedings may give creditors too much leverage in the delicate balance of interests. Thus it is important to get debtors, who do have the necessary information, to initiate proceedings.

Early initiation may be by carrot or stick. The stick approach is favoured in the United Kingdom, among many other jurisdictions, where devices like the rules on fraudulent trading are designed to force debtors to file insolvency proceedings promptly. In the United States and many other jurisdictions, the debtor in possession concept encourages management to file because it leaves them in control and gives the shareholders at least a hope of salvage.

B *Priorities*

The push to reduce or eliminate priority provisions has enjoyed strong support across the spectrum of experts who often disagree on other issues. Notable successes have included the near-abolition of Crown priority in Canada[43] and the abolition of almost all priorities in the new German law.[44] The two priorities that have been generally favoured for retention are those for employees and for

41 Or, in the increasingly important case of tort-victim creditors, the hope is for a tortfeasor who will be around to pay claims that may not become manifest for years. See, eg, *In re Dow Corning Corp* (6th Cir 1997) 113 F.3d 565.

42 See text, above note 25.

43 *Statement of Canadian Bankruptcy Law*, above note 3, at 26.

44 Kamlah, above note 2, at 434.

secured parties.[45] On the other hand, equally universal has been the trend toward including secured parties in the insolvency process, which necessarily means sharply limiting their collection rights once an insolvency proceeding has been filed.[46]

C *Cross-border*

As noted earlier, several initiatives have been launched to improve cross-border cooperation in insolvency matters. Despite the unfortunate stall in adoption of the European Convention, it now appears that it may be adopted by regulation. The other leading possibility for global progress in this area is the Model Law from UNCITRAL.[47] The Model Law has actually passed both Houses of Congress in the United States, although it did not become law because of controversies over unrelated provisions upon which the Houses could not agree. It is likely to be adopted this year or next. It is under serious consideration in several other countries, including New Zealand.

Institutional Issues

There is an absence in the current reform discussions. Relatively little attention has been given to institutional questions: who are the judges, trustees, and lawyers who must administer whatever system is adopted? That omission may arise in part from the familiar anomaly of legal education in most countries: law professors study everything about the law except the institutions and persons who operate it.

The choices made in reforming an insolvency law must be closely linked to the capacities (and institutional prejudices) of existing institutions or institutional reform must accompany legal reform. For example, the kind of court supervision that is plausible in a society with a highly developed and politically insulated judicial system is very different from that found in many developing countries. Even among developed countries, the nature of decisions demanded of judges must depend on their background and training: a former commercial lawyer on the bench is a very different decision-maker from the professional judge typical in civil law countries. This topic is little discussed in the literature, but is every bit as important to successful reform as economic analysis or legal concept.

45 Balz, above note 2, at note 34. As Balz explains, in Germany the workers' privilege is paid from a special fund outside of insolvency and is not a priority in insolvency. Some observers would likely argue that this approach amounts to a subsidisation of creditors.

46 Ibid at 173.

47 The best discussion I have seen of the pros and cons of the Model Law is found in New Zealand Law Commission *Report No 52: Cross-Border Insolvency: Should New Zealand Adopt the UNCITRAL Model Law on Cross-Border Insolvency?*

Research

Academic analysis on a purely theoretical, non-empirical basis has been mentioned earlier.[48] There is just emerging some empirical work as well.

In the United States, a path-breaking study was completed by Professors LoPucki and Whitford in the late eighties.[49] Although it is narrow in coverage, because it looks only at publicly held companies, it has provided the only large-scale factual analysis of business insolvency in the United States since the sixties.[50]

I am currently engaged, with others, in a larger study of a cross-section of all business insolvencies, based upon both court files and telephone interviews with insolvent businesses.[51] This is a five-year longitudinal study of many aspects of the business insolvency process in both liquidation and reorganisation, with 1999 being the fifth year. Some of our students have already published articles on specific points.[52] We will publish our first round of results later this year.[53]

Conclusion

An insolvency law is always a matter of striking the correct balance between debtors and creditors. One aspect of that balance is rejection of easy stereotypes. Debtors are not always fraudulent or incompetent and creditors are not always grasping and selfish. Companies fail because of incompetence, but they fail also because of huge economic difficulties that overwhelm both good and bad management. The economic history of most insolvent businesses provides some of each story. Policy makers who assume that all or most insolvencies can be easily cast into one mould or the other are naïve – and doomed to fail.[54]

It is generally recognised that the risk of economic distress and even turmoil has increased in recent years, along with the prospect of dramatically increased wealth, in a globalised economy. The current wave of insolvency law reform represents the emergence of an understanding of the increased need for fast, flexible responses to economic change, often in the context of financial difficulty. Insolvency law is becoming a matter of adaptation as much as survival or internment. Because interest in this topic is now global, there is much we can learn from each other.

48 Above note 14.
49 See LoPucki & Whitford, above note 34.
50 Stanley & Girth, *Bankruptcy: Problem, Process, Reform* (1971).
51 See generally, Warren & Westbrook, "Searching for Reorganization Realities" (1994) 72 Wash ULQ 1257; Sullivan, "Methodological Realities: Social Science Methods and Business Reorganizations" (1994) 72 Wash ULQ 1291.
52 See, eg, Frasier, "Caught in a Cycle of Neglect: The Accuracy of Bankruptcy Statistics" (1996) 101 Comm L J 307.
53 Warren & Westbrook, "Financial Characteristics of Businesses in Bankruptcy" (1999) Am Bankr LJ (forthcoming).
54 See, eg, de Balzac, *Cesar Birotteau* (1994).