CORPORATE INSOLVENCY LAW REFORM

An Autopsy on the Past and an Anatomy of the Future

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INTRODUCTION

This paper comments on comparative aspects of judicial corporate rehabilitation compared to private consensual work-outs in the international arena, as a comment on the outstanding papers of the main speakers. The paper ranks jurisdictions according to whether they are support the private work-out or seek to replace it by a judicially-supervised formal rehabilitation proceeding. This paper is not concerned with final liquidations but only with non-terminal cases.

THE INTERNATIONAL DRIVE TOWARDS JUDICIAL CORPORATE REHABILITATION

Japan	-	Corporate Rehabilitation Law (1952)
US	-	Chapter 11 (1978)
Italy	-	*amministrazione straordinaria* for large companies (1979)
Austria	-	preliminary procedure - a five week observation period (1982)
France	-	*redressement judiciaire* (1985)
Britain	-	administration coupled with company voluntary arrangement/judicial scheme of arrangement (1986)
New Zealand	-	statutory management for special cases (1989)
Eire	-	examinership (1990)
Canada	-	commercial reorganisation (1992)
Australia	-	voluntary administration and deed of company arrangement (1992-93)
Finland	-	reorganisation (1993)
Russia	-	rehabilitation (1992-93)
Germany	-	new legislation is under consideration (1993)

One of the earliest examples - pre-dating the US reorganisations of the 1930s - was the Spanish suspension of payments, apparently initiated to protect a Barcelona company manufacturing garments for the Spanish militia in North Africa (?). Compare the crystallising impetus of DFC in New Zealand and (perhaps) Goodman in Ireland.

Rehabilitation statutes fall broadly into three main classes:

(1) **Traditional compositions**, available in most jurisdictions. These have been rarely used, mainly because of the high opening requirements, eg that the debtor makes an immediate minimum payment (varying typically form 25% to 40%) in excess of what most debtors can realistically pay (Austria, Brazil, Germany, the Italian *concordato preventivo*, Norway, Sweden); or that the debtor's assets ultimately exceed his liabilities on a balance sheet basis, although he does not have the liquidity to pay his debts as they fall due (Swiss banks - a cautious 1930's innovation); or because the debtor must prove misfortune rather than negligence (Belgium, Luxembourg).

(2) **Mild rehabilitation proceedings** which impose a protective freeze on creditor actions (including, sometimes temporary freezes on repossessions and enforcement) so as to give the debtor a breathing-space, but do not fundamentally distort creditor rights by overriding security, set-off, contract cancellations and the like. Examples are the Australian voluntary administration coupled with a deed of company arrangement, the British administration combined with a company voluntary arrangement, the Japanese corporate reorganisation (based on pre-1978 US bankruptcy law), and the Irish examinership.

(3) **Tough rehabilitation proceedings** which significantly erode the rights of creditors so as to augment and preserve the debtor's estate, eg the United States Chapter 11, the French *redressement*, the Canadian reorganisation and the New Zealand statutory management. France appears to be the most extreme amongst the developed countries. The writer has been informed that the French redressement has not been an unqualified success and that 90% of reorganisations have ended in liquidation, but much more research is needed.

One can disregard the traditional composition proceedings which have been shown to be of very limited value, so that the essentially one should compare the work-out with the modern judicial rehabilitations available in, say, Australia, Britain, Canada, Ireland, France, Italy, Japan, New Zealand and the United States.

KEY INDICATORS

The pro-creditor/pro-debtor labels are convenient, short-hand expressions to describe jurisdictions, which, on the one hand, assist creditors to get out of the mess (eg the floating charge, insolvency set-off, contract cancellation, tolerant preference doctrines) and, on the other hand, those which seek to enlarge the debtor's estate. But the position is more complex. For example, pro-debtor rules are sometimes directed to protecting a particular class of creditor, eg employees, as opposed to unsecured creditors generally.

Unfortunately it is not possible to prove which is economically the most efficient because of the absence of and subjectivity of the data. Still, experience will accumulate. Apart from economics, a society's notions of equity and fairness play a fundamental role.

Key indicators of the impact of the proceedings are:

- ease of entry (potential insolvency, court involvement and delay, application by debtor)
- eligible debtors (note special protective provisions for banks and insurance companies in many jurisdictions, eg FDIC, UK insurance regime)
- length of any observation period (short in Austria and Australia)
- freeze on executions and liquidation petitions (universal)
- impact on security (almost overridden in France). Degree of protection of special cases - perishable assets, aircraft/ship liens, market margin collateral, receivables, general prejudice. US carve-out for US ships and aircraft subject to purchase money security interests. Consider interest roll-up, priming of security by administration charges
- protection of universal business charge (Britain, Australia: the floating charge rules OK)
- impact on insolvency set-off (no impact in England - usually; Canadian stay)
- impact on repossession of vendor/lessor 'security', eg leasing, HP, factoring, retention of title, repos, sale and lease-back

- impact on chain leases (eg **Atlantic Computers**)
- impact on loan and bond accelerations (frozen in France)
- impact on contractual rescission clauses (none in England, contrast US, France, Canada). Note substantial US carve-outs, eg shop leases, licences of intellectual proprietary rights, broker markets, and financial contracts. Note also carve-outs for financial netting in Canada, US.
- disclaimer/abandonment powers for contracts, leases, onerous property. Note environmental issues.
- avoidance powers for preferences and undervalue transactions
- director incentives to apply for formal proceedings (compulsory petitions, penalties, debtor in possession)
- directors liability
- administrator immunity/liability
- priority of preferential claims (taxes, employees)
- whether distributive (no, England)
- currency conversions into local currency
- ease of debt/equity conversion
- ability to replace the management
- initiation and control of plan (management, creditors, court)
- flexible or tightly regulated plan (class voting, cram-downs, protection of prejudiced creditors, disclosure requirements)
- special interest privileges (labour unions, markets)
- stopping of interest (critical for frozen security)
- voting majorities and power to bind dissenting minorities
- power to bind non-notified creditors (defect of the English CVA)
- involvement of the court (significant in France; but not in Britain and not, apparently, in Australia)
- involvement of creditors committees
- ease of amendment
- jurisdictional reach (local branches, local assets, fugitive companies, fugitive directors). French, Japanese and US procedures cover local assets, but Japan has restricted territoriality. Limited English extension of administration to foreign companies
- tax
- potential for abuse as 'quick 'n easy' liquidation.