9. Conclusion

This concluding chapter looks at the similarities and differences between the corporate reorganisation codes in the UK and US. It first of all considers the similarities highlighting the automatic stay and the provisions for overcoming hold-outs. It then addresses the differences focusing in particular on ease of access to the respective procedures and control of the company during the reorganisation process. The differences are usually summed up in the expression that the UK law is pro-creditor and the US law pro-debtor. An attempt is made to unpack the expression and the conclusion is reached that while the statement is somewhat of an over-simplification it is probably true to say that the US law is more pro-manager or pro-shareholder than the UK. Secured creditors however, may be no less well protected in the US than in the UK though the form of protection is different. In the US it takes the form of loan covenants whereas in the UK protection is enshrined in statute. The chapter then summarises the impact of the reforms introduced by the Enterprise Act 2002 which had the explicit objective of pushing UK law in an American direction. It suggests that the reforms are less thorough than they might appear on the surface. Administrative receivership has been scrapped in the majority of cases but the new-style administrator has taken on some of the habits and colouring of the receiver. The Act may have introduced greater accountability and transparency but the emphasis in practice continues to be on preserving value through asset disposals and business rescue rather than on corporate rescue as such. Finally, the chapter makes the point that Chapter 11 has assumed much more of a market mantle in recent years and this appears to have muted calls for its complete overhaul. At the same time however, there is still much more of an emphasis in the US on keeping alive the existing corporate entity as a business vehicle. Chapter 11 contains features such as a specific mechanism for super-priority new financing that might usefully be replicated if corporate rescue as such is going to play the same role in the UK.

THE UK AND US – SIMILARITIES AND DIFFERENCES

In the Insolvency Codes of both the UK and the US there are possibilities for both the reorganisation/restructuring of ailing companies as well as for the
liquidation of such companies.\textsuperscript{1} In the UK Insolvency Act there is provision for compulsory winding up by order of the court or for members’ or creditors’ voluntary liquidation. The Insolvency Act also contains an administration regime that is expressly designed for rescuing the business of the company as a going concern as well as for company voluntary arrangements which allow the company to modify the rights of creditors and shareholders if a prescribed percentage of the requisite group agrees. The US Bankruptcy Code contains Chapter 7, dealing with the liquidation of companies and also Chapter 11, where the statutory goal is the preparation and confirmation of a reorganisation plan.\textsuperscript{2}

Both the UK and US are committed to the concept that the going-concern value of company assets is, or may be, greater than the value if these assets are liquidated on a piecemeal basis.\textsuperscript{3} The two countries are also at one in the view that this going-concern premium may be captured and realised in different ways. A fundamental feature of the legislation in the two countries is the moratorium (as it is called in the UK) or automatic stay (as it is referred to in the US) on creditor enforcement actions during the currency of the administration or Chapter 11 period.\textsuperscript{4} The details of the moratorium or stay may differ as between the two countries; whether, for example, criminal proceedings against the company are covered. Nevertheless, the basic features are the same in that creditors are precluded from taking enforcement action either against the company or against company assets during the currency of the rehabilitation


\textsuperscript{2} Bank of America v 203 North LaSalle Street Partnership (1999) 526 US 434.

\textsuperscript{3} For a somewhat sceptical perspective on the existence of a going-concern surplus see Douglas G Baird and Robert K Rasmussen ‘The End of Bankruptcy’ (2002) 55 Stan L Rev 751 at 758: ‘We have a going-concern surplus (the thing the law of corporate reorganizations exists to preserve) only to the extent that there are assets that are worth more if located within an existing firm. If all the assets can be used as well elsewhere, the firm has no value as a going concern.’

\textsuperscript{4} Section 362 of the US Bankruptcy Code and para 43 Schedule B1 Insolvency Act 1986.
period. The temporary prohibition may be relaxed however, with the consent of the court and, in the UK, the administrator may also give consent for enforcement action to be taken. The purpose of the stay/moratorium is to give the company a breathing space to allow survival prospects to be assessed.

The UK and US also have special provisions to overcome hold-outs by creditors. In other words, a prescribed number and/or percentage of creditors can bind dissentients to accepting a modification of their rights. If the specified numbers of creditors agree to a degree of debt forgiveness and/or conversion of debt into equity, then this agreement becomes binding on other creditors who did not individually sign up to the plan.5

Notwithstanding these obvious similarities, there are also clear differences in the legal framework governing corporate restructuring in the two countries and this, in turn, impacts on the practice. The clearest difference lies in who is in control of the company during the restructuring period. Chapter 11 is based on debtor-in-possession, which means that the existing corporate governance structure remains in place notwithstanding the formal commencement of the restructuring process.6 Management displacement in favour of an outside administrator (or trustee as it is called in the US) is a possibility, but the statute confines the opportunities for this to occur to exceptional cases such as fraud.7 The half-way house appointment of an examiner is also possible but this is equally rare. The contrast with the UK is quite stark. Mandatory displacement of management in favour of an external administrator is an intrinsic feature of administration. The Insolvency Act 2000 introduced, in effect, a debtor-in-possession type procedure for smaller companies; namely, the company voluntary arrangement with a moratorium. Management control is subject, however, to oversight by an insolvency practitioner in the shape of the nominee who performs a continuing monitoring function. The nominee is supposed to pull the plug on the process if s/he considers that the company has insufficient funds to continue trading during the restructuring or where there is no reasonable prospect of the arrangement with creditors being approved. In any event, these provisions of the Insolvency Act 2000 have hardly been used in practice. CVAs with a moratorium remain a rarity.8

5 See s 1129 of the Bankruptcy Code on the conditions for getting a reorganisation plan approved.
7 S 1104 of the US Bankruptcy Code.
8 See the statistical information available on the Insolvency Service website – www.insolvency.gov.uk/.
Chapter 5 tries to explain why there is such a superficially stark difference between the UK and US when it comes to control of the company during administration/Chapter 11. Various reasons were adduced and put through their paces. These reasons included different attitudes towards entrepreneurship and risk-taking; differences in the nature of the task to be performed by the administrator and debtor-in-possession; path dependency or the continued gravitational pull of historical circumstances and finally, the issue of concentration in debt markets and the extent to which it is possible for a single concentrated creditor to exert control over the process. This chapter concluded by suggesting that there is no single knock-out factor that explains the divergence but that the individual reasons, when viewed collectively, have a greater explanatory power that they lack when considered singly.

The chapter also made the point that the differences between the two countries can be exaggerated in that informal restructurings, based more or less on the continuation of existing governance structures, are more the norm for larger companies in the UK. In the US, there is easy access to Chapter 11, with a company having more or less an unfettered right to invoke the procedure if it has a genuine reorganisational objective in mind. This may mean that, comparatively, completely informal restructurings are less common than in the UK, though it is often the case that some negotiations take place before and outside Chapter 11 (substantial negotiations in some cases) and then recourse is had to Chapter 11, possibly to overcome hold-outs by dissentient creditors. Another important point to note is that there appears to be increasingly greater creditor control over the Chapter 11 process; in particular through provisions in debtor-in-possession financing agreements (DIP financing). Creditors may condition their support for the company during the

---


restructuring period on management changes being implemented. A Chief Restructuring Officer may be brought in at the instigation of creditors to oversee the reorganisation process. Empirical evidence suggests that in the majority of cases the identities of top management personnel will change at least once as a company goes through Chapter 11.12 DIP financing may be a particularly lucrative line of business for lenders with more favourable (i.e. higher) interest rates on loans as well as an array of transactions fees that are often obscured from the casual observer.13 Lenders may also use the opportunity that DIP financing provides to bootstrap earlier loans and gain an advantage over other creditors. So the overall message is that debtor-in-possession in Chapter 11 may be different from management displacement in UK administration, but solely to focus on this fact gives a misleading impression. The overall picture is much more subtle and nuanced.

The same message emerges in many other places in the book. The two procedures are quite different but the differences are quite different (if that makes sense) from what might originally appear.14 Take, for instance, the oft-stated generalisation that UK law in this area is pro-creditor whereas US law is pro-debtor.

PRO-DEBTOR VERSUS PRO-CREDITOR – A MEANINGFUL COMPARISON?

US law is often said to be pro-debtor15 because it allows for easy access to Chapter 11; it is based on debtor-in-possession; it contains the automatic stay;
existing security interests can be ‘primed’ or trumped by a DIP financier and finally creditors, including secured creditors, can be ‘crammed down’, i.e. forced to accept a reorganisation plan against their wishes. Moreover, the company can assume or reject so-called ‘executory’ contracts which means that ipso facto clauses whereby another contracting party purports to terminate a contract on the company’s entry into Chapter 11 are generally of no effect.\textsuperscript{16}

All this is true but two comments are appropriate. Firstly, in certain respects, like the automatic stay, Chapter 11 is not fundamentally different from UK administration. Secondly, what does it mean to say that Chapter 11 is ‘pro-debtor’? The debtor in this case is a company – an artificial entity that is purely the creature of the law. In the broadest sense, it has no life of its own. One has to disentangle the community of interests that make up the company. For a start, one might take five separate or independent interest groups – shareholders, creditors, directors or management, employees and finally, and more amorphously, the environment. Shareholders obviously benefit if insolvent entities are given the opportunity to restructure and continue their business operations. In insolvency, shareholders are out of the money. Their investment in the company is financially worthless if the company is liquidated. Their interest is only worth something to the extent that they can obstruct and delay efforts by others who have something still of value to lose. If the company is allowed to remain alive, then shareholders may benefit financially in that they have the opportunity of coming back into the money. To the extent that the law allows insolvent ailing companies to remain alive, despite creditor objections, one might say that the law is ‘pro-shareholder’.

Creditors are part of the community of interests that sustain the company. It is often been stated judicially, on both sides of the Atlantic, that the primary focus of directors, in carrying out their duties on behalf of the company, should switch from maximising long-term shareholder value to maximising creditor value or, at least, move in this direction.\textsuperscript{17} But in common characterisations of corporate reorganisation law, ‘pro-creditor’ is often, indeed normally, juxtaposed with ‘pro-debtor’. The contrast does not really make sense if creditor concerns are regarded as part of what makes up the debtor.

It probably makes sense to say that a corporate restructuring law is ‘pro-manager’ or ‘pro-director’ if it allows the existing board of directors, and the management and governance structure as a whole, to remain as it were

\textsuperscript{16} See s 365 of the Bankruptcy Code.

notwithstanding the fact that the company is in a restructuring process. Managers do not lose their positions automatically. Their reputation may have taken a hit to a greater or lesser extent, depending on the causes of the company’s financial difficulties, but they have a chance to turn things around. Managers have a greater chance of seeing their entrepreneurial, or risk-taking, strategies paying off despite the fact that the company may have experienced some temporary dislocations or financial difficulties.\(^{18}\) More generally, one might say that Insolvency or Bankruptcy Law is ‘pro-manager’ or at least ‘pro-entrepreneurship’ if it allows a company to ride out some short-term economic squalls instead of being pressured into liquidation by a few anxious creditors.

UK Company Law says that the interests of a company include the interests of its employees as well as the interests of its shareholders, though there is no general statutory statement to equivalent effect in the US. One might say that the law is ‘pro-employee’ if employees’ interests are factored into the restructuring decision, for example, if they are consulted on major decisions affecting the company’s future and the company cannot renege on existing commitments to employees in cost-cutting measures, at least without going through some major consultation procedure. Another issue to consider is whether terms and conditions and employment are protected in the course of any business transfers that might occur as part and parcel of corporate restructuring. In all this, US law does not score very highly.\(^{19}\) Collective bargaining agreements freely negotiated with unions can be abrogated, or modified, during Chapter 11, though there is a prescribed consultation process that has to be gone through.\(^{20}\) There is no protection in Chapter 11 of existing terms and conditions of employment during business transfers. In the enumerated respects, UK law is much more friendly towards employees. A supporter of the US position might contend that UK law makes it much more difficult to achieve business rescue.\(^{21}\) This is a version of the ‘rising tide raises all boats’ philosophy. Business works best, and brings about greater increases in employment and prosperity when management are not fettered by labour law constraints. Chapter 7 endeavoured to consider these competing ideologies in more detail. Suffice it to say here that if ‘pro-debtor’ is regarded as a synonym for ‘pro-employee’ then US law is not ‘pro-debtor’.


\(^{19}\) See D Skeel, Jr ‘Employees, Pensions, and Governance in Chapter 11’ (2004) 82 Wash U LQ 1469 at 1472.

\(^{20}\) S 1113 of the US Bankruptcy Code. See also s 1114 on retiree benefits.

As regards the environment, Chapter 11 is supposed, broadly speaking, to be neutral. It does not really differ in this respect from UK administration. A company in Chapter 11 is supposed to comply with the provisions of the general law. It cannot violate environmental regulations in the same way that it cannot sell cocaine.22 The automatic stay does not bar criminal proceedings from being brought against the company nor does it bar regulatory action from being taken by environmental protection agencies. The position is slightly different in the UK where the moratorium is sufficiently broad to encompass the institution of criminal proceedings against the company and probably also administrative actions of the enforcement variety.23 Nevertheless, it appears that the courts, almost invariably, will allow both criminal proceedings and regulatory proceedings to go ahead. Therefore, there does not appear to be a great deal of difference between Chapter 11 and UK administration when it comes to environmental protection.

From this summary, one might fairly conclude that Chapter 11, to a certain extent at least, is ‘pro-manager’ and also ‘pro-shareholder’, though even here one has to impose substantial qualifications. For example, Chapter 11 reorganisation plans must conform to the absolute priority rule, i.e. a senior class of claimants must be paid in full before a class of junior claimants receives anything. All creditors are superior in the hierarchical pecking order to shareholders, which means that shareholders should not receive any stake in the reorganised company unless creditor claims are met in full. Consensual plans, i.e. plans where all classes sign up to the agreement, normally will leave something on the table for equity. In other words, shareholders, whatever the theoretical position, are given some stake in the restructured business.24 If a class, or classes, of creditors object to this, then their objections can be overcome (crammed down) if the dissenting class will receive at least as much under the plan as it would do in a liquidation and provided that the shareholders are putting something on the table in return for their stake. This is the ‘new value’ exception to the absolute priority rule which US courts have tentatively recognised.25

---

22 See s 959 of the Bankruptcy Code.
One might say that UK administration is less ‘pro-manager’ than Chapter 11 in that it involves automatic management displacement but, so far as being less ‘pro-shareholder’ is concerned, the picture is not as clear-cut. Administration can be a gateway towards reorganisation rather than liquidation and, in that respect, offers shareholders the opportunity of earning a return on their investment. Administration, or rather CVAs, in formal terms do not have anything like the new-value exception to the priority principle which states that creditors must be repaid before shareholders. Nevertheless, it appears to be normal practice for existing shareholders to keep a stake in a restructured company and, depending on the size of the stake, the existing shareholders may put up some new capital. As explained in Chapter 8, CVAs are much less circumscribed by legalistic requirements than Chapter 11 plans of reorganisation. There is a great deal of flexibility about what may, or may not, be in a CVA, apart from the deference shown to secured creditors whose ability to enforce collateral cannot be adversely affected without their consent.

THE POSITION OF SECURED CREDITORS IN RESTRUCTURING

On the surface, there is much greater respect shown in administration for the rights of secured creditors than in administration. The absence of ‘cramdown’ in administration and CVAs has already been noted. This means that the wishes of secured creditors must be accommodated in whatever ‘rescue’ plan is envisaged as resulting from administration, or else they must be left out of the equation entirely, with them being paid off or left to enforce their collateral. Generally, the secured creditor has no veto on a company going into administration but has an effective veto on the identity of the person appointed as administrator. 26 When the Enterprise Act revamped the administration procedure in 2002 there was a widespread assumption that the most common route into administration would entail out-of-court appointment by the general secured creditor, i.e. the creditor with a floating charge or other security that covered the whole, or substantially the whole, of a company’s assets. The reality has been somewhat different, with most appointments in fact being made by the company itself though the company, before making the appointment, has to give prior notice to the floating charge holder who can step in and make its own appointment. 27 The legislation is structured in such a way that the

---

26 See generally paras 14, 22 and 26 Schedule B1 Insolvency Act 1986.
27 See the ‘Report on Insolvency Outcomes’ – a paper presented to the Insolvency Service by Dr Sandra Frisby. The paper is available on the Insolvency
company is likely to negotiate with the lender about who might be a suitable candidate to take on the reins of administration. If the person proposed is not acceptable to the lender, then the lender ultimately can make its own appointment. For public relations and reputational reasons, however, it seems better if the lender is not seen to drive the administration process. Therefore, nominally, the appointment is made by the company but of a person who is acceptable to the lender.

Formally there are differences with the position in the US where the Chapter 11 petition, in the vast majority of instances, is initiated by the company itself. The debtor-in-possession notion constitutes another difference, but the influence that lenders can exert through DIP financing agreements signifies a degree of creditor control over the company during the Chapter 11 period.

The fact existing security interests can be trumped by the DIP lender might be said to be another pointer towards the fact that Chapter 11 is less creditor friendly, or at least secured-creditor friendly, than UK administration. But again, the statement requires qualification. Before existing security interests can be relegated under Chapter 11 in favour of the newcomer, the court must find that the existing security interest holder is adequately protected. Effectively, this means that the court must be satisfied that there is sufficient value in the collateral to support both the new and the existing lenders. This is exceptional. Far more common is where the new lending is done with the consent of the existing lender. Indeed the new lender may be an existing lender. The equivalent of DIP financing does not appear to have developed in the UK, or at least not on anything like the same scale. Arguably however, the legislative framework governing administration is sufficiently flexible, if Canadian experience is anything to go by, to permit its use on a modest scale. The administrator’s remuneration and expenses, as well as liabilities on contracts made on behalf of the company by the administrator, are payable out of assets secured by a floating charge, in priority to the floating charge holder.

Service website – www.insolvency.gov.uk and for a summary of the paper see S Frisby ‘Not Quite Warp Factor 2 Yet?’ at 327.
They are not payable though, in the same way out of assets subject to fixed-
charge security. The concept of an administrator’s liability on contracts may
be broad enough to catch repayment obligations under financing agreements
entered into on behalf of the company.32 In the debates on the Enterprise Act,
however, the government resisted the opportunity of including provisions that
would mirror more closely the DIP financing regime of Chapter 11.33 DIP
financing was seen as equalling super-priority and the trumping of existing
security. It did not want a situation that would effectively guarantee a return to
a new lender, irrespective of the economic merits of a financing proposal. But
there is more to DIP financing than super-priority. It might be argued that the
merits of a specific legislative regime, dedicated to the financing of companies
in financial difficulties, is that it may open up the credit market more and
encourage other players to come on board. It stimulates more of an emphasis
on corporate rescue as distinct from creditor wealth maximisation through
asset sales and business disposals.

THE ENTERPRISE ACT AND REMODELLED
ADMINISTRATIONS

When the Enterprise Act was enacted, the emphasis, very squarely and
consciously, was on promoting transparency, accountability and collectivity –
but to what end?34 Business rescue and corporate rescue were talked about.35
Rescuing the business of the company as a going concern is what the legisla-
tion refers to, rather than the preservation of empty corporate shells. That is
the easy part, but there seems also to be a sense pervading the parliamentary
debates that too much emphasis had been placed in the past on asset sales
through the receivership route36 – on business rescue through disposals of
profitable parts of an undertaking, as it were. The government seemed deter-
mined to push an unwilling insolvency practitioner lobby down the avenue of
‘corporate’ rescue, at least as an alternative to asset sales. The objective was to

33 See House of Lords parliamentary debates for 29 July 2002 and the discus-
34 See generally D Milman ‘Reforming Corporate Rescue Mechanisms’ in J De
Lacy ed The Reform of United Kingdom Company Law (London, Cavendish, 2002) at
p 415.
35 See DTI/HM Treasury report ‘A Review of Company Rescue and Business
Reconstruction Mechanisms’ (London, DTI, 2000) and the White Paper Insolvency – a
36 But for a defence of receivership see J Armour and S Frisby ‘Rethinking
Receivership’ (2001) 21 OJLS 73.
borrow what were perceived to be some of the best features of Chapter 11, such as the company staying alive as an economic activity but, at the same time, junking its undesirable features such as its delay and the sheer legalistic and lawyer-dominated nature of the process. Whatever the tone of the parliamentary debates, the law on the statute books plays to a somewhat different melody. There is a statutory statement of the objectives of administration, and while rescuing the business of the company as a going concern comes at the top of the statutory list, this objective cannot be pursued if some other result is likely to achieve a better result for company creditors. The person who decides what is likely to produce the best result for company creditors is the administrator. Remember that the administrator, if not appointed by the main secured creditor, is going to be a person acceptable to that creditor and in tune with the creditor’s way of thinking. The scope for judicial review of the administrator’s judgement is very limited in that the statute uses the criterion of what the administrator ‘thinks’ and not some more objectively reviewable criterion.

After the passage of the Enterprise Act, there are some who predicted a sea change in attitude and practice; that administrators would put a lot of emphasis on corporate rescue and that they would go about their task in a completely different way than administrative receivers of yore. Others might argue that this prospect was always an unrealistic one given, in particular, the wording of the legislation and the mindset of insolvency practitioners. It appears that the latter forecast has come to pass. There is increased accountability and greater transparency and collectivity in the new administration regime, but insolvency practitioners who act as administrators do not seem to approach their task in a fundamentally different way from insolvency practitioners acting as administrative receivers. It seems that there are greater gross creditor realisations in administrations, compared with administrative receiverships, but this is balanced out by the increased cost of the procedure, which means that the net overall effect, in terms of returns to creditors, is roughly the same. Of course,

37 Schedule B1 Insolvency Act 1986 para 3.
40 See ‘The Impact of the Enterprise Act 2002 on Realisations and Costs in Corporate Rescue Proceedings’ a report to the Insolvency Service by John Armour,
supporters of the Enterprise Act might say that increased transparency, accountability and collectivity have also to be brought into the reckoning and these are not easily measurable as part of an economic calculus.

Another empirical finding is that ‘corporate rescue’ as such is achieved in only a very small minority of cases. In the vast majority of cases, value is obtained through business transfers and asset sales, rather than the existing corporate vehicle being turned around and continuing to function on that basis. Again, this finding does not come as a shock to many observers who view informal restructuring rather than statutory administration as being more appropriate for larger companies because administration may lead to an immediate loss of reputation and custom. On the other hand, the coming of the Pension Protection Fund for companies in formal insolvency proceedings with pension deficits may have the effect of pushing such companies into administration instead of attempting to restructure informally as heretofore.

The empirical evidence may disappoint the architects of the Enterprise Act in some of their more ambitious aspirations. It is hardly surprising, however, given the wording of the legislation. The changes of substance are not negligible but, at the same time, they can be spun into something that they are not. To some, this assessment will be a disappointment in that the promise of radical transformation has not been fulfilled. But to others, it may be unsurprising, and indeed reassuring, that beneath the ‘New Labour’ style rhetoric of the Enterprise Act lurks time-honoured Conservative concepts. Old-style administrative receivership has re-emerged in a new legislative guise wearing more modern, and up-to-date, clothes.

Another empirical finding is evidence of liquidation substitution, in that administration is used in the case of some companies that formerly would have

Aubrey Hsu and Adrian Walters (March 2007) summarised in ‘Recovery’ (Autumn 2007) at p 39. But for a somewhat different conclusion see the interim report by Sandra Frisby to the Insolvency Service ‘Returns to Creditors from Pre- and Post- Enterprise Act Insolvency Procedures’ (July 2007). Dr Frisby says at p 34: ‘it would appear that the policy makers were correct in their estimation that administration, as a procedure, is likely to produce better outcomes, in terms of returns, for all creditors.’

41 See the ‘Report on Insolvency Outcomes’ – a paper presented to the Insolvency Service by Dr Sandra Frisby. The paper is available on the Insolvency Service website – www.insolvency.gov.uk and for a summary of the paper see S Frisby ‘Not Quite Warp Factor 2 Yet?’ at 327.

42 See A Tilley ‘European Restructuring: Clarifying Trans-Atlantic Misconceptions’ [2005] Journal of Private Equity 99 at 102: ‘New pensions legislation could be seen to be encouraging a move into UK administration to deflect under funding liabilities to a proposed government-legislated but industry-funded contingency fund. Legacy issues are not just a preserve of US airlines, it seems.’
gone into creditors’ voluntary liquidation. Administration is used in such a case because of a possible saving in time and expense and because the assets of the company may be more advantageously realised than in a liquidation. This appears to be within the spirit of the legislation but what is less justifiable is where directors opt for administration rather than liquidation on the supposition that their conduct would be less subject to scrutiny by an administrator rather than a liquidator.

WB Yeats in his poem ‘Easter 1916’ about the 1916 Easter Rising in Ireland, wrote that ‘All changed, changed utterly: a terrible beauty is born’. The same thing cannot be said about the Enterprise Act in the UK and changes to corporate restructuring procedures. The changes have largely been on the surface, and the fundamentals in the world of practice do not appear to have changed all that much, though there have been incremental adjustments. The adjustments to the UK administration regime, one might say, have been in the direction of the US Chapter 11 but the world of Chapter 11 practice has turned, perhaps more significantly, in a more market-oriented UK administration-style direction.

MORE OF A MARKET FOCUS TO CHAPTER 11

When Chapter 11 was first promulgated in 1978, there was much talk about corporate rehabilitation, the preservation of jobs and the interests of parties other than the company and secured creditors. Community interests were given broad consideration. The focus has now changed. Creditor interests

---


44 It should be noted that empirical evidence from the US suggests that Chapter 7 liquidations offer little advantages over Chapter 11 reorganisations. They take almost as long to resolve, require similar fees and ‘in the end provide creditors with lower recovery rates – often zero – than a comparable Chapter 11 procedure’ – see Arturo Bris et al ‘The Costs of Bankruptcy: Chapter 7 Liquidations vs Chapter 11 Reorganizations’ (2006) 61 Journal of Finance 1253 at 1301.


have come to the fore more.\textsuperscript{47} This is partly through provisions in DIP financing agreements. Creditors may also devise key employee-retention programmes (KERPS), promising those employees whose retention by the company is considered crucial, bonuses and other inducements if the reorganisation is completed quickly.\textsuperscript{48} This leads to a momentum in favour of asset sales and quicker cases. Under s 1123, it is permissible for the company in Chapter 11 to prepare a liquidating plan as a reorganising plan. This is one vehicle for an asset sale. But another vehicle is s 363 which permits disposals outside the ordinary course of business with court approval. The courts have sanctioned the disposal of substantial parts of the company’s undertaking using this provision.\textsuperscript{49} Moreover, the dichotomy between liquidation and reorganisation no longer appears so obvious.\textsuperscript{50} There may have been partly liquidation or realisation of assets and partly reorganisation. What emerges at the end of the process is a smaller, slimmed-down, company with only part of its original undertaking intact.\textsuperscript{51}

In the 1980s, and early 1990s, there were many calls for the reform of Chapter 11, or its complete replacement.\textsuperscript{52} One set of proposals involved the...
introduction of a mandatory auction procedure for company assets that would come into effect, perhaps, if the company remained in Chapter 11 for a certain period of time.\textsuperscript{53} Another set of proposals involved a compulsory debt/equity swap whereby the company’s equity would evaporate on the occurrence of certain events. Senior creditors would become the new owners of the company but junior creditors, in order of hierarchy, would be given an option to buy out the senior creditors. If junior creditors did not want to exercise the option then shareholders could then do so and effectively buy back the company. A final set of proposals suggested the introduction of a special regime for small business bankruptcies that would mean simplified procedures and speedier throughput of cases. For instance, empirical research by Professors Elisabeth Warren and Jay Lawrence Westbrook has suggested that on the standard criteria, small business cases made up more than 80 per cent of Chapter 11 filings.\textsuperscript{54} though such cases are not nearly so significant in terms of financial importance.\textsuperscript{55} In many of these cases, an expeditious liquidation from the outset might have been the best way forward.

Apart from a new procedure for small business bankruptcies, none of the proposed reforms has come to legislative fruition though the market has moved in the direction of the reformers.\textsuperscript{56} This is particularly evident when it comes to so-called ‘auctions’. Creditor influence and, in particular, creditor control over the continuing financing tap has meant that cases are likely to be

\begin{footnotesize}
\begin{enumerate}
\item It seems that the total assets or liabilities of companies in this group are no more than 5 per cent of those of all the companies in Chapter 11. See also Douglas G Baird and Edward R Morrison ‘Serial Entrepreneurs and Small Business Bankruptcies’ (2005) 105 Columbia Law Review 2310 and especially at 2317 ‘Perhaps only ten to fifteen percent of all failing businesses ever file a bankruptcy petition. An even smaller fraction use Chapter 11. For the typical corporations that enter Chapter 11, the benefits and costs are both modest.’ For information on the number of Chapter 11 filings (generally running at about 10,000 a year) and other bankruptcy filings see www.uscourts.gov.
\end{enumerate}
\end{footnotesize}
turned around faster than before, with more liquidation or realisation of assets rather than a long-drawn-out process of formulating a reorganisation plan and gaining acceptances. ‘Pre-packaged’ bankruptcy cases have also gained a greater prominence. \(^{57}\) Features of the proposed options regime are less evident in the new reality of Chapter 11 practice but one might foresee a world in which investment banks, advising on capital structures, market a form of ‘chameleon equity’ to entrepreneurs and investors. ‘Chameleon equity’ would have some features of debt and some features of equity. The possibilities are almost endless, but basically the debt or bonds would convert into equity in certain circumstances. Legally, the question is whether a conversion mechanism would be recognised in the company’s bankruptcy and, economically, the issue is how to put a proper valuation on these complex financial instruments.

On the small business bankruptcy arena, there has been legislative movement originally on an optional basis in 1994 but with the new procedures becoming compulsory as a result of the Bankruptcy Abuse Prevention and Consumer Protection Act 2005.\(^{58}\) The provisions apply to all small business debtors, subject to certain monetary limits. They aim to speed up procedures by imposing tighter deadlines for the confirmation of a reorganisation plan, failing which the case will be converted into Chapter 7 liquidation. There are continuing obligations on the debtor to provide financial information that will enable the US Trustee to assess the likelihood of plan confirmation. The US Trustee is required to perform an oversight function; to weed out cases early where there is no genuine reorganisational prospect and to move for the dismissal of cases, or their conversion into Chapter 7 liquidation, where reorganisation prospects have dimmed. Finally, to reduce costs, the debtor can make use of standard form disclosure statements and the bankruptcy court can combine hearings on the adequacy of the disclosure statement to affected parties with a hearing on whether to authorise confirmation of the plan. All in all, the objective of the reforms is to reduce costs, simplify procedures and speed up cases. But the US Congress has shied away from introducing a wholly new and separate reorganisation chapter devoted to small businesses.


Until 1978 there were two separate reorganisation chapters in the Bankruptcy Code. There was a feeling that the duplication had led to a gaming of the system and that resources had been misapplied into trying to assign cases to the appropriate chapter.\textsuperscript{59}

Chapter 11 has changed but some of the criticisms that UK observers may have remain.\textsuperscript{60} Cases can take a long time.\textsuperscript{61} Apart from the small business provisions, there are no automatic cut-off points for ending a case or converting it into a liquidation. The procedures seem legalistic and cumbersome, in particular the confirmation of a reorganisation plan. The provisions and procedure also seem rather lawyer driven. All the parties involved in the process, including creditors’ committees, may engage counsel whose fees and expenses may be taken out of the bankruptcy estate. Also the ease of access to Chapter 11 may crowd out informal restructurings which are often the best means of preserving value in an ailing enterprise. That is not to say that UK law may not borrow from Chapter 11 in greater respects. New financing mechanisms, stripped of their undesirable features such as bootstrapping by earlier creditors, may be one such example. Even today, the prominence placed on corporate


\textsuperscript{60} Empirical studies about the direct costs of Chapter 11 proceedings have produced somewhat different results or at least results that are open to varying interpretations. Stephen J Lubben suggests that the direct costs of reorganising large public companies in Chapter 11 consists of 3 per cent of the value of company assets – see ‘The Direct Costs of Corporate Reorganization’ (2000) 74 American Bankruptcy Law Journal 509. See also Stephen P Ferris and Robert M Lawless ‘The Expenses of Financial Distress: The Direct Costs of Chapter 11’ (2000) 61 U Pittsburgh L Rev 629. A more recent study suggests that the median Chapter 11 case takes up around 8 per cent of the pre-bankruptcy value of the company in legal fees – see Arturo Bris et al ‘The Costs of Bankruptcy’ at 1253. They also suggest (at p 1254) that ‘bankruptcy costs are measurement sensitive. For example, the conclusions one draws depend on whether one uses at-bankruptcy declared values or end-of-bankruptcy declared values, whether one believes the value declarations filed by management, and whether one reports means or medians.’

\textsuperscript{61} See LA Bebchuk ‘A New Approach to Corporate Reorganizations’ (1988) 101 Harvard Law Review 775 at 780: ‘Management will use delay to take unjustified risks with the firm’s assets in a feeble hope of returning the firm to solvency and providing equity holders with residual value. . . . Because high-priority creditors of an insolvent firm may have more to lose than low-priority creditors, the low-priority creditors may be able to force concessions from high-priority creditors by threatening to prolong bankruptcy through litigation over their relative entitlements’ and see also Barry E Adler ‘Financial and Political Theories of American Corporate Bankruptcy’ (1992) 45 Stan L Rev 311 at 316. See now on the duration of Chapter 11s Arturo Bris et al at 1253.
rescue in Chapter 11 serves as an important corrective to the mindset of insolvency practitioners in the UK that the going-concern premium is invariably best captured through an asset sale.

AN END NOTE

This book has challenged the traditional thesis that UK law in the sphere of corporate bankruptcy is pro-creditor whereas US law is pro-debtor. It suggests that this characterisation is something of an over-simplification. Creditors have a greater role in the initiation of the formal procedure in the UK than they do in the US, but creditors in the US may have a decisive role in the outcome of the process and the terms of any restructuring through their willingness to grant, or withhold, new financing and the terms on which such financing is granted.

The book also points to the conclusion that there is evidence of convergence between the UK and US systems in practice. The Enterprise Act has made some modest moves down the Chapter 11 path but Chapter 11 practice has itself moved in a more market-led direction. The rescue system in the UK is market-oriented with the process centring on saving businesses rather than corporate shells. The UK ‘rescue culture’ embraces the sale of businesses as operational going-concerns or alternatively, the piecemeal realisation of assets where that improves the position of creditors. The company voluntary arrangement (CVA) is, however, a bargaining procedure and can be used to negotiate a rehabilitation plan between creditors and shareholders but, in practice, most CVAs are concluded in association with an administration. CVAs, in fact, may not involve reorganisation of the company, instead focusing on going-concern sales or disposal of particular assets. Practitioners have also become adept in using administration and CVAs as more efficient liquidation tools rather than rehabilitation regimes.

In Chapter 11, the process is initiated by the company and the emphasis has then traditionally been on classes of creditors and shareholders working together under the supervision of the bankruptcy court to come up with a restructuring plan. The plan comes before the court for its judgment that the required procedural safeguards for minority interests have been satisfied and that the plan itself is feasible. In other words, that the company is likely to be able to perform the promises it made in the plan. It is envisaged that the company will continue as a business entity after court confirmation of the plan. But the focus in Chapter 11 practice has shifted. Often Chapter 11 is now used as a convenient mechanism for the division up and sale of company assets. Companies may also come under pressure to sell off assets to meet funding needs if restructuring proposals agreed with creditors are not carried
through. Lenders may turn the company’s financing tap on or off, depending on the speed at which restructuring is implemented. Senior managers in the company may also be offered financial inducements if they manage to complete the company’s journey through Chapter 11 quickly. There has been increased recourse to pre-packaged cases where the main contours of the proposed disposition of the case have been mapped out in advance of the Chapter 11 filing.

The third general conclusion is that, despite the changes in practice and the increased market flavour to Chapter 11, certain crucial differences remain between Chapter 11 and equivalent UK procedures. Chapter 11 is centred on ensuring the survival of the existing business entity and even now, in an era of greater creditor influence, the corporate rescue outcome is much more likely than in the UK. Contrary to the claim that corporate reorganisations have all but disappeared,62 there is evidence that many large companies do in fact use Chapter 11 as a forum for reorganisation. One empirical study of companies that enter Chapter 11 as a going concern during the 1997–2004 period found that 36.7 per cent reorganise, 42.2 per cent were acquired in whole or in part and 21.1 per cent were liquidated.63 Broadly comparable studies of UK administrations suggest that the ‘corporate rescue’ outcome is achieved in very few cases. Perhaps driving the corporate rescue result, Chapter 11 contains a special funding mechanism for companies in financial difficulties and, more fundamentally, it is also based on the notion of ‘debtor-in-possession’.

---
