EE

CORPORATE RESCUE LAW – AN ANGLO-AMERICAN PERSPECTIVE

Gerard McCormack

Corporations, Globalisation and the Law

Corporate Rescue Law – An Anglo-American Perspective

Gerard McCormack

Professor of International Business Law, University of Leeds, UK

CORPORATIONS, GLOBALISATION AND THE LAW

Edward Elgar
Cheltenham, UK • Northampton, MA, USA

© Gerard McCormack 2008

All rights reserved. No part of this publication may be reproduced, stored in a retrieval system or transmitted in any form or by any means, electronic, mechanical or photocopying, recording, or otherwise without the prior permission of the publisher.

Published by
Edward Elgar Publishing Limited
The Lypiatts
15 Lansdown Road
Cheltenham
Glos GL50 2JA
UK

Edward Elgar Publishing, Inc.
William Pratt House
9 Dewey Court
Northampton
Massachusetts 01060
USA

A catalogue record for this book
is available from the British Library

Library of Congress Control Number: 2008932868

ISBN 978 1 84720 274 1

Typeset by Cambrian Typesetters, Camberley, Surrey
Printed and bound in Great Britain by MPG Books Ltd, Bodmin, Cornwall

Corporate Rescue Law – An Anglo-American Perspective

CORPORATIONS, GLOBALISATION AND THE LAW

Series Editor: Janet Dine, *Director, Centre for Commercial Law Studies, Queen Mary College, University of London, UK*

This new and uniquely positioned monograph series aims to draw together high quality research work from established and younger scholars on what is an intriguing and under-researched area of the law. The books will offer insights into a variety of legal issues that concern corporations operating on the global stage, including interaction with WTO, international financial institutions and nation states, in both developing and developed countries. Whilst the underlying foundation of the series will be that of company law, broadly defined, authors are encouraged to take an approach that draws on the work of other social sciences, such as politics, economics and development studies and to offer an international or comparative perspective where appropriate. Specific topics to be considered will include corporate governance, corporate responsibility, taxation and criminal liability, amongst others. The series will undoubtedly offer an important contribution to legal thinking and to the wider globalisation debate.

Titles in the series include:

Human Rights and Capitalism
A Multidisciplinary Perspective on Globalisation
Edited by Janet Dine and Andrew Fagan

Company Law in the New Europe
The EU *Acquis*, Comparative Methodology and Model Law
Janet Dine, Marios Koutsias and Michael Blecher

EU Corporate Law and EU Company Tax Law
Luca Cerioni

Corporate Governance and China's H-Share Market
Alice de Jonge

Corporate Rescue Law – An Anglo-American Perspective
Gerard McCormack

此为试读,需要完整PDF请访问: www.ertongbook.com

Preface

Britain and the United States are sometimes spoken of as two countries divided by a common language. One may find some truth to this paradox in the sphere of insolvency and corporate restructuring. Americans talk of corporate bankruptcy whereas in Britain the talk is of corporate insolvency with the language of bankruptcy in the main confined to the insolvency of individuals. Moreover, Americans speak of corporations and in the UK the talk is of companies. But certainly in the corporate rescue sphere the differences are more deep-rooted than mere matters of terminology. The differences are often presented in the form of a generalisation that US law is pro-debtor and UK law is pro-creditor. US law is based on a debtor-in-possession norm whereas in the UK the norm is that of management displacement. In addition there is superficially greater secured creditor control of the restructuring process in the UK. But part of my thesis is that the traditional generalisation is, at best, a potentially misleading over-simplification. Debtor-in-possession does not necessarily mean that the management team that was responsible for the company's financial misfortunes remain in control of the business. Creditors in the US can exercise decisive influence over the restructuring process through debtor-in-possession financing agreements.

The book also offers the conclusion that there is a degree of functional convergence in practice but, at the same time, acknowledges that corporate rescue, as distinct from business rescue, still plays a larger role in the US. The functional convergence has partly come through the UK Enterprise Act 2002 but the book suggests that the main move has been that of US law and practice in a UK direction with greater emphasis on business disposals and speedier cases than on corporate reorganisations, as traditionally understood. This mirrors practice in the UK where the emphasis has always been on the rescue of businesses through disposals of profitable or potentially profitable parts of a company's operations rather than carrying on business through the vehicle of the existing corporate entity. This outlook has not changed with the Insolvency Service Evaluation Report (January 2008) on the Enterprise Act revealing that the corporate rescue outcome is achieved in very few cases. The emphasis continues to be on maximising recoveries for creditors by means of business and asset sales. US law contains certain features such as a special funding mechanism for companies in financial difficulties that might usefully be transplanted across the Atlantic if corporate rescue is going to play a larger role in the UK and the hopes of the architects of the Enterprise Act realised.

The focus throughout the book has been on providing a critical comparative evaluation of US and UK law, incorporating relevant empirical evidence where appropriate. Developments in other jurisdictions and on the international level have not been neglected however. Part of the interest in this book may lie in providing a possible way forward for other jurisdictions or at least in illuminating the path not to follow.

Gerard McCormack
Leeds, UK
April Fool's Day, 2008

Acknowledgements

I have incurred many debts in the course of writing. Amongst others, thanks are due to Tracey Evans Chan, Andrew Griffiths, Andrew Keay, Herbert Lemelman, David Milman, John McMullen, Maisie Ooi, George Triantis and Wee Meng Seng. I would also like to thank the UK's Arts and Humanities Research Council (AHRC) for facilitating some of the research on which the book is based and the University of Manchester, National University of Singapore and University of Leeds for providing a hospitable academic environment. But the biggest debt is owed to my family – por todo. Finally, my mother passed away during the writing process and I would like to dedicate the book to her memory.

Contents

1. Introduction

This book compares and contrasts corporate rescue (reorganisation) procedures in the UK and the US. A dedicated corporate rescue procedure has existed in the UK since the 1980s in the form of administration, or at least administration coupled with a company voluntary arrangement (CVA). In the US, corporate rescue law is much older, with the law now contained in Chapter 11 of the US Bankruptcy Code 1978. In 2002, by means of the Enterprise Act, UK law was moved in the US direction. US law in this area has traditionally been seen as very 'pro-debtor' compared with the UK, which is seen as 'pro-creditor'.[1] Part of the theme of the book is that this generalisation is, at best, a potentially misleading over-simplification. The book will ask a number of questions including the following:

1. Firstly, what values and purposes are served by reorganisation procedures? Such procedures are generally premised on the assumption that the 'going-concern' value of a business is greater than the liquidation value. The question arises, however, whether the concern of the law should simply be about creditor wealth maximisation or whether a business should be kept alive for other reasons. Related to this is the issue of the destination of the 'surplus' value that is captured during the reorganisation process. In distributing this 'surplus' value, is the law simply interested in respecting pre-insolvency legal entitlements or should a different set of interests enter into the equation during the reorganisation process?
2. Why are the mechanisms for entering the procedures different in the UK and the US and, in particular, why does the secured creditor have such a central role in the procedure in the UK but apparently not in the US?
3. Why do solvency requirements before a company can enter the reorganisation process differ in the UK and the US? There is no insolvency

[1] See the paper by Rafael La Porta, Florencio Lopez-De-Silanes, Andrei Shleifer and Robert W Vishny (1998) 'Law and Finance' 106 Journal of Political Economy 1113, where the US is given a score of 1 for creditors' rights whereas the UK is given the maximum score of 4.

prerequisite in Chapter 11 but a case can be dismissed early if filed in bad faith or without reasonable hope of success.

4. To what extent does the stay on creditor enforcement proceedings differ between the two countries and what are the conditions for getting the stay lifted? In the US, secured creditors may succeed in having the stay lifted unless the debtor has provided them with 'adequate protection' against a decline in the value of their property interests but the question arises about how this concept is interpreted in practice. In the UK, there is ostensibly more of a discretionary approach.
5. What are the reasons for allowing the incumbent management to remain in charge of company affairs during Chapter 11 whereas in the UK responsibility is entrusted to an outside insolvency practitioner? The difference has often been ascribed to a difference in entrepreneurial culture between the two countries, with many in Britain associating business failure with personal fault and stigma whereas in the US, business failure is often seen as one of the vicissitudes of fortune. But how convincing are these attributions?
6. Unlike in England, there is a specific provision in Chapter 11 to deal with financing of companies undergoing reorganisation – 'DIP' financing. Super-priority new financing is even permitted if the debtor can show such a loan is a condition of obtaining new financing and existing secured creditors are adequately protected against loss. The opportunity to introduce a similar procedure in the UK has however been rejected and the research will explore the reasons for this.
7. To what extent can a reorganisation plan be made binding on creditors (including secured creditors) against their wishes? In the US every impaired class of creditors must approve the plan though 'cramdown', which means confirmation of a plan despite creditor objections is possible. Generally, a secured class may be crammed down if it receives the value of its collateral, plus interest, over time, while an unsecured class may insist that shareholders receive nothing if a plan is to be approved over its objection. Objecting creditors are protected by the 'best interests' test under which each objecting creditor must receive at least as much under the plan as it would in liquidation and also by a 'feasibility test' which requires that the debtor should be reasonably likely to be able to perform the promises it made in the plan. In the UK there is no facility for 'cramdown'. I will endeavour to ascertain to what extent 'cramdown' is used in the US and ask whether the differences between the two countries in this respect are more subtly nuanced than would initially appear.

The first set of questions looks at the justifications for having corporate

此为试读，需要完整PDF请访问：www.ertongbook.com

rescue laws[2] and also at the philosophy behind such laws. Most people might say that corporate rescue is all about maintaining going-concern value, in that the value of a company's business operations is likely to be far greater than the scrap value of its assets.[3] They may be nonplussed, however, if asked to explain why going-concern value is likely to be greater than the liquidation value of assets. This chapter looks in more detail at the concept of going concern value. It then considers whether a company should be kept alive for reasons other than the preservation of going-concern value. In other words, are there wider purposes served by corporate rescue laws?

This leads into a discussion of the various academic theories offered up to justify the existence of corporate rescue laws and which are also used to critique such laws. Finally, the discussion returns to the legislative record in both the US and the UK and to a consideration of the factors that influenced both the enactment and content of Chapter 11 and the administration procedure in the UK.

GOING-CONCERN VALUE

In the UK, administration can be contrasted with liquidation. Liquidation of a company involves the cessation of its business, the realisation of its assets, the payment of its debts and liabilities, and the distribution of any remaining assets to the members of the company. At the end of the liquidation process, a company is wound up and ceases to exist. Administration, or administration coupled with a CVA, by contrast, is designed primarily as a rescue procedure aimed at facilitating the survival of the company's business either in whole or in part. The legislation states that an administrator must perform his/her functions with the objective of (a) rescuing the company as a going concern, or (b) achieving a better result for the company's creditors as a whole than would be likely if the company were wound up (without first being in administration), or (c) realising property in order to make a distribution to one or more secured or preferential creditors.[4] The statute sets out this hierarchy of objectives. An

---

2 One may define 'rescue' pragmatically as a major intervention necessary to avert corporate failure – see Alice Belcher *Corporate Rescue* (London, Sweet & Maxwell, 1997) at p 36. See also A Belcher 'The Economic Implications of Attempting to Rescue Companies' in H Rajak ed *Insolvency Law: Theory and Practice* (London, Sweet & Maxwell, 1991) at p 235.

3 'The premise of a business reorganisation is that assets that are used for production in the industry for which they were designed are more valuable than those same assets sold for scrap' – HR Rep No 595, 95th Congress, Ist Sess 220 (1977).

4 Insolvency Act 1986 Schedule B1 para 3(1). An administrator must also perform his/her functions in the interests of the company's creditors as a whole.

administrator can only move from one objective to another if s/he thinks that it is not reasonably practicable to achieve a preceding objective. The administrator, however, is obliged to move from (a) to (b) if s/he thinks that (b) would achieve a better result for the company's creditors as a whole.[5]

The underlying principle behind restructuring or reorganisation proceedings is that a business may be worth a lot more if preserved, or even sold, as a going concern than if the parts are sold off piecemeal.[6] In other words, there is a surplus of going-concern value over liquidation value.[7] In the UK, the DTI review of company rescue and business reconstruction mechanisms[8] has spoken of:

> a growing sense that, in many cases, rescue or reconstruction, whether informal or moderated through formal insolvency procedures, probably benefits everyone involved with a company and its business more than a liquidation. The basis of this belief is that the 'fire sales' of assets that accompany such terminal procedures as liquidation inevitably reduce the values obtained whereas creditors will, over time, receive a better return where the company survives as a 'going concern'.

In the US, as one court put it, 'the purpose of [Chapter 11] is to provide a debtor with the legal protection necessary to give it the opportunity to reorganize, and thereby to provide creditors with going-concern value rather than the possibility of a more meagre satisfaction of outstanding debts through liquidation [under Chapter 7 of the Bankruptcy Code].'[9] Influential US commentators have reduced the liquidation versus reorganisation question to a quasi-mathematical formula. It has been suggested that whether a company should be kept together as a going-concern is answered by estimating the

---

5 Ibid para 3(4).

6 For a somewhat sceptical perspective 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.' Richard V Butler and Scott M Gilpatric see 'going-concern surplus' more broadly in 'A Re-Examination of the Purposes and Goals of Bankruptcy' (1994) 2 American Bankruptcy Institute Law Review 269 at 282 – 'part of the going-concern surplus represents the value to the firm of the relationships which it has established with factor owners. The rest reflects the value to it of its relationships with customers, regulators, and other interested parties.'

7 Omer Tene 'Revisiting the Creditors' Bargain: The Entitlement to the Going-Concern Surplus in Corporate Bankruptcy Reorganisations' (2003) 19 Bankruptcy Developments Journal 287.

8 London, DTI, 2000 at p 5.

9 *Canadian Pacific Forest Products Ltd v JD Irving Ltd* (1995) 66 F 3d 1436 at 1442.

income stream that the assets would generate if they were kept together, taking into account the risk of reorganisation failure, discounting that stream to present value, and comparing it to the amount that the assets would realise if they were sold off in separate pieces.[10]

Since going-concern value may be a lot more than the value of a business on a break-up basis, reorganisation proceedings are designed to keep the business alive so that this additional value can be captured.[11] This objective is itself controversial for there is a widely held view that if a company encounters economic difficulties the simplest and most effective solution is to put it out of its misery, so to speak, by terminating its existence. If a business is no longer viable then the most sensible solution may be to shut it down.[12] If a company is producing goods and services for which there is no ready market then why leave it in existence? For example, take the case of a dog food company that is producing food that the dogs do not like. There seems little gain in keeping such a company alive.[13] Moreover, preserving dying companies or putting them on a life support and resuscitation machine may do little to benefit the industry in which they operate. Instead, it may leave competitors

---

10 See DG Baird and TH Jackson 'Corporate Reorganizations and the Treatment of Diverse Ownership Interests: A comment of adequate protection of secured creditors in bankruptcy' (1984) 51 U Chi Law Review 97 at 109. See also Thomas H Jackson *The Logic and Limits of Bankruptcy Law* (Cambridge MA, Harvard University Press, 1986) at p 184. For a European perspective see Horst Eidenmueller 'Trading in Times of Crisis: Formal Insolvency Proceedings, Workouts and the Incentives for Shareholders/Managers' [2006] European Business Organization Law Review 239 at 241–242.

11 But see Charles W Adams 'An Economic Justification for Corporate Reorganizations' (1991) 20 Hofstra L Rev 117 at 133 '[M]ost assets are probably not firm-specific, and so, most insolvent corporations will not have substantially greater going concern than liquidation values and, consequently, will not be good candidates for an effective reorganization.'

12 For a different view of Chapter 11 see Lynn M LoPucki 'The Debtor in Full Control – Systems Failure Under Chapter 11 of the Bankruptcy Code?' (1983) 57 American Bankruptcy Law Journal 99 at 114: 'Congress has asserted that "the purpose of a reorganization . . . case is to formulate and have confirmed a plan of reorganization . . ." It is likely that only a few of the debtors studied came to Chapter 11 for this purpose. A large majority of them entered Chapter 11 with one or more of their creditors in hot pursuit, and filing was probably the only way they could remain in business or avoid liquidation. Their focus, quite naturally, was on short term survival, and only later, if at all, would a substantial number of them turn their attention to the long range prospects for their businesses.'

13 See generally Michelle J White 'Does Chapter 11 Save Economically Inefficient Firms' (1994) 72 Wash U LQ 1319; 'The Corporate Bankruptcy Decision' (1989) 3 J Econ Persp 129; James J White 'Death and Resurrection of Secured Credit' (2004) 12 American Bankruptcy Institute Law Review 139.

suffering by forcing them to compete with debt-reduced and reorganised, but ultimately inefficient, companies in crowded markets. In this regard, American commentators have highlighted the example of Eastern Airlines in the early 1990s where, in a desperate attempt to win back lost customers, Eastern offered a number of discount fares that priced its services below cost.

> Such a strategy made sense for the insolvent airline because getting passengers back was Eastern's only hope to emerge from bankruptcy as a viable entity. Unfortunately, these low fares induced other airlines to reduce their fares, thus generating losses at these other airlines as well. The slow death of Eastern thus compounded the losses of both Eastern's creditors and its competitors.[14]

After all, one of the principal characteristics of a market economy is that some companies fall by the wayside, and forcing investors to keep their assets locked up in what is, at best, a marginal enterprise may prevent these investors from making more productive use of their assets in a more efficient enterprise. It also may reduce their incentive to invest, rather than consume, those assets in the first place. Moreover, the effect of keeping open a business in a particular town may be to prevent a potentially more profitable business in a different town from opening.[15]

GOING-CONCERN VALUE AND THE MODERN SERVICE SECTOR-ORIENTED ECONOMY

It has been suggested that, with changes in the nature of advanced economies and the disappearance of heavy industry, corporate restructurings may have less of a role to play than previously, if any role at all.[16] This thesis has been advanced in the American context by Professors Baird and Rasmussen, who argue that because of economic changes and, in particular, technological advances, globalisation and the rise of the service sector, corporate reorganisations as traditionally understood are coming to an end.[17] In their view: 'To

[14] See Robert K Rasmussen 'The Efficiency of Chapter 11' (1991) 8 Bankruptcy Developments Journal 319 at 320–321.

[15] See Baird and Jackson (1984) 51 U Chi L Rev 97 at 102.

[16] DG Baird and RK Rasmussen 'Chapter 11 at Twilight' (2003) 56 Stanford Law Review 673 and DG Baird and RK Rasmussen 'The End of Bankruptcy' (2002) 55 Stan L Rev 751.

[17] One study suggests that in 2002, in more than 80 per cent of all large Chapter 11s, the companies concerned used the process to sell off their assets rather than to reconstruct their debts in the traditional way – see Baird and Rasmussen 'Chapter 11 at Twilight' at 674.

the extent we understand the law of corporate reorganizations as providing a collective form in which creditors and their common debtor fashion a future for a firm that would otherwise be torn apart by financial distress, we may safely conclude that its era has come to an end.'

They point to the decline of heavy industry and make the point that successful companies today are not very much like the railways of the nineteenth century. In the case of a railroad company, the assets of the firm had very little value when sold off individually – nothing but a streak of rust iron in the prairie, to use a memorable phrase. In the case of a modern capital the most valuable resource may be human capital. The most valuable assets may walk out the door at five or six o'clock in the evening. The accoutrements of the modern office may have just as much value if sold off to another firm than if kept by the debtor: 'There is no special magic beyond transaction costs in accounting for any particular collection of assets assembled within a single firm.'

In the real world however, transaction costs cannot be ignored. Perhaps Baird and Rasmussen overstate their case.[18] Transaction costs are all around us. They exist in almost every move of daily life. Going-concern value resides principally in various relationships 'among people, among assets, and between peoples and assets'.[19] It is tough to start a business from scratch. Networks of relationships are at the heart of a modern business. Costs incurred in creating most of these necessary relationships will inevitably be lost if the business is scattered to the winds through a piecemeal sale of assets. Substantial additional costs will be incurred in the establishment of new relationships and the starting up of a business afresh. Moreover, centralised management, and other benefits from economies of scale, can be the source of going-concern value.[20]

---

[18] Even Professor Baird himself seems to acknowledge this implicitly – see the discussion in *Elements of Bankruptcy* (New York, Foundation Press, 4th ed, 2006) at pp 229–235 and see the comment at p 235: 'The players in a large corporate reorganization, even those that most resemble the nineteenth-century railroad, no longer see a Hobson's choice between a sale in an illiquid market or a costly reorganization. Instead, they see the choice as one between selling the business to other investors in a developed, but not perfect, market or keeping it themselves in a proceeding that has become cheaper and easier to control over time.'

[19] L M LoPucki 'The Nature of the Bankrupt Firm: A Reply to Baird and Rasmussen's The End of Bankruptcy' (2003) 56 Stan L Rev 645.

[20] See H Miller and S Waisman 'Does Chapter 11 Reorganization Remain a Viable Option for Distressed Businesses for the Twenty-First Century?' (2004) 78 Am Bankr LJ 153 at 192–193. 'Starting a business from scratch is expensive and time-consuming and entails a large degree of entrepreneurial risk.' Miller and Waisman also make the point that the flurry of recent mergers and acquisitions activity and the move towards consolidation across many industries suggests that there are benefits that cannot be obtained by simply contracting with the marketplace.

These points have been well made by the Legal Department of the International Monetary Fund (IMF), who go so far as suggesting that changes in the nature of the economy have meant that restructuring of ailing firms has become more important than ever before:

> [I]n the modern economy, the degree to which an enterprise's value can be maximized through liquidation of its assets has been significantly reduced. In circumstances where the value of a company is increasingly based on technical know-how and goodwill rather than on its physical assets, preservation of the enterprise's human resources and business relations may be critical for creditors wishing to maximize the value of their claims.

Simply stated, some companies are worth more as going-concerns run by existing managers and with existing shareholders than if sold to third parties and managed by new teams.[21] The going-concern surplus may result from the informational advantages of existing management or from the sunk costs of arranging assets in strategic blocks. The surplus has to be substantial, however, to justify the very substantial administrative, negotiating and legal costs of the reorganisation proceedings themselves.[22]

In the US context, on the other hand, the world of Chapter 11 has changed such that there is now a much greater emphasis on market sales rather than reorganisations in the traditional sense.[23] But, contrary to the position that might have appeared during the fall-out from the bursting of the bubble in technology-related shares in 2001/2002, traditional reorganisations have not completely disappeared. There is empirical evidence that reorganisation remains essential for dealing with distressed large public companies.[24] Commentators have compared the prices for which 30 large public companies were sold with the values of 30 similar companies that were reorganised in the 2000/2004 period. It was found that companies sold for a 35 per cent average of book value but reorganised for an average fresh value of 80 per cent of book value. Moreover, the average market capitalisation value as determined by post-reorganisation market trading was 91 per cent of book value. 'Even controlling for the differences in the prefiling earnings of the two sets of companies, sale yielded only half of reorganization value. These results

---

21 See D Baird and R Picker 'A Simple Noncooperative Bargaining Model of Corporate Reorganizations' (1991) 20 J Legal Studies 311 at 315.

22 Robert Clark 'The Interdisciplinary Study of Legal Evolution' (1981) 90 Yale Law Journal 1238 at 1254.

23 See Douglas G Baird 'The New Face of Chapter 11' (2004) 12 American Bankruptcy Institute Law Review 69 at 71.

24 Lynn M LoPucki and Joseph W Doherty 'Bankruptcy Fire Sales' (2007) 106 Michigan Law Review 1 at pp 3–4.

此为试读,需要完整PDF请访问: www.ertongbook.com