

**Reconsidering the Goals of Irish Corporate
Rescue Law: Identifying Appropriate
Models and Legal Provisions suitable for a
Small Open Economy**

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Declaration

I, Edmund Shanahan, declare that this thesis:

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Summary

The Companies (Amendment) Act, 1990 as amended has proven to be one of the most controversial pieces of commercial legislation introduced in the State. This thesis investigates for the most part formal company rescue law in Ireland, that is the Companies (Amendment) Act 1990, as amended, and now found in the Companies Act 2014, so as to determine whether or not they are efficient mechanisms which are fit for purpose.

The major conclusion of this thesis is that examinership to date has been successful in catering for a comparatively limited number of large or sometimes medium-sized Irish companies in distress. Those who designed it in its original form did not intend it for small companies or did not give the question much thought. If such is the range of consideration, examinership using the yardsticks developed by Finch is at least efficient and has been substantially a success. Moreover, prepack examinership of the kind exemplified in the *Eircom* rescue has proven itself to be very worthwhile. On the other hand, examinership to date has had very little to offer most Irish companies. Examinership lite, for its part, has yet to prove itself. Given the significant obstacles which still remain for small to medium-sized companies in the examinership process, it is difficult to be optimistic about the examinership lite development.

The major argument of this thesis is that if examinership is to have meaning for small companies in Ireland, it should take the form of that outlined in the Donnelly proposal and to a lesser extent in the recommendation of the Company Law Review Group; that is to say an examinership mechanism which would be initiated by a non-judicial administrative procedure. This simplified procedure would extend only to the appointment of an examiner. It would remain necessary in this model to obtain the approval of the Circuit Court for any scheme of arrangement that the examiner would recommend. This would allow creditors to

receive at least as much as they would in any other possible outcome. In addition, the small company in distress would be incentivised to use this approach because of the drastically reduced costs involved.

The methodology employed has been that of functional comparative law. Planning and negotiation features of company rescue law in the three jurisdictions selected –that is, the United States, the UK and the Irish Republic- as well as the related moratoria have been analysed. The relevant case law and literature has also been considered.

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During the last two years topics related to the thesis were presented by me at both the Irish Law Teachers Conference and at the American University of Bulgaria, Blagoevgrad. These were useful exercises which obliged me to establish distance from my subject so as to gain a greater perspective and to communicate ideas in a manner which made the subject available to non-specialists.

I have incurred many academic and professional debts. Not the least of these have been insights offered by some members of the legal professions and by one or two people active respectively in political and business life. In addition, Mr Tom McGovern of the Companies Registration Office in Dublin very kindly supplied me with relevant statistics on examinership.

While insolvency law research is markedly practical, life at what at times seems like the coalface can sometimes be an isolated one. I must thank Patricia for reminding me of the sunlight.

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Table of Abbreviations

BAPCPA	The Bankruptcy Abuse Prevention and Consumer Protection Act 2005
CBT	Creditors' Bargain Theory This normative theory seeks to explain the Goals of bankruptcy in terms of a hypothetical bargain of creditors
CVA	Company Voluntary Arrangement
ILTR	Irish Law Times Reports
RSC	Rules of the Superior Courts
SC	Supreme Court
SME	Small- and medium-sized enterprises

Chapter 1

COMPANY RESCUE LAW IN IRELAND: THE CONTEXT

INTRODUCTION

It is perhaps forgivable in a scholar who has ventured forth awhile to address one or two questions in corporate restructuring law to doubt sometimes, if only briefly, that he or she has arrived at a conclusion that is altogether defensible. A great many of the propositions central to it remain contested. More fundamentally, there is the specific risk identified by the celebrated psychologist Daniel Kahneman, of not attaining sound judgment because of the very nature of our habits of mind.¹ Kahneman has argued that we are too quick to draw conclusions based on the information more easily available to us, while failing to consider fully that which is not then being spotlighted. This has relevance for researchers in the insolvency law context: we are subject to many biases and less rational than we would care to be. Nevertheless courage and discipline can help to win the day and a start must necessarily be made.

Any useful discussion of corporate rescue mechanisms must consider a broad range of phenomena that can be divided into a number of categories. These mechanisms may be formal or informal in nature and one or other of them may be employed at certain times in a company's history and not merely when the company is in crisis or close to crisis. Corporate rescue in most instances can be described as a method of whatever kind having legal, financial and business implications which enables the continuation of a business entity that is threatened with insolvency. In certain instances, the objective may be the preservation of the corporate entity, in others just the business. Many commentators make reference to Belcher's observation that the rescue concept covers a wide spectrum of activity: from late hour

¹ D Kahneman, *Thinking, Fast and Slow* (1st edit Farrar, Straus and Giroux 2011).

interventions to everyday management activity. That is to say that management activity can be seen as a kind of continuous rescue exercise in that it is directed towards steering companies away from disaster and oblivion.² Stated in plain terms, the more a company approaches disaster and oblivion, the more it is in need of rescue. When disaster looms, a major intervention is almost invariably called for. This thesis is concerned mostly, but by no means exclusively, with both formal and informal interventions in companies both large and small that are already experiencing or are showing signs of moving towards a condition of severe financial difficulty. No assumption is made at the outset that a formal legally sanctioned intervention is necessarily a good thing. Specifically, the thesis focuses on developments in company rescue law in this jurisdiction at a time when that law of company rescue has been somewhat extended.³ It offers a critique of these developments. The focus throughout is both upon the mechanics of formal- that is, court enabled- company rescue processes suitable for a small open economy that is composed overwhelmingly of small companies and upon the appropriateness or otherwise of the present forms of examinership and to a lesser extent of schemes of arrangement in this jurisdiction.

As a first approximation, it may be said that corporate rescue laws are there “to assist a struggling company by providing protection to the company while a way forward is identified and implemented, (so as to provide) a framework for negotiation with creditors.”⁴ Their ostensible purpose is to protect and to promote the continuing existence of a specific business activity rather than a specific company which is experiencing financial difficulties, in cases

² A Belcher, *Corporate Rescue* (1st edn .Sweet and Maxwell 1997) 11. Belcher defined corporate rescue as a major intervention necessary to avert the eventual failure of the given company.

³ That is to say that in addition to the Companies (Amendment) Act 1990, as amended, together with the Companies (Miscellaneous Provisions) Act 2013, the Examinership lite system (available for many examinership candidates which are SMEs) which came into being under the terms of the Companies (Miscellaneous Provisions) Act 2013. The relevant legislation is now largely found in Part 10 of the Companies Act 2014. There have been no profound changes in company rescue legislation in the Companies Act 2014, although the redesigned scheme of arrangement mechanism, which is discussed later, is of some significance.

⁴ R Parry, *Corporate Rescue* (Sweet and Maxwell 2008)1.The rescue culture in many English-speaking countries, excepting the United States, has taken its inspiration from the Cork Report: K Cork, *Report of the Cork Advisory Committee* (Cmnd 6692, 1976). The drafters of the 1986 Insolvency Act in the UK drew upon the report’s recommendations. See page 13 below for further details.

where prudence would allow such protection. This is certainly the case in the UK, but not the case in the Irish Republic.⁵ In this jurisdiction, the objective is to preserve the company. The objective of the Companies (Amendment) Act 1990 – the original Act- is stated in section 2(2) of that Act. This is now found in the Companies Act 2014, Part 10 at section 509. It is to “facilitate the survival of the company and the whole or any part of it as a going concern.” The emphasis in an examination exercise is upon saving viable companies and jobs. This is highlighted in *Re Tivway Ltd*⁶, *Re Traffic Group Ltd*⁷, and *Re Irish Car Rentals*.⁸ Corporate rescue is here understood as a major intervention that is necessary to avert eventual failure of the company. It covers a large spectrum from compromises, schemes of arrangement to voluntary arrangements with creditors. Legal formality is the exception rather than the rule in company rescue, as a majority of rescue exercises are undertaken informally. In contrast to this, much of the rest of insolvency law largely involves “collective procedures whereby the debtor’s assets are administered for the benefit of all of its creditors depending on what securities they (the creditors) may have and statutory priorities, if any, they may possess.”⁹ The most frequently used method of handling insolvent companies for at least one-hundred-and-fifty years in Ireland and in many other common law jurisdictions has been the liquidation procedure.¹⁰

⁵ By contrast, a UK administration, under the terms of the Insolvency Act 1986, Schedule B1, para 3(1), can be undertaken for a variety of reasons:

- To rescue the company as a going concern or
- To achieve a better result for the company’s creditors as a whole than would be likely if the company were wound-up or
- To realise property in order to make a distribution to one or more secured or preferential creditors.

⁶ *Re Tivway Ltd* 3 IR [2010] 49 at 62.

⁷ *Re Traffic Group Ltd* [2007] IEHC 445 at 446.

⁸ *Re Irish Car Rentals* [2010] IEHC 235 (*ex tempore*).

⁹ M Forde, H Kennedy and D Simms, *The Law of Company Insolvency* (2nd edn Round Hall 2009) 1.

¹⁰ See the Joint Stock Companies Act 1856 20&21 Vict. c.78 and the Companies Act 1862 19&20 Vict.c.47 for the sources of this approach. The relevant statutory regime applicable to registered companies which are being liquidated was as follows: Part V1 of the 1963 Companies Act (ss206-313). This was, in turn, amended by Part V1 of the 1990 Companies Act (ss122-179) and superseded by Part 11 of the Companies Act 2014. RSC 1986, Ord 74 is also applicable.

Thinking on corporate rescue has a far longer history than events of recent decades.¹¹ Muir Hunter, in his celebrated journal article, cites Joseph Chamberlain who was President of the UK Board of Trade in the early eighteen-eighties. He introduced the Bill which became the Bankruptcy Act, 1883 to the House of Commons in the following terms “(in) every good bankruptcy law, Parliament had to endeavour, as far as possible, to protect and salvage and also to diminish the number of wrecks.”¹²

1.1: OVERVIEW OF EXAMINERSHIP

On the formal side, an innovation since the early nineteen-nineties in Irish law has been the examinership process.¹³ The essential task of the examiner is to investigate an ailing company’s operations, to consider its prospects and at the earliest stage possible to formulate a plan for its return to business health.¹⁴ Usually the companies which opt for examinership would be regarded as being large, by Irish standards¹⁵ In December 2013, the Irish government enacted legislation making examinership more easily available to SME

¹¹ See M Hunter, ‘The Nature and Functions of a Rescue Culture’ (1999) *Journal of Business Law* 491.

¹² *Hansard*, March 1883, cols 621, 622.

¹³ Companies (Amendment) Act, 1990, s 2(1): this states the criteria which the court employs in determining whether or not an examinership process will be undertaken. The legislation has been updated by Part 2 of the Companies (Amendment) (No2) Act of 1999. (See, in particular, s7 and s9 of the 1999 Act). The effect of this last Act has been to make more stringent the criteria that companies must meet before they can be admitted to examinership; to increase the protection offered to relevant creditors and to amend details relating to the way the examinership is undertaken. The relevant legislation today is the Companies Act 2014, section 50.

¹⁴ Dáil Debates of August 28th, 1990. Mr Desmond O’Malley, the responsible Minister at that time, expressed matters in the following way: “To use a medical analogy, these provisions (relating to examinership) are intended to be of use to companies that are temporarily “sick”— I would not normally expect to see them being used by healthy companies or indeed in the final analysis by companies that are terminally ill.”

¹⁵ That is to say, companies employing 250 or more people. Microenterprises and small companies, at 98.8% of the percentage overall, make up the majority of enterprises in the economy of the Irish Republic. These companies employ less than 10 person (90.7%) or ten to 49 persons (7.7%) respectively. Medium-sized companies (employing fifty to two hundred and forty-nine persons) constitute 1.3% and large companies constitute 0.3% of the percentage overall. CSO, 15 “Business in Ireland” Dublin 2012 22 last downloaded at <http://www.cso.ie/en/media/csoie/releasespublications/documents/multisectoral/2012/businessinireland2012.pdf> on May 29th, 2015. Very few small companies have ever sought to enter examinership, because of the prohibitive costs involved. Kelly J in *Missford Limited t/a Residence Members Club & Companies Acts* [2010] 3 IR 756 at 761 referred critically to the legal fees of €50,000 and examiner’s fees of €61,157 related to that case. Moreover, Section 2 of the Companies (Miscellaneous Provisions) Act 2013, now section 509(7) of the Companies Act 2014 first put down stipulations whereby examinership lite candidates must have a balance sheet of less than or equal to €4.4m and turnover not exceeding €8.8m and an employee number not exceeding 50. These last indicia are appropriate to most small and micro enterprises in Ireland. Prior to the Companies (Miscellaneous Provisions) Act 2013, the costs of examinership in a complex case could be as much as to €300,000, but more often about €70,000 as stated by Deputy Donnelly in the *Sunday Independent* on February 9th, 2014. This is simply beyond the means of smaller entities.

companies through the Irish Circuit Court.¹⁶ The costs of petitioning in such cases may be much reduced as proceedings will be conducted swiftly and the lower court, the Circuit Court, is now undertaking this work¹⁷ In addition to examinership, the Companies Act 2014¹⁸ provides a streamlined scheme of arrangement which is another method of company rescue and, at least for some companies, constitutes a significant alternative to examinership option.¹⁹ A scheme of arrangement is a procedure which can be used by a company to reach a binding agreement with its creditors about payment of all or part of its debts over an agreed period of time. It can be proposed by the directors of the company or by its liquidator. It is possible to agree a scheme of arrangement with just one court appearance.²⁰

As Examinership is the most important mechanism in corporate restructuring law in Ireland, it will be described in some detail in the following paragraphs. The law relating to examinerships has its origins in the Companies (Amendment) Act 1990 which was passed by the Oireachtas at a time when the Goodman Group of companies appeared to be in danger of going out of business. Subsequently, the Companies (Amendment) (No. 2) Act 1999 was passed to give legislative effect to the recommendations of the Company Law Review Group (discussed later in the thesis) which had been set up in 1994 by the then Minister for

¹⁶ On 24 December 2013 the Companies (Miscellaneous Provisions) Act 2013 was signed into law by the President of Ireland. The relevant legislation is now found in Part 10 of the Companies Act 2014.

¹⁷ Dail Debates of November 22nd, 2012. The relevant Minister, Mr Richard Bruton, stated that SME company candidates who wished to petition for the examinership process in the Circuit Court would have to meet two of the following three criteria as regards size: their balance sheet must not exceed €4.4million; their turnover must not exceed €8.8 million and their number of employees must not exceed 50. Section 10 (the relevant section) of the Companies Bill available at <http://www.arthurcox.com/companiesbill/volume-1-analysis/part-10-examinership.html> was last downloaded on 17th September, 2013. There is, however, no guarantee that the costs of examinership for a petitioner will be reduced by having proceedings conducted in the Circuit Court. If any creditor were to contest proposals, the legal costs would escalate dramatically.

¹⁸ The Companies Act 2014 is the largest substantive act in the history of the state. It has served to modernise Irish company law. It has consolidated seventeen Acts and fifteen Statutory Instruments dating from 1963 to 2013 into a single coherent piece of legislation.

¹⁹ Companies Act 2014, Part 9, Chapter 1 ss 449 to 454. This scheme of arrangement mechanism is discussed in chapters 2 at page 129. As stated, it is now possible to put together a scheme of arrangement with just one court appearance. This will serve to make schemes of arrangement much more attractive to financially distressed companies. The Companies Act 2014 has just six sections dealing with schemes of arrangement. This compares to the fifty sections dealing with examinership. All of this is discussed in chapters 2 and 5 of the thesis below.

²⁰ Section 201 of the Companies Act, 1963 – the section relating to the scheme of arrangement mechanism that was operated previously – was in practice rarely availed of because of the costs involved in related court appearances.

Enterprise and Employment to review the law relating to examinerships. The 1999 Act became effective on 1 February 2000 and made very substantial and significant changes to the examinership regime. Examinership lite was introduced by the Companies (Miscellaneous Provisions) Act 2013. All the relevant legislation on examinership is now contained in Part 10 of the Companies Act 2014. The Companies Act 2014 did not bring about fundamental changes to the examinership process, but it did offer a redesigned scheme of amendment mechanism which would be of value to some companies experiencing financial distress.²¹ Procedures in relation to examinerships are set out in Order 75A of the Rules of the Superior Courts.

It is a court-enforced moratorium on creditor actions which allows a brief period during which a financially troubled company can be reconstituted. It has some similarities to the Chapter 11 process in the United States. The similarities are detailed in the following chapters. In addition to the automatic stay, the process involves the appointment of an examiner (invariably an accountant) to act as examiner.²² The examiner has the task of formulating proposals for a compromise or scheme of arrangement between the company and its shareholders and creditors. The examiner has no executive role and the company's directors and management remain in control of the company during the moratorium.²³ The procedure is open to any company having its centre of main interest in Ireland.²⁴

In order to obtain an order for the appointment of an examiner, it is necessary for the company to petition the High Court (or the Circuit Court) and persuade the court that there is a reasonable prospect of survival of the company and the whole or a part of its undertaking,²⁵

²¹ Sections 449-454 of the Companies Act 2014. This is analysed in chapter 5 of this thesis.

²² Companies Act 2014, s519(1).

²³ Companies Act 2014, s524.

²⁴ This is in accord with the EU insolvency regulation (1346/2000). A related company to the company placed in examination that has its centre of main interest in Ireland can also be admitted to the process.

²⁵ Companies Act 2014, s517(1).

if the examiner is appointed.²⁶ It is also necessary to demonstrate that the company is or is likely to be unable to pay its debts. A company is judged to be unable to pay its debts, if it is unable to pay them as they fall due or when the value of its assets is less than the amount of its liabilities (taking into account both contingent and prospective liabilities) or in cases where section 570 of the Companies Act 2014 applies to the company.²⁷ The petition must be supported by an affidavit sworn by or on behalf of the petitioner. It must be accompanied by a detailed report prepared by an independent accountant.²⁸ In general, the petition can be presented by the company, by the directors or by shareholders holding at least 10% of the company's shares issued, by the creditors or by the relevant Government Minister or Regulator.²⁹ An *ex parte* application is made to court on the day of presentation of the petition for directions in relation to the hearing of the petition and frequently the appointment of an interim examiner is sought. As an interim examiner has the same powers of certification of expenses as a full examiner, the court will be circumspect with regard to the appointment of an interim examiner.

The automatic stay on creditors' rights begins with the filing of a petition in the High Court or Circuit Court.³⁰ Prohibited creditor activity following the appointment of an examiner includes the appointment of a receiver or the enforcement of security as well as the repossession of goods on lease or on hire or supplied on retention of title.³¹ The moratorium can last for a maximum of 100 days. At that point, the examiner is obliged to have formulated proposals and circulated them to the relevant parties. The examiner also holds meetings with all classes of shareholders and creditors affected by the proposals and then reports back to the High Court or the Circuit Court. The scheme of arrangement must be approved by at least

²⁶ Companies Act 2014, s510.

²⁷ Section 570 of the Companies Act 2014 relates to the criteria applicable for a company to be deemed to be unable to pay its debts.

²⁸ Companies Act 2014, s511.

²⁹ Companies Act 2014, s510.

³⁰ Companies Act 2014, s520.

³¹ Companies Act 2014, s520.

one class of creditors of the distressed company. If it is demonstrable that the scheme can enable the survival of the company and the whole or part of its undertaking and that it is not unduly prejudicial to any creditors of the company, the court has discretion to approve the scheme.³² Creditors and shareholders have their first opportunity to express their views on any future company restructuring at the court hearing in respect of the examiner's petition.³³ In the High Court, for instance, this usually takes place within two weeks of the presentation of the examiner's petition.

Once appointed, the examiner sets about formulating his/her proposals.³⁴ These typically involve the introduction of new finance and the writing down of historic debt. The write down under the examiner's scheme will normally leave both secured and unsecured creditors in no worse a position than they would have been had the company been subject to a receivership or a liquidation. The examiner is obliged to convene meetings with each class of creditor affected by the scheme. Creditors are assigned to creditor classes by reference to their priority for payment.³⁵ Creditors have a right to voice objections to the scheme at the confirmation stage.³⁶

An examinership-type option has become available in one form or another in many common law jurisdictions in the last thirty-five years, although some insolvency systems are much more elaborate than others and the details vary considerably. Corporate rescue can, in given instances, provide a better alternative to other insolvency processes such as liquidation which often, but not invariably, bring about value destruction. In the Irish case, the view of the judiciary on examinership has been in some part as follows (as expressed by Clarke J):

It is clear that the principal focus of the legislation is to enable, in an appropriate case, an enterprise to continue in existence for the benefit of the economy as a whole and,

³² Companies Act 2014, s541.

³³ Companies Act 2014, s515.

³⁴ Regarding the Examiner's Report see Companies Act 2014, s534.

³⁵ Companies Act 2014, s539.

³⁶ Companies Act 2014, s543.

of equal, or indeed greater, importance to enable as many as possible of the jobs which may be at stake in such enterprise to be maintained for the benefit of the community in which the relevant employment is located. It is important both for the court and, indeed, the examiners, to keep in mind that such is the focus of the legislation. It is not designed to help shareholders whose investment has proved unsuccessful. It is to seek to save the enterprise and jobs.³⁷

This, however, does not provide a full view. His colleague, O'Donnell J stated that while rescue is an important objective, it cannot displace other interests.³⁸ The purpose of the Companies (Amendment) Act 1990 as amended was, in O'Donnell J's view, to rescue 'fundamentally sound businesses in a manner that is not unfair to any party.'³⁹ These other objectives were re-expressed by McCarthy J as being both the preservation of the company and upholding of the rights of the larger body of creditors.⁴⁰

An important insight into the nature of examinership in recent years, particularly regarding the burdensome nature of the more stringent requirements⁴¹ placed upon the candidate at petition stage comes from *Vantive*.⁴² The candidate must now go far to prove the commercial cogency of his or her financial and business projections. Having reviewed the projections for

³⁷ Clarke J in *Re Traffic Group Ltd* [2007] 3 IR 253 at 261.

³⁸ O'Donnell J in *Re McInerney Homes Ltd* [2011] IESC 31 at para 7.4.

³⁹ O'Donnell J in *Re McInerney Homes Ltd* [2011] IESC 31 at para 7.4. This very much accords with the UNCITRAL *Legislative Guide on Insolvency Law* (UN 2005). Among the key objectives identified in that document is that of striking a balance between liquidation and reorganisation. Achieving that balance is likely to have implications for other social policy considerations which would include the promotion of an entrepreneurial class and employment protection. UNCITRAL *Legislative Guide on Insolvency Law* (UN 2005) 11. The following is also noted on the same page. In order to ensure that the court proceedings are not abused by either the creditor or the debtor and that the court procedure that is most apposite for the resolution of the debtor's financial difficulties is being availed of, the legislation should provide for easy conversion between the different types of proceeding as deemed appropriate.

⁴⁰ *Re Atlantic Magnetics Ltd* [1993] 2 IR 561 at page 578. In this case, McCarthy J made the point equivocally that in an examinership context that secured creditors should not alone be in a position to dictate what will happen to a stricken company.

⁴¹ The requirements are now more burdensome, because the application for examinership must be accompanied by a report into the company by an independent accountant. The accountant will provide his/her opinion about whether or not the company can reasonably be expected to survive and will give details of the company's arrangements with creditors and the company's funding requirements during the period of examinership. This is in accordance with Section 3(3A) of the Companies (Amendment) Act 1990, as inserted by s. 7 of the Companies (Amendment) Act (No2) 1999. As originally conceived, the test as detailed in section 2(2) of the Companies (Amendment) Act, 1990 was not so demanding. It provided that no order should be made by the court regarding the appointment of an examiner unless the court was satisfied that there was a reasonable prospect of the survival of the company and the whole or any part of its undertaking as a going concern. The relevant section in the Companies Act 2014 is section 511.

⁴² *Re Vantive Holdings* [2010] 2 IR 108 at page 116. Vantive was part of the Zoe Property Group. The case, on appeal finally reached the Irish Supreme Court *Re Vantive Holdings* [2010] 2 IR 108.

Vantive offered by of the independent accountant concerning the property market at the petition stage, Kelly J of the High Court was less than impressed. He commented as follows:

I have the gravest reservations about the projections on which the independent accountant has relied in forming an opinion. They appear to me to be lacking in reality.....I am not satisfied that the petitioners have discharged the onus of proof of showing that there is a reasonable prospect of the survival of the company.

Quite clearly, when the examinership is initiated, it frequently has severely adverse consequences for the insolvent company's existing creditors, particularly its unsecured creditors. Creditors' remedies are automatically restricted in a significant manner.⁴³ Company rescue initiatives work against the traditional principles of insolvency law (they modify creditors' rights substantially) and against property rights.⁴⁴ Examinership does, nevertheless, offer the possibility of some creditors getting something rather than nothing. There is therefore a tension between property rights on the one hand and company rescue initiatives on the other and matters are not easily resolved. This tension is something that policy planners must take account of when they are developing leading-edge insolvency and company rescue legislation so as to promote in this country the goal of reanimating a small open economy that was once very dynamic, but that is only now beginning to regain momentum.⁴⁵

While neither the rational working out of competitive processes in the marketplace nor the overall welfare efficiency of market processes can, in most cases, be questioned in a substantive way, it can still be said that the rehabilitation of commercial enterprises in particular instances can potentially be a worthwhile objective where there are good reasons to promote that rescue in whatever form it may take and where it is just and equitable to do

⁴³ 1990 Companies (Amendment) Act, 1990, s5.

⁴⁴ See Lynch-Fannon I and G N Murray, *Corporate Insolvency and Rescue* (2nd edn. Bloomsbury 2012) chapters 12 and 13 for a fuller explanation of this.

⁴⁵ At the time of writing (2015), Ireland is rated as the ninth most "economically free" economy worldwide in an index established by economists from the [Index of Economic Freedom](http://www.heritage.org/index/country/ireland). Data downloaded from <http://www.heritage.org/index/country/ireland> on December 11th, 2015.

so. In cases of company dissolution, moreover, it does not necessarily follow that all divisions of the former company will be eliminated; some divisions may have a significant commercial future. In addition, many, if not most, company rescue initiatives are short-term in nature and the real purpose of these initiatives is often to promote more easily the absorption of the company formerly in financial difficulties into some other company. So negotiations at the formal company rescue stage must be dealt with in a circumspect manner.⁴⁶ This is particularly so in large company cases, given the increasingly complex nature of business finance and the usually very cautious nature of institutional creditors today.⁴⁷ Societies vary in their approach to these questions.⁴⁸

1.1.2: ADMINISTRATION

Regarding insolvency law in the UK, Administration is the most prevalent corporate rehabilitation procedure. The administration procedure, as we know it today, was first introduced under the Enterprise Act 2002,⁴⁹ with the intention of promoting a “rescue culture” in the UK.⁵⁰ An administrator may now be appointed by the court, by the holder of a

⁴⁶ A Belcher, *Corporate Rescue* (Sweet and Maxwell 1997). Company rescue initiatives can vary in nature. They can be formal or informal. They can be undertaken at any stage once a company begins to experience difficult revenue generating conditions. They can come from within or without the company.

⁴⁷ Many of the most flexible and effective initiatives may have been generated within the banking sector and have not been prompted in any way by government statute. See J AA Adriaanse, *Restructuring in the Shadow of Law, Informal Reorganisation in the Netherlands* (Kluwer 2005).

⁴⁸ In the United States, for example, the balance has for many years tilted in favour of the debtor at the expense of the creditors (although this is now much less so), whereas in the UK, the opposite has more often been the case (although this too has changed in more recent years). It is sometimes argued today that the original purpose of the Chapter 11 company rescue legislation in the United States has now become almost a dead letter. See D G Baird and R K Rasmussen, “The End of Bankruptcy” (2002) 55 *Stan Law Rev* 751. For a comparative study of corporate rescue legislation in both the US and the UK see: G McCormack, “Apples and Oranges? Corporate Rescue and Functional Convergence in the US and the UK” (2009) 18 *Int Insolv Rev* 109. For instance, in the UK, the Insolvency Act of 1986 did continue the creditor wealth maximisation approach while bowing in the direction of other goals such as corporate rescue. When the Enterprise Act, 2002 became law, however, corporate rescue became the major objective or at least ostensibly so; although, in practice, the creditor wealth maximisation model remained also at the heart of that enactment. All of this is discussed later in the chapter.

⁴⁹ Enterprise Act 2002 last downloaded on 19th November, 2015 at <http://www.legislation.gov.uk/ukpga/2002/40/contents>

⁵⁰ The term “rescue culture” is connected with the Insolvency Act 1986, Part 2, Sch B1 and the introduction of the Administration procedure. D Prentice, F Odith and N Segal, “Administration: The Insolvency Act 1986 Part 2 [1986] *Lloyd’s Maritime and Commonwealth Law Quarterly* 487. This drew upon recommendations made by Sir Kenneth Cork in the Cork Report. Sir Kenneth Cork had contended that “a concern for the livelihood and well-being of those dependent upon an enterprise which may well be the livelihood of a whole town or even a

qualifying floating charge which has become enforceable, or by the company or its directors.⁵¹ Simplifying slightly, a qualifying floating charge is a floating charge over all or substantially all of the property and assets of the company, which contains a power to appoint an administrator. Administration is intended to enable an eligible company to undergo reorganisation or to realise its assets under the protection of a statutory moratorium. As in the case of examinership, the moratorium prevents winding up petitions from being made or resolutions from being passed.⁵² Security over the company's assets may not be enforced without the Court's permission.⁵³ While this means a bank with a debenture cannot crystallise a floating charge or enforce its security where the customer is in administration, the administrator can only dispose of assets with the security holder's consent, or with permission of the Court.⁵⁴ The administrator must perform his functions with the objective of achieving a particular purpose. There are three possible objectives.⁵⁵ The first is to rescue the company as a going concern, if it is not reasonably practicable to do so. The second is to realise the assets of the company in such a way that there is a better realisation than there would be on liquidation. The third, if the objectives mentioned above cannot be achieved, is to achieve a payment or realisation of assets for the benefit of secured or preferential creditors of the company. Subject to these objectives, the administrator must perform his functions in the interests of the company's creditors as a whole.

There are two routes to administration:⁵⁶ (1) application by either the directors, the company or creditors to the Court, (the "court route"); or (2) by filing prescribed documents by the

region is a legitimate factor to which a modern insolvency law must have regard." K Cork, *Report of the Review Committee on Insolvency Law and Practice* (1982) Cmnd 8558 London.

⁵¹ Enterprise Act 2002, Schedule 16.

⁵² Insolvency Act 1986, section 14(A).

⁵³ Insolvency Act 1986, section 14(A).

⁵⁴ *Rollings (as Joint Administrators of Musion Systems Ltd) v O'Connell* [2014] All ER (D) 210 (May).

⁵⁵ Enterprise Act 2002, Section 647 (3).

⁵⁶ The options more specifically are these: an application for a court order can be made by one or more creditors of the company, the company itself, its directors, a liquidator, a supervisor of a company voluntary arrangement, or under section 359 of the Financial Services and Markets Act 2000 or section 87A of the Magistrates' Courts Act 1980. Alternatively, a company can be put into administration by filing at court a notice of appointment and

directors, the company or a qualifying floating charge holder at Court (the “Out of Court Route”).⁵⁷ The Out of Court Route is not available where a company is in liquidation or in provisional liquidation or, generally, where an administrative receiver has been appointed. The Court, however, can still appoint an administrator. The Court making an administration order would, in such cases, automatically dismiss any winding up petition, and a qualifying floating charge holder using the out-of-court route would also suspend any winding up petition.⁵⁸ In this situation the petition would be revived once the administration had terminated. Under the court route, the administrator is appointed by the court.⁵⁹ Under the out-of-court route, the administrator is appointed by the applicant (that is, the directors, the company or the qualifying floating charge holder). A bank, for instance, may be in a position to appoint its own administrator, if it is a qualifying floating charge holder or to appoint an administrative receiver if its charge was created before 15 September 2003 or if it falls within one of the exempt categories.

Whether the court or out-of-court route is used, anyone entitled to appoint an administrative receiver or any qualifying floating charge holder will need to be notified of the application.⁶⁰ If administration is being sought by a qualifying floating charge holder any prior qualifying floating charge holder must be notified and give its consent.⁶¹ When applying to the court to appoint an administrator, the party wishing to make an appointment will first need to gain either written consent from the person it would like to appoint as administrator,⁶² or it must give that person two days written notice of the proposal. Once the appointment has been

certain specified supporting documents. This procedure may be commenced by either the company or its directors, or a party (often a bank or other commercial lender) which has a floating charge that meets the requirements of paragraph 14(2) of Schedule B1 to the IA 1986 (known as a qualifying floating charge holder.

⁵⁷ Enterprise Act 2002, Sch B1 para 22.

⁵⁸ See technical manual last downloaded on 19th November at <https://www.insolvencydirect.bis.gov.uk/technicalmanual/Ch49-60/Chapter%2056/Part1/part1.htm> at paragraph 56.67.

⁵⁹ Insolvency Act 1986, Schedule B1, paragraph 14(2).

⁶⁰ Insolvency Act 1986, paragraph 26 of Schedule B1.

⁶¹ Insolvency Act 1986, paragraph 26 of Schedule B1.

⁶² Form 2.2B in accordance with Insolvency (Amendment) Rules 2010, Schedule 4.

made, notice in the prescribed form must be filed with the court.⁶³ If the court route is followed, even if a party is not a qualifying floating charge holder, it should be able to attend the court hearing and contribute an opinion as to who should be appointed as administrator.⁶⁴ During the administration, if a creditor wishes to challenge the conduct of the administration it may: (1) apply to the court for directions to be given to the administrator;(2) require the administrator to call a meeting of creditors at which resolutions may be considered if the bank, either alone or with other creditors in agreement, represents more than 10% of the amount/value of the company's total debts; (3) apply to the court on the grounds that the administrator is acting or has acted in a way that would unfairly harm the interests of the bank; or (4) apply to the court on the grounds that the administrator is not performing his functions as quickly or as efficiently as is reasonably practicable.

An administrator may be appointed in respect of most companies incorporated in England and Wales or Scotland or in another EEA state other than Denmark.⁶⁵ A sometimes controversial use of the administration procedure – which is discussed later- is the so-called pre-packaged (or “pre-pack”) administration.⁶⁶ This is an arrangement where the sale of all or part of a company's business or assets has been negotiated with a purchaser before the appointment of an administrator. The sale is then executed by the company acting through its administrator, shortly after the company is put into administration. The UK Insolvency Service continues to monitor the use of pre-packs against the risk that they are abused to the disadvantage of creditors.

⁶³ Insolvency Act 1986, Schedule B1, paragraph 46(4).

⁶⁴ Insolvency Act 1986 Schedule B1, paragraph 36. See Chapter 2, page [find] of this thesis.

⁶⁵ Insolvency Act 1986, Schedule B1, paragraphs 74 and 88.

⁶⁶ The pre-pack initially developed out of a creative approach to insolvency legislation and is now sufficiently widespread to be regarded as a regime in itself.

1.1.3: CHAPTER 11

In addition to the Examinership and Administration models, Chapter 11 of the US Bankruptcy Code is subject to much analysis throughout this thesis. Chapter 11 bankruptcy is a form of bankruptcy reorganisation available to individuals, corporations and partnerships. Debtor corporations in Chapter 11 cases are not subject to a ceiling on the amount of debt that may be owing to creditors. It is the usual choice for US corporations in financial distress, although the great majority of Chapter 11 candidates are small- and medium-sized companies⁶⁷ The management of the debtor company usually remains in possession of the company assets during the automatic stay period, under the supervision of the court.⁶⁸The automatic stay provides a period of time in which all judgments, collection activities, foreclosures, and repossessions of property are suspended and may not be pursued by the creditors on any debt or claim that arose before the filing of the bankruptcy petition.⁶⁹ The debtor-in-possession is usually seen as a fiduciary for the creditors.⁷⁰ If the debtor company management is ineffective or less than honest, a trustee may be appointed.

Within 60 days of the filing of the Chapter 11 case, a written disclosure statement must be filed with the court in accordance with 11 U.S.C. § 1125. The disclosure statement is a

⁶⁷ A Chapter 11 case begins with the filing of a petition with the bankruptcy court where the debtor has its principal place of business or assets. 11 U.S.C. § 301, 28 U.S.C. § 1408

⁶⁸Upon filing a petition for relief under Chapter 11, the debtor assumes an additional identity as the “debtor in possession.” 11 U.S.C. § 1101. The term refers to a debtor that keeps possession and control of its assets while undergoing a reorganization under Chapter 11. Generally, as “debtor in possession” the debtor operates the business and performs many of the functions that a trustee performs in cases under other chapters, including the right, with the court’s approval, to employ attorneys, accountants, appraisers, auctioneers, or other professional persons to assist the debtor during its bankruptcy case. 11 U.S.C. § 1107(a). Other responsibilities include filing tax returns and reports that are either necessary or ordered by the court after confirmation, such as a final accounting.

⁶⁹The stay automatically goes into effect when the bankruptcy petition is filed and provides a breathing spell for the debtor, during which negotiations can take place to try to resolve the difficulties in the debtor’s finances. 11 U.S.C. § 362(a).

⁷⁰ Section 1107 of the Bankruptcy Code places the debtor in possession in the position of a fiduciary, with the rights and powers of a Chapter 11 trustee, and it requires the debtor to perform all but the investigative functions and duties of a trustee. These duties, set forth in the Bankruptcy Code and Federal Rules of Bankruptcy Procedure, include accounting for property, examining and objecting to claims, and filing informational and duties of a trustee. These duties, set forth in the Bankruptcy Code and Federal Rules of Bankruptcy Procedure, include accounting for property, examining and objecting to claims, and filing informational reports as required by the court and the U.S. trustee, such as monthly operating reports. 11 U.S.C. §§ 1106, 1107; Fed. R. Bankr. P. 2015(a).

document that contains "adequate information" concerning the assets, liabilities, and business affairs of the debtor sufficient to enable a creditor to make an informed judgment about the debtor's plan of reorganization.

The debtor has an exclusive right to file a "plan of reorganization" within 120 days from the date the petition is filed.⁷¹ This time period may be extended for an additional 60 days upon an order of the court.⁷² 11 U.S.C. § 1121(d).

In order for the plan of reorganization to be confirmed, the plan must contain certain information, set forth in Section 1123 of the Code.⁷³ For example, Section 1123(a)(1) provides that a Chapter 11 plan must designate classes of claims and interests for treatment under the reorganization. Generally, a plan will classify claim holders as secured creditors, unsecured creditors entitled to priority, general unsecured creditors, and equity security holders. Creditors whose claims are "impaired" (i.e., those whose contractual rights are to be modified or who will be paid less than the full value of their claims under the plan) vote on the plan by ballot.⁷⁴

Section 1129(a)(7) of the Bankruptcy Code requires that each holder of an impaired allowed claim or interest either (1) accept the plan of reorganization⁷⁵ or (2) receive or retain under the plan property of a value, as of the effective date, that is not less than the value such holder

⁷¹ 11 U.S.C. § 1121(b).

⁷² 11 U.S.C. § 1121(d).

⁷³ Section 1123(a) of the Bankruptcy Code lists the mandatory provisions of a Chapter 11 plan,

⁷⁴ 11 U.S.C. § 1126. Creditors often form creditor committees. Creditor committees can play a major role in Chapter 11 cases. The committee is appointed by the US trustee and ordinarily consists of unsecured creditors who hold the seven largest unsecured claims against the debtor.(11 U.S.C. § 1102) Among other things, the committee consults with the debtor-in-possession on administration of the case, investigates the debtor's conduct and operation of the business and participates in formulating a plan. (11 U.S.C. § 1103) A creditors' committee may, with the court's approval, hire an attorney or other professionals to assist the performance of the committee's performance. A creditors' committee can be an important safeguard to the proper management of the business by the debtor-in-possession.

⁷⁵Under section 1126(c) of the Bankruptcy Code, an entire class of claims is deemed to accept a plan if the plan is accepted by creditors that hold at least two-thirds in amount and more than one-half in number of the allowed claims in the class. Under section 1129(a)(10), if there are impaired classes of claims, the court cannot confirm a plan unless it has been accepted by at least one class of non-insiders who hold impaired claims (i.e., claims that are not going to be paid completely or in which some legal, equitable, or contractual right is altered). Moreover, under section 1126(f), holders of unimpaired claims are deemed to have accepted the plan.

would receive or retain under the plan or reorganization if the applicable debtor were liquidated under Chapter 7 of the Bankruptcy Code on the effective date. This is referred to as the “best interests” test. After the disclosure statement is approved by the court and the ballots are collected and tallied, the court will conduct a confirmation hearing to determine whether to confirm the plan.⁷⁶

Chapter 11 cases involving small businesses are processed in a different manner to that described above.⁷⁷ This is due in part to the absence in many cases of creditor committees or the absence of creditors. As a consequence, the small business debtor is subject to additional oversight by the U.S. trustee. In addition, certain filing deadlines are different and extensions are more difficult to obtain, a case designated as a small business case normally proceeds more quickly than other Chapter 11 cases. The American Bankruptcy Institute noted that most small businesses avoid Chapter 11 proceedings, because of the excessive bureaucratic demands that are entailed by such proceedings and because the management of ailing small businesses perceive Chapter 11 as not being useful for them.⁷⁸

SECTION 1.2: RESEARCH QUESTIONS

The central aim and objective of this thesis is to investigate the evolution company rescue law in Ireland, including the Companies (Amendment) Act, 1990, as amended, together with the Companies (Miscellaneous Provisions) Act, 2013 now found in the Companies Act 2014

⁷⁶ 11 U.S.C. § 1128. A small business case is defined as a case with a "small business debtor." 11 U.S.C. § 101(51C). Determination of whether a debtor is a "small business debtor" requires application of a two-part test. First, the debtor must be engaged in commercial or business activities (other than primarily owning or operating real property) with total non-contingent liquidated secured and unsecured debts of \$2,490,925 or less. Second, the debtor's case must be one in which the U.S. trustee has not appointed a creditors' committee, or the court has determined the creditors' committee is insufficiently active and representative to provide oversight of the debtor. 11 U.S.C. § 101(51D).

⁷⁷A small business case is defined as a case with a “small business debtor.” (11 U.S.C. § 101(51C) A two-part test applies. The debtor must be engaged in commercial or business activities (other than primarily owning or operating real property) with total non-contingent liquidated secured and unsecured debts of \$2,490,925 or less. Second, the debtor's case must be one in which the U.S. trustee has not appointed a creditors' committee, or the court has determined the creditors' committee is insufficiently active and representative to provide oversight of the debtor. 11 U.S.C. § 101(51D).

⁷⁸American Bankruptcy Institute, *Commission to Study the Reform of Chapter 11* (2014) ABI Alexandria at 275.

so as to determine whether or not Irish corporate law has produced efficient company rescue mechanisms which are fit for purpose. Fitness for purpose is here understood as an assessment of the quality of company rescue law in this jurisdiction with regard to the fulfilment of stated outcomes. At a fundamental level, the following questions are being addressed: to what extent, if any, has the examinership process improved the efficiency of insolvency law in Ireland? Is that level of improvement sufficient in the circumstances? Do the examinership processes meet the requirements of the EU Commission Recommendation C (2014) on a New Approach to Business Failure?⁷⁹ Why has the Companies (Miscellaneous Provisions) Act, 2013 offered a slightly scaled-down version of the existing examinership process rather than something more simple that is geared to the needs of small companies?⁸⁰ Is examinership, as traditionally understood -and while allowing for some exceptions- suitable only for large- or some medium-sized companies? Does the revamped scheme of arrangement in the Companies Act 2014 constitute a serious rival to examinership lite or to a redesigned examinership lite mechanism? In order to address these questions, a full engagement will be made with the theoretical literature relating to efficiency and fairness. It is hoped that this discussion can contribute something to the policy debate.

In a slightly larger context, what is being investigated here is whether or not a principled justification exists for company rescue law in its present form in Ireland. Account must also be taken of the nature and form of that law in comparison to that found in other and in some ways similar jurisdictions. For instance, this kind of exercise would, of necessity, require the identification of the desirable criteria by which the principled justification could be arrived at. One such criterion would be the following: that court-based company reorganisations should only be permitted upon the establishment of a proper foundation. Such a foundation would require empirical justification before legislative intervention, at least on a best case scenario.

⁷⁹ Commission Recommendation C (2014) 1500 of 12.03.2014 on a New Approach to Business Failure.

⁸⁰ This is now found in ss 508 to 558 of Part 10 of the Companies Act 2014.

Any proposed intervention should, at a minimum, be justifiable, a priori. In the absence of such, legislative intervention could only represent a value judgment of what the legislator considered appropriate. So, for instance, if proposed legislation in insolvency law were to have the effect of weakening creditors rights, it would also have the indirect and longer-term effect of causing bank lending policies to become more stringent as well as increasing the rate of interest charged to commercial debtors. There are good reasons to think that legislators in this country are mindful of this risk. This illustration simply serves to demonstrate the unintended consequences of poorly thought out policy⁸¹

There are good reasons for undertaking such an investigation at this time. The legislation – the Companies (Amendment) Act, 1990 as amended⁸²– has been in operation for many years (as has much of the comparable legislation in the UK and the US)⁸³ and some evidential material is now available on its impact. There have been many developments internationally in company rescue law thinking and practice. Besides the continuing reforms of company rescue law in many jurisdictions, the European Union, for instance, has issued both a company restructuring recommendation⁸⁴ and an Insolvency Regulation.⁸⁵ The American Bankruptcy Institute have published their pathfinding report regarding the reform of Chapter

⁸¹ There are, in addition other criteria which could be considered together with the one already mentioned. G DelPont and L Griggs, “A Principled Justification for Business Rescue Laws: A Comparative Perspective Part 2” (1995) 4 International Insolvency Review 47 at page 79 identify these: the formal rescue system should encourage the management of the financially distressed company to act in the best interests of the parties to which the company’s responsibilities are owed; the formal rescue system should effect a redistribution of resources consistent with the policies which underline it and the commercial realities which surround it; it should ensure that like be treated alike; of necessity, it must recognise that insolvent entities should not be entitled to reorganise and it should encourage the practice of minimum court involvement and the resolution of restructuring cases within a short time frame. This substantive paper by G DelPont and L Griggs also serves to provide a framework through which reform can be generated. While the criteria mentioned here will not be employed in a mechanistic fashion throughout this thesis, they will, at all times, be acknowledged.

⁸² Now found in Part 10 of the Companies Act 2014.

⁸³ Principally, the Insolvency Act, 1986 and the Enterprise Act, 2002 respectively in the UK and the Bankruptcy reform act 1978 (of which Chapter 11 is a part).

⁸⁴ “Commission Recommendation on a New Approach to Business Failure and Insolvency” (2014) Brussels last downloaded on 17th November, 2015 at http://ec.europa.eu/justice/newsroom/civil/news/140312_en.htm

⁸⁵ EU Commission, “ Proposals for a Regulation of the European Parliament and of the Council amending Regulation (EC) No 1346/2000 on Insolvency Proceedings” last downloaded on 17th November, 2015 at COM/2012/0744 final – 2012/0360

11⁸⁶ The lessons from this as applied in the Irish context could be considered in a further study.

In addition, globalisation has brought about international agreements on conflict of laws that have relevance in the corporate rescue context.⁸⁷ At a day-to-day level also, insolvency and company rescue issues in Ireland were for some years at the centre of attention in both the commercial and legal worlds. While the Irish economy is now no longer in recession,⁸⁸ corporate restructuring questions have not declined in importance.⁸⁹ In 2013, a reduced-cost examinership process for small- and medium-sized enterprises was introduced; these cases were to be processed by the Irish Circuit Court rather than the High Court as was previously the case.⁹⁰ The Irish government has also put in place a redesigned scheme of arrangement for small companies.⁹¹

Some parts of both insolvency and company law in their current forms can sometimes serve a minority of Irish companies that are in financial difficulties rather poorly. For instance,

⁸⁶ American Bankruptcy Institute, *Commission to Study the Reform of Chapter 11* (2014) ABI Alexandria. Chapter 8 of the report -relating to small and medium sized enterprises- offers critically important insights into the reasons why Chapter 11-type bankruptcy does not work for such companies. For small companies, Chapter 11 is both too expensive and bureaucratic. Over 90% of potential Chapter 11 candidates are small businesses, but in spite of this most small businesses are now avoiding the process. The ABI Commission has proposed a separate framework for SMEs that could help change the dynamics of Chapter 11 for most debtors. A separate ABI taskforce is considering individual Chapter 11 cases. The principles applicable to SMEs would cover non-public companies with less than \$10 million in assets or liabilities. Non-public companies with more in assets or liabilities (but less than \$50 million) could request treatment as an SME debtor. As a general matter, the SME principles would allow the company, court, and stakeholders to tailor the Chapter 11 case to the particular company, rather than forcing smaller business debtors to tailor their reorganization to the existing provisions in the US Bankruptcy Code. For example, SMEs would work with the court to establish a realistic timeline for the case and could use an “estate neutral” (an expert and advisor) to help with various aspects of the case (including business planning, financial matters, or a plan of reorganization). Owners of these businesses (often families or founders) would have an opportunity to retain their ownership interests.

⁸⁷ The reference here is to the *European Union Regulation on Insolvency Proceedings* (Council Regulation No 1346/2000 of 29th May 2000, OJL 160 of 30 June 2000) and UNCITRAL *Model Law on Cross-Border Insolvencies*. The text of the Model Law can be found at www.uncitral.org.

⁸⁸ The GDP is now increasing significantly. In 2014, the figure for the Irish Republic was \$245.92 billion compared to \$232.08 billion in 2013. Data last downloaded on 11th December, 2015 at <http://www.tradingeconomics.com/ireland/gdp>

⁸⁹ See B Kirwan, “Aspects of Examinership” (2010) 17(4) *Commercial Law Practitioner* 72 in this context. It is stated in this article that by the end of 2009 there had been sixty applications for court protection in that year under the relevant legislation. This compared with a figure of sixty-two for the whole of 2008. In the year 2007, the relevant figure was thirty. See B Kirwan ‘Aspects of Examinership’ (2010) 17(4) *Commercial Law Practitioner* at 72.

⁹⁰ See Part 10 of the Companies Act 2014.

⁹¹ Companies Act, 2014, Part 9, Chapter 1, ss 449 to 454.

company directors in a potential insolvency context may have been prompted to act out of fear of personal liability and thus to have limited their company's options unduly.⁹² Emergency funding to financially troubled companies that have significant commercial potential can also be said to have proven problematical in earlier years, but this is much less the case now.

How can this doctoral thesis add value? Much of the existing literature available internationally, while of considerable extent, has usually either a focus on formal restructuring in large or very large commercial entities or a focus that is narrowly technical. In both cases it tends not to be particularly useful for the type of companies commonly found in a small open economy. In addition, there is little in the way of rigorous academic analysis of corporate rescue law in Ireland. The literature that exists is either obsolescent or practitioner focussed. It does not engage critically with alternatives models, much less does it question arrangements in a fundamental way⁹³ It completely lacks a comparative perspective. A discursive gap is evident in that the literature does not include consideration of early stage

⁹² See s297 of the Companies Act: under this section officers of a company are at risk of civil liability for fraudulent trading. The section established for the first time the criminal offense of fraudulent trading. Officers of a company are also at risk of prosecution for reckless trading under ss137 and 138 of the Companies Act, 1990.

⁹³ On the academic side, the key texts are: I Lynch-Fannon and G N Murphy, *Corporate Insolvency and Rescue* (2nd edn Butterworth, Dublin, 2012) and M Forde, H Kennedy and D Simms, *The Law of Company Insolvency* (2edn Round Hall 2008). Of these two, the first text is excellent in its own terms, but does not 'go upstream' and the second is solid, although it is conventional in its coverage of corporate rescue. There is a third text: M Forde *Reorganising Failing Businesses: the Legal Framework* (Mercier Press 1990) which is dated. The same applies to J L O'Donnell *Examinerships: The Companies (Amendment) Act, 1990* (Oak Tree Press 1994) although this last is wonderfully strong on detail and it provides many insights. It is, in addition, very much practitioner focused. A good example of a text that has current relevance is Kavanagh Fennell's, *A Practical Guide to Insolvency* (Chartered Accountants Ireland 2011). This covers examinerships and schemes of arrangement in a good and strictly practitioner-focused way. The Company Law Review Group, Report, 1994 www.clrg.org offers a trenchant analysis of the Companies (Amendment) Act, 1990. The Report of the Working Group on Company Law Compliance and Enforcement 1998 and the Company Law Review Group, First Report, 2001 at www.clrg.org places corporate rescue law in the larger context of company law reform generally. The Company Law Review Group Annual Report for 2012 considered the relevance of examinerships for SMEs. The Irish legal journals have occasionally carried articles on examinership. The most insightful of these have been D Murphy, 'Examinerships after the Companies (Amendment) (no2) Act, 1999' (The Bar Review July 2000) 482 and B Kirwan "Aspects of Examinership" 2009 16(11)CPL 252. A useful analysis on examinership today is G McCarthy and S Collins, 'Examinerships in Hard Times'. (Bar Review June 2011) 62. The Company Law Review Group's First Report of 2001 was the blueprint of the Companies Act 2014. In 2007, the Company Law Review Group *Report on General Scheme of Companies Consolidation and Reform Bill* became available. The report was accompanied by a draft of the Companies Bill. The draft contained nearly 1,300 sections.

intervention or creditor-based informal renegotiation. The literature to date has taken no account of the pay-offs involved in the success or failure of company rescue exercises vis-à-vis going concern sales.⁹⁴ In a context that has seen both the enactment of the Companies Act 2014⁹⁵ and the publication by the European of the *Recommendation on New Approach to Business Failure* Commission⁹⁶ there is much room for debate about whether or not the present legislation in Ireland is sufficient to incentivise management of financially vulnerable companies to seek assistance by way of formal rescue and rehabilitation at an earlier stage.⁹⁷ The Companies Act 2014 introduces a number of changes related to the constitutional provisions and governance of companies in the Irish Republic. Part 9 of the Companies Act 2014 reforms in a radical way the law relating to certain forms of company reorganisation. This is so particularly with regard to mergers legislation, but innovations have also been introduced in legislation relating to schemes of arrangement, acquisitions and divisions. Examinership legislation which is covered in Part 10 of the Act has not been altered in any significant way. The significance of the above for the purposes of this thesis is that it shows a commitment by the Government and the member of the Houses of the Oireachtas to meaningful change in company law legislation where this is necessary. For its part, this thesis is informed by reflection on the relevant international literature, particularly that of the United States.

⁹⁴ There is no presupposition here that the pay-off may necessarily be positive. On the contrary, some of the existing empirical work would not prompt confidence in rescue mechanisms, at least the ones that are, at present, in operation. See K Luttikhuis, 'The Effectiveness and Efficiency of Corporate Insolvency Law ' (2008) *International Insolvency Review* Vol 17 at 189-209 The data employed by Professor Luttikhuis relates to companies in the Netherlands.

⁹⁵This Act was last downloaded at <http://www.irishstatutebook.ie/pdf/2014/en.act.2014.0038.pdf> on 11th December, 2015. The Companies Act 2014 is covered much more fully in chapter 5 of this thesis.

⁹⁶ 12th March 2014, C (2014) 1500. The objective of the Recommendation is to make much more likely that all EU Member States will have a legal mechanism in place that will enable businesses to "restructure at an early stage with a view to preventing their insolvency." Recommendation (n1) Recital (1).

⁹⁷ This is considered in J A A Adriaanse, *Restructuring in the Shadow of the Law: Informal Reorganisation in the Netherlands* (Kluwer 2005).

Given the above, the contribution which this thesis makes is by way of a critical appraisal of much of the literature in the English-speaking world on corporate rescue law so as to determine whether or not company rescue initiatives of a formal nature are worth undertaking in a small open economy.⁹⁸ Learning from comparative perspectives facilitates the making of an insightful contribution to the policy debate in the Irish context. At least as importantly, the writer will seek to ascertain new approaches - should such feasible methods exist- that may help towards increasing the range of broadly acceptable outcomes in company recovery and restructuring cases. In addition, the thesis will review and appraise relevant developments in the years following the enactment of the Company (Amendment) Act, 1990 and the underlying policy choices.

SECTION 1.2: METHODOLOGY

The approach adopted will be the conventional functionalist approach.⁹⁹The formal company rescue systems chosen for comparison with what operates in this country are those found in the United States and the United Kingdom respectively. This choice has been made, because of the role that Chapter 11 had for the designers of the original examinership model, in the first instance and the substantive relevance of the law of England and Wales as an inspiration for the drafters of legislation in this jurisdiction, in the second. All writers employing

⁹⁸ There were 27 examinerships commenced in 2013 and 28 in 2010 according to the Deloitte Insolvency Department. Data last downloaded on 12th November, 2015 at <http://www.insolvencyjournal.ie/news/10-increase-in-corporate-insolvencies-in-q2-2015-deloitte>

⁹⁹ For the functional method, the *tertium comparationis* is the function of a law – that is, its social purpose. In its most prevalent form, functionalism in comparative law rests on the following three premises: (1) legal systems face similar problems; (2) for the same problem, different legal systems take different legal measures; and (3) despite differing measures, legal systems reach similar results. K Zweigert and H Koetz, *An Introduction to Comparative Law* (T Weir tr, 3rd edn, OUP 1998) Chapter 1. The functional method has three steps: (1) a statement of the problem in purely functional terms; (2) a one-by-one objective presentation of the ways which different legal systems resolve the particular problem and (3) a comparison and evaluation of the preceding analysis from a purely functionalist perspective. There is also a fourth component, identified by Michaels: functionality can sometimes serve as an evaluative criterion. Functional law from this perspective is a “better law” comparator. R Michaels, (2006) *Oxford Handbook of Comparative Law* (2006) at page 342. It is important to stress that a large part of the legal scholarship employing the functional method is much characterised by a liberty of approach and sometimes of method. A Platas, “The Functional and Disfunctional in the Comparative Method of Law: Some critical Remarks” (2008) 12.3 *Electronic Journal of Comparative Law* December 2008 last downloaded on 25th November, 2015 at <http://www.ejcl.org/123/abs123-3.html>

functionalist methodology are painfully aware of the criticisms that have been levelled at it.¹⁰⁰ A course will be charted such as to avoid both a “juxtaposition plus”¹⁰¹ paradigm and a comparative legal functionalist approach that is usually seen as much too narrow. While allowing for full consideration of the work of agencies such as courts, the writer will seek to avoid “negating or marginalizing the effects of legal forms and ideas in the realm of consciousness as ideologies and rituals”¹⁰² to employ Frankenberg’s terms. The writer is also conscious of the importance of finding a “doctrinal fit” in any given instance; that is to say, that it is not assumed that a legal response to a similar problem elsewhere could necessarily work well in an Irish context.

The Team Production Theory (TPT) Model will be used as the comparator, because it represents more adequately, in the view of this writer, the nature of Chapter 11 as originally conceived. The fundamental propositions of Team Production Theory come from the law-and-economics literature.¹⁰³ The model allows for an interpretation of the public corporation as a complex of inputs provided by a range of team members.¹⁰⁴ These include shareholders, managers, other employees, creditors and the local community. Simply stated, these parties have come together by necessity, because they believe that they can earn a better return on their labour and capital through cooperation than they would individually. There is, however, at least one major difficulty in all of this. The output produced by the team will typically be

¹⁰⁰P Zumbansen, ‘Comparative Law’s Coming of Age? Twenty Years after Critical Comparisons’ (2005) 6 German Law Journal 1074. These terms are taken by the author of the article from Frankenberg’s very penetrating critique of the comparative law method as currently employed. G Frankenberg, ‘Critical Comparisons: Re-thinking’ Comparative Law (1985) 26 Harvard International L J 411. See also R Michaels, ‘The Functionalist Method in Comparative Law’ in M Reimann and R Zimmermann (eds), ‘The Oxford Handbook of Comparative Law’ (OUP 2006). The major text on functionalism is Zweigert and Koetz, *An Introduction to Comparative Law* (T Weir tr, 3rd edn, OUP 1998).

¹⁰¹ G Frankenberg, ‘Critical Comparisons: Re-thinking’ Comparative Law (1985) 26 Harvard International L J 411.

¹⁰² G Frankenberg, ‘Critical Comparisons: Re-thinking’ Comparative Law (1985) 26 Harvard International L J 411, 438.

¹⁰³ The relevant law-and-economics literature is as follows. A Alchian and H Demsetz, “Production, Information Costs and Economic Organisation” (1972) 62 American Economic Review 777; B Holmstrom, “Moral Hazard in Teams” (1982) 13 Bell Journal of Economics 324 and R Rajan and L Zingales, “Power in the Theory of the Firm” (1998) 113 Quarterly Journal of Economics 387.

¹⁰⁴ M Blair and L Stout, “A Team Production Theory of Corporate Law” (1999)85(2) Virginia Law Review 247 at 290.

non-separable. It is therefore all but impossible to determine the value of each team member's contribution to the overall enterprise. It is a requirement that some mechanism for rent allocation can be agreed upon. The invocation of property rights may not necessarily serve to solve this difficulty, because property rights, in themselves, may be a source of problems in the enterprise. For instance, it is probable that the putative owner of assets used in the enterprise could extract a larger share of the gains from production by selling the assets rather than making his/her own specialised human capital investment in the corporation. This possibility would at all times be evident to the other team members. They would thus be reluctant to contribute to the enterprise to the extent that is necessary. Thus, any simple ownership principle can have unintended consequences.

Having arrived at this point in the argument, it is possible to hypothesise that the optimal structure for some team production enterprises would be for an independent third party to control the team's assets.¹⁰⁵ This independent third party would also have control over the corporate assets and it would monitor job performance. It would not have the authority to have ownership rights in the assets. In addition, it would allocate production revenues among the team members. TPT suggests that the board of directors can serve this function better than any other party.¹⁰⁶ Thus, by investing ownership of the rents generated by joint production in the corporation and assigning responsibility for their division to an independent board of directors subject to a legal prohibition on self-dealing,¹⁰⁷ the various team members submit themselves to an independent monitor that will police shirking and provide a disinterested agency for rent allocation. In addition, they create an environment in which each team member can invest financial or human capital-including firm-specific investments without

¹⁰⁵ The authors of Team Production Theory, M Blair and L Stout, borrow this key concept from R Rajan and L Zingales, "Power in the Theory of the Firm" (1998) 113 *Quarterly Journal of Economics* 387 at page 422.

¹⁰⁶ M Blair and L Stout, "A Team Production Theory of Corporate Law" (1999) 85(2) *Virginia Law Review* 247 at page 290.

¹⁰⁷ M Blair and L Stout, "A Team Production Theory of Corporate Law" (1999) 85(2) *Virginia Law Review* 247 at page 315.

fear of opportunistic exploitation by other team members. Charged with the responsibility to look after the interests of all team members, the corporation's independent board of directors serves as a mediating hierarch.¹⁰⁸ Team Production Theory fits well with bankruptcy law and procedure. It accounts for the Debtor-in-Possession phenomenon, the protection of the board from the holder of the residual interests, the board's central role in the negotiation of a plan, the commitment to a wider vision of corporate reorganisation and other phenomena that cannot be explained cogently or indeed at all by the Creditors' Bargain Theory.¹⁰⁹ Team Production Theory, in addition, is a falsifiable theory and thus empirically testable.

SECTION 1.3: THEMES

The themes explored in this thesis include the following:

1.3.1 TO WHOM IS EXAMINERSHIP AT PRESENT ADDRESSED AND TO WHAT EXTENT DOES IT PROMOTE EFFICIENCY IN IRISH INSOLVENCY LAW?

To express matters very simply, examinership can in itself be said to be efficient if it provides a reorganisation surplus which would not otherwise be available to creditors and others in the event of a liquidation. The difficulty here is that the overwhelming majority of Irish companies are small and do not have a reorganisation surplus¹¹⁰ Is examinership geared only to the needs of large- and medium- sized companies or is this a misperception? Other matters also need to be addressed. For instance, if it can be found that the general costs of examinership are less than those of the costs of company liquidation in a given set of cases (perhaps for larger companies) that merits further investigation. Viewing matters from a wider perspective can also prove helpful. While to a limited extent it goes against the spirit of

¹⁰⁸ M Blar and L Stout, "A Team Production Theory of Corporate Law" (1999) 85(2) Virginia Law Review 247 at page 304.

¹⁰⁹ This point is made by L LoPucki, "A Team Production Theory of Bankruptcy Reorganisation" (2004) 57(3) Vanderbilt Law Review 742 at 779.

¹¹⁰ This reintroduces the salient argument of Baird and Rasmussen regarding company assets and going concern surpluses. The critical rule is this: if the company's assets can be employed equally well elsewhere, it is not meaningful to talk of its going concern surplus. D G Baird and R K Rasmussen, 'The End of Bankruptcy' (2002) 55 Stanford Law Review 751.

those who designed the corporate rescue legislation in Ireland, it is still necessary to see insolvency law very largely if not quite exclusively from an economic perspective. An insolvency system can be said to be efficient if *ex ante* it promotes rational risk-taking by both large creditors and debtors in the commercial world.¹¹¹ For instance, insolvency law impacts on the preparedness of entrepreneurs to take risk and the contractual terms upon which loans can be arranged.

Ex post, following this way of thinking, an insolvency law system is efficient if it successfully screens out the great majority of candidates for corporate rescue who are likely to remain both economically inefficient and financially distressed. Besides this, questions relating to the potential abuse of process must also be considered. For instance, some examinership candidates could seek to enter the process for the purpose of gaining an unfair competitive advantage over their market rivals. In addition, a company subject to formal rescue may inadvertently put at risk the competitive fortunes of a well-run supplier company connected with it. There are additional perspectives on these matters, but one popular line of approach is to determine the efficiency of an insolvency regime by the extent to which it complements the corporate governance of the given company.¹¹² To those who support this approach, the debt structure of a company has major implications for its corporate governance. They contend that from a debt structure perspective the best solution is to match the insolvency arrangements applicable to the company's debt structure.¹¹³ From this

¹¹¹ R Blazy and B Chopard, 'Bankruptcy Law: a Mechanism for Governance of Financially Distressed Firms' (2008) 25 *European Journal of Law and Economics* 253, 267.

¹¹² S Franken, 'Creditor- and Debtor- Oriented Corporate Bankruptcy Regimes Revisited' (2004) 5 *European Business Organisation Law Review* 645.

¹¹³ S Franken, 'Creditor- and Debtor- Oriented Corporate Bankruptcy Regimes Revisited' (2004) 5 *European Business Organisation Law Review* 648. Franken writes as follows:

It is suggested that the capital structure of the small and medium-sized business assigns *ex ante* a contingent residual right of control to the concentrated secured bank lender. As a consequence, the role of bankruptcy law is to confirm the residual right of control of the relational bank lender....amending creditor-oriented regimes with measures designed to enhance the reorganization possibilities for SMEs may not be warranted....(This paper) concludes by arguing that creditor- and debtor-oriented regimes essentially offer optimal bankruptcy regimes for different types of firms.

perspective, there is no right or wrong answer with regard to whether or not a particular insolvency regime is seen mostly to favour creditors or debtors. Another very different perspective much employed in this thesis is to view matters from a Team Production Theory perspective, which was described earlier.¹¹⁴ Overall, it may prove difficult to establish a global cross-reference in these matters.¹¹⁵

1.3.2 IDENTIFICATION OF A METHODOLOGY FOR ASSESSING RESCUE QUALITY IN FORMAL CORPORATE RESCUE IN IRELAND

One observation that can be made about the examinership process or any similar mechanism as found in the Companies Act 2014 is its usefulness for at least a minority of financially distressed companies. Very often, but not invariably, these companies have a turnover of €8.8 million or more.¹¹⁶ In court, candidates can be found to have the forensically proven capacity to return to commercial health or not, as the case may be. The yardsticks are taken from everyday business practice; to an extent, they are also based on theoretical considerations. It is nevertheless the case that these matters remain contentious. It may prove useful to employ the methodologies used by Finch so as to identify suitable quality measures for formal

¹¹⁴ M M Blair and L A Stout, “A Team Production Theory of Corporate Law” (1999) 85 Virginia L Rev Team 247. Production Theory, as already noted, is a descriptive and normative theory of the corporation. It is non-conventional in that it is in opposition to the prevailing view that corporations serve the shareholders and that directors are shareholders agents. Blair and Stout contend that corporations consist of bargains made between various parties directly connected with the corporation. The theory has much application to insolvency law and to what follows in this thesis.

¹¹⁵ W W Bratten and J A McCahery, ‘Theory of the Firm: the Case against Global Cross-Reference’ (1999) 38 The Columbia Journal Transnational Law 213.

¹¹⁶ The €8.8 million figure is the line which divides small- and medium sized-companies on the one side from large ones on the other for the purposes of company law in this jurisdiction. This was under what was formerly section 2(1)(b) of the Companies (Miscellaneous Provisions) Act 2013 and is now covered in Part 10 of the Companies Act 2014. The Companies (Miscellaneous Provisions) Act 2013 was specifically geared to rescuing SME companies and was otherwise known as ‘examinership-lite.’ Examinership candidates which are ‘small companies’ for the purposes of sections 350 of the Companies Act 2014 can go before the Circuit Court. Small companies are defined in the Companies Act 2014 as being those to which two or more of the following three conditions apply for a given year and the preceding financial one. The conditions are these:

- the turnover for that year does not exceed €8.8 million
- the balance sheet total for that year does not exceed €4.4 million and
- the average number of employees in the company in that year does not exceed 50

Candidates for examinership with a turnover above €8.8 million are regarded as large by Irish standards. For the latest published overview of the relevant company size statistics and related matters see ‘Business Statistics in Ireland in 2012’ (CSO 2014).

corporate rescue initiatives.¹¹⁷ The key to this will be the “capacity to resolve” criterion – that is, its capacity to facilitate company rescue- and its applicability or otherwise to an economy composed mostly of small companies.

1.3.2 THE MERITS OR OTHERWISE OF INCREASING THE RANGE OF LEGAL MECHANISMS DESIGNED TO PROMOTE COMPANY RESCUE IN IRELAND: AN INVESTIGATION

The legal options available to management in Irish companies contemplating a company rescue scenario through a court process are now less limited than in the past. They are streamlined schemes of arrangement (under Part 9 of the Companies Act 2014) and examinerships.¹¹⁸ A scheme of arrangement (as redesigned) and as already noted enables the directors or the liquidator of a company to reach a binding agreement with its creditors about payments.¹¹⁹ It also offers a moratorium to the debtor company so as to prevent creditors taking action against the company or its property.¹²⁰ The examinership process, for its part, involves shielding financially ailing companies from creditors and endeavouring to restore them to good health. The agent of this processes is the court-appointed examiner. In the UK, by contrast, the choices are broader. There, they have had in addition to statutory administration, company voluntary arrangements and “pre-pack”¹²¹ administrative processes. A company voluntary arrangement in the UK is a new agreement negotiated between the

¹¹⁷ Finch V, ‘Corporate Rescue Processes: the Search for Quality and the Capacity to Resolve’ (2010) 6 Journal of Business Law 502. Finch identifies four types of performance measures . They relate to inputs, processes, outputs and outcomes. Inputs measures relate to resource inputs. Process-based measures estimate the adherence to procedural requirements, laws, policies and related matters. Outputs-based assessments are concerned with rescue statistics. Outcome-based measures concern the efficacy of the rescue system: its capacity to attain the objectives stated both in terms of saving distressed companies and in the returns to creditors.

¹¹⁸ Under the law prior to the Companies Act 2014, the terms of schemes of arrangement were set down in section 260, Companies Act 1963. The Companies (Amendment) Act 1990 as amended related to examinerships.

¹¹⁹ See L McCann and T B Courtney *Companies Acts 1963-2009* (Bloomsbury Professional 2010) 520. See also Michael Forde *Re-Organizing Sale in Business - the legal framework* (Mercier Press 1991).

¹²⁰ Companies Act 2014, Part 9, Chapter 1, ss 449 to 454.

¹²¹ The term “pre-pack” (which is not a term of art, as it has no legislative recognition) can have different meanings in different jurisdictions, but its essence is that before an insolvency process occurs, whether that be receivership, liquidation or examinership, the buyer/investor has been identified and the commercial and legal terms negotiated to a conclusion, thereby enabling the deal to be completed immediately or closely following the appointment of the insolvency office holder. This enables the financially distressed debtor company to continue trading without interruption.

debtor company and its creditors to pay some or all of its debts where the company is in financial distress. The relevant legislation is in Part 1 of the Insolvency Act 1986. A pre-pack is an insolvency procedure where a company restructuring plan is agreed in advance. A pre-pack sale occurs where some or all of a company's assets are arranged to be sold prior to the appointment of a company administrator. The sale is then completed when the administrator is appointed. The pre-pack mechanism in its present form is set out in The Enterprise Act 2002, Schedule B 1. It has been said that "Pre-packs offer an effective mechanism by which influential parties can bypass carefully elaborated statutory protections."¹²² They are often viewed as "a form of anticipatory action."¹²³ The range and complexity of businesses phenomena to which UK company rescue law has application is somewhat wider than that usually found in Ireland. It remains the case, however that even with a sophisticated system such as that found in the UK, the different routes towards rescue are not necessarily harmonious, one with the other.

It is worth remembering also that at the various stages of a company's decline, the aspirations and objectives of the interested parties involved accordingly vary. When a company first encounters difficulties, it is most common for the directors to concentrate on how the company can be rescued. On the other hand, when the company is likely to become insolvent, the emphasis is totally different: here, the parties are often concerned with how the remaining assets can be distributed to creditors most efficiently. More often than not in Ireland, formal company rescue is equated with examinership and the early stage intervention options are underemphasised. This thesis will, therefore, in part allow for consideration of early-stage and informal company rescue or business asset sale models which will throw light upon the range of rescue and business purchase mechanisms available here. This will be framed within

¹²² See further S Harris, 'The Decision in Pre-Pack 2004 *Recovery* Winter at 26

¹²³ V Finch, 'Pre-Packaged Administrations: Bargains in the Shadow of Insolvency or Shadowy Bargains' (2006) JBL 568.

a larger context allowing for questions such as the following: do market generated solutions lessen the need for formal court-based rescue processes?

1.3.4 THE DEGREE TO WHICH CORPORATE RESCUE LEGISLATION SHOULD CATER FOR SMALL COMPANIES: AN INVESTIGATION

The question to be addressed here is why formal corporate rescue activity has proven to be such a minority option for small companies in this country who are in financial distress. Both Britain and the US have formal mechanisms specifically dedicated to rescuing small companies: the company voluntary arrangement (cva) with a moratorium and Bankruptcy Abuse and Consumer Protection Act (BAPCPA) respectively.¹²⁴ Neither has worked well. Given such results, it is sometimes argued that a going concern sale approach is a more practical option in such cases.¹²⁵ This needs to be reconsidered in the Irish context.

The above section has set out the research questions that will be examined in this thesis and the manner in which the investigation will be undertaken. The remainder of the chapter is as follows. Section 1.2 will offer a theoretical discussion of the objectives of corporate rescue, Section 1.3 will go upstream and offer a brief and selective history of corporate rescue law and Section 1.4 will present a literature review. This will be followed by some comments in conclusion.

SECTION 1.2: THE OBJECTIVES OF COMPANY RESCUE LEGISLATION

The term “corporate rescue” has a plurality of meanings. It includes methods such as corporate reorganisation or corporate reconstruction, creditor composition, the informal

¹²⁴ Insolvency Act 2000 ss 1-4 and Bankruptcy Abuse Prevention Consumer Protection Act 2005 11 U.S.C. § 707(b). The BAPCPA legislation has proven itself to be singularly burdensome for small companies in the United States seeking to enter Chapter 11. For instance, there is restricted availability of the automatic stay for small businesses entering Chapter 11. 11 U.S.C §441 Such companies are also obliged to provide enhanced post-filing financial reports. 11 U.S.C. §434 (a) This is covered in J Haines and P Hendel, ‘No Easy Answers: Small Business Bankruptcies after BAPCPA’ (2005) 47 Boston College L R 71

¹²⁵ G McCormack, ‘Rescuing Small Businesses: Designing an “Efficient” Legal Regime’ (2009) Journal of Business Law 299.

“London approach”¹²⁶ and the conventional takeover method.¹²⁷ At best, it may imply a plan to return a corporate entity to financial health and in a context where its existing management will retain their positions.¹²⁸ Certainly it can be said that the ostensible purpose of much of the relevant legislation to be considered here is to promote such a rescue, although that purpose may in practice be of lesser importance than the provision of substantive recompense to secured creditors.¹²⁹ It is therefore necessary to focus on the details of the legislation, rather than to assume that it offers more to debtor companies than it really does. The cardinal point is that the probability of a company being the subject of a straightforward restructuring is low. What is much more likely is that in the given instance considerable energies will be expended on preserving much or at least some of the former business entity in so far as that option optimises business value.

These exercises in preservation can take a variety of forms. In each case there will be losses suffered by the creditors, shareholders, management and other employees and the processes both in their particulars and in more substantive ways will be specific to each jurisdiction. The type of rescue approach employed will, moreover, depend on the corporate entity’s finances and the distance it has travelled on the road towards corporate dissolution. The rescue mechanisms may be formal or informal in nature, the latter being employed more

¹²⁶The “London Approach” relates to informal restructuring of large UK companies in financial distress. These restructuring initiatives were engaged in by large banks led by and facilitated by the Bank of England. The phenomenon occurred most often in the 1970s. The initiatives were first undertaken with regard to some UK banks which did not meet standard liquidity criteria, but were then applied more widely. J Flood and others, ‘The Professional Restructuring of Corporate Rescue: Company Voluntary Arrangements and the London Approach’ (ACCA 1995) last accessed 24th June, 2015 at <http://www.johnflood.com/search.php?q=London%20Approach>

¹²⁷ For an overview see E A Stallworthy and O P Kharbanda, *Takeovers, Acquisitions and Mergers, Strategies for Rescuing Companies in Distress* (Kogan Page 1987) and H Rajak, *Insolvency Law: Theory and Practice* (Sweet and Maxwell 1993) 236.

¹²⁸ Elizabeth Warren, ‘Bankruptcy Policymaking in an Imperfect World’ (1993) 92 Mich. L. Rev 1 336.

¹²⁹ See R.K Rasmussen, ‘An Essay on Optimal Bankruptcy Rules and Social Justice’ (1994) U Illinois Law Review 1. It will be recalled that following the financial collapse of Enron, Professor Baird and Professor Rasmussen announced that the Chapter 11 reorganisation mechanism, that is, 11 U.S.C. §§ 1101- 1174, was dead in real terms. See Douglas G. Baird & Robert K. Rasmussen, ‘The End of Bankruptcy’ (2002) 55 Stan. L. Rev 751.

frequently and in instances where the corporation's finances have not yet collapsed. Where a more formal approach is adopted – for instance, administration in the UK- it is likely to be used in combination with a streamlined company rescue mechanism such as a cva (company voluntary arrangement).¹³⁰ Another important question that should not be neglected when considering a rescue exercise is that relating to the type of distress that the corporation is suffering. There is often very little point, for instance, in attempting to rescue a business entity in a declining industry or one that has a fundamentally flawed business strategy. In cases where the entity is experiencing financial distress and is in need of rescue, there may on occasion be grounds for rescue initiatives.

While it can be said that corporate rescue legislation today has a recognised place within the insolvency law context, it is important not to exaggerate that level of recognition. For instance, in the UK, while the 1982 Cork Committee Report seemed to presage a new era in insolvency and company rescue thinking, this was not necessarily the case in practice.¹³¹

Rescue exercises of small companies in the UK have often been undertaken by means of

¹³⁰ In a more detailed fashion, it can be said that a company voluntary arrangement is a legally binding agreement between the debtor company and its creditors in settlement of debts outstanding. It can take the form of restructuring, delayed or reduced payment of debts or an orderly disposal of assets. Any agreement reached at the negotiation stage is put before a creditors' meeting for approval. The relevant legislation in the UK is in Part 1 of the Insolvency Act 1986 and Part 1 of the Insolvency Rules 1986, as amended by the Insolvency Act 2000 and the Insolvency (Amendment) (No2) Rules 2002. The Insolvency Act 2000 amended the Insolvency Act 1986 so as to enable a small companies to obtain an initial moratorium in the context of a company voluntary arrangement.

¹³¹ *Report of the Insolvency Law Review Committee* 1981, Cmnd. 1982. Cork offered the first detailed elaboration of corporate rescue legislation and advocated such legislation in a measured way. For instance, paragraph 204 of the Report included the following:

“204. We believe that a concern for the livelihood and well-being of those dependent upon an enterprise, which may well be the lifeblood of a whole town or even a region, is a legitimate factor to which a modern law of insolvency must have regard. The chain reaction consequent upon any given failure can potentially be so disastrous to creditors, employees and the community, that it must not be overlooked.”

For a useful examination of what company rescue legislation entails in a UK context see M Hunter, 'The Nature and Functions of a Rescue Culture' (1999) 491. A radically different interpretation of the company rescue regime in the UK to that of Muir Hunter is put forward by G McCormack in 'Apples and Oranges? Corporate Rescue and Functional Convergence in the US and the UK' (2009) 18 Int Insolv Rev 109. McCormack takes the view that the creditor interest has maintained its predominance in company rescue matters and that administration and company voluntary arrangements are best seen as 'efficient liquidation tools rather than rehabilitation regimes.' Regarding the poor performance of formal rescue mechanisms in the UK, this will be discussed throughout chapters 2 to 5.

company voluntary arrangements. (cvas) with a moratorium.¹³² CVAs together with the BAPCPA mechanism for small companies in the United States have not worked well to date and are unlikely to work well in the future.¹³³ The pragmatic approach adopted by the drafters of the Enterprise Act, 2002 (as well as the Insolvency Act 2000) in the UK context is evident in the comments by significant politicians as well as academic and business commentators.¹³⁴ On the one hand, the goal of the 2002 legislation was stated to be the preservation of companies in financial distress as going concerns; on the other, the overarching purpose was to rescue companies in such cases where the rescue exercise did not impair creditor value.¹³⁵ Ultimately, matters were to be left to the business judgment of the administrator who had been appointed: in most such instances, the creditors' concerns would prove to be paramount in the thinking of the administrator.¹³⁶ In the United States, things had also changed in a different but no less fundamental way: the more important objective in Chapter 11 cases now

The title "small company" is understood to be within the terms of section 247 of the Companies Act, now section 382 of the Companies Act 2006. A moratorium temporarily blocks certain legal acts and processes being performed or continued. There were 93 cvas in the first quarter of 2015. This is a 34.5% decrease on the figure for the first quarter of 2014. This data was downloaded from https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/424345/Q1_2015_statistics_release_-_web.pdf on June 25th, 2015. There is no commentary available on the company size of cva candidates. A Walters and S Frisby, *Preliminary Report to the UK Insolvency Service into Outcomes in Company Voluntary Arrangements* (2011) last downloaded at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1792402 on June 25th, 2015 found that 73% of the cvas -in the database sample investigated- which were successfully concluded were in the "small" category. The data relates to the year 2006. Walters and Frisby note that there appears to be a strong bias towards the use of cvas by small companies.

¹³³This argument is developed throughout the thesis. The same applies with regard to the BAPCPA legislation for small companies in the United States. McCormack G, 'Rescuing Small Businesses: Designing an "Efficient" Legal Regime' (2009) *Journal of Business Law* 299.

¹³⁴ Lord Hunt of Wirral HL Debates 29th July, 2002; J Willcock, 'How the Banks won the Battle for the Enterprise Bill' (2002) *Recovery* 24 and L Linklater, 'New Style Administration: a Substitute for Liquidation?' in H Picarda (ed), *The Law relating to Receivers, Managers and Administrators* (4th edn Bloomsbury Professional 2005). For a radically critical approach to some of the thinking behind the Enterprise Act and corporate rescue generally see T Papworth, 'The Trading Dead: the Zombie Firms plaguing Britain's Economy and what to do about them' (2013) *Adam Smith Research Trust*.

¹³⁵ The writer of two leading researcher papers in this area tend to this view: S Frisby, 'In Search of a Rescue Regime: The Enterprise Act 2002' (2002) 67 *MLR* 262 and V Finch, 'Control and Coordination in Corporate Rescue' (2005) *Legal Studies* 395. See also the comments made by Lord Hunt of Wirral in the Lords' debates. See HL debates, col766, 29th July, 2002.

¹³⁶ This phenomenon is analysed by L Linklater. 'The Enterprise Act: Fulfilling Great Expectations' (2003) 24 *Company Lawyer* 225. It is worth recalling also that statistically the cva mechanism, with its large element of informality, has been more frequently employed in the UK since the passing of the Insolvency Act, 1986. The general pattern does not, however, necessarily take away from the Linklater argument.

became that of maximising creditor interests.¹³⁷The BAPCPA amendments to Chapter 11 which have relevance to small companies in the US have also proven to be singularly burdensome and unhelpful for those companies.¹³⁸Traditional examinership in this country can work well for a minority companies that are usually large and that on the balance of probabilities can be returned to robust good health. Examinership lite has not worked well to date because it is not being taken up by small companies in financial distress.¹³⁹

More generally it can be said that the theory and practice of corporate rescue has been treated in a dismissive way by some very influential legal scholars.¹⁴⁰ A recent criticism relates to the appropriateness of a rescue mechanism for corporates that are in themselves, fundamentally, intellectual capital entities.¹⁴¹ The question is asked, what possible role could rescue offer in a service economy and globalised marketplace to an entity whose personnel could leave, as it were, overnight?¹⁴² According to this line of criticism, company rescue laws are simply

¹³⁷ D A Skeel, 'Creditors' Ball: The 'New' New Corporate Governance in Chapter 11' (2003) 152 U Pa L Rev 918.

¹³⁸ The BAPCPA amendments became operative as of April 20th, 2005. BAPCPA is discussed at length throughout chapters 2 to 6.

¹³⁹ It has been suggested that not enough has been done to streamline the process. S McNamara, "Examinership Lite" in "Focus Newsletter" (2014) Smith & Williamson, Dublin at 8.

¹⁴⁰ This critical literature – that is, scholarly literature critical of corporate rescue law- often coming from the law and economics school, is a vast one. Its advocates emphasises property rights, economic rigour and the reasonableness of the "creditors" bargain" model: the last mentioned indicating that the creditors alone have a valid right to the proceeds of the entity about to be dissolved. The following are representative of this critical approach: T H Jackson, *The Logic and Limits of Bankruptcy Law* (Harvard University Press, 1986). T H Jackson, Bankruptcy, Non-Bankruptcy Entitlements and the Creditors Bargain (1982) 91 Yale L J, 857, 866-867; T T Jackson and R E Scott, 'On the Nature of Bankruptcy and the Creditors' Bargain' (1989) 75(2) Virginia Law Review 155, 158. For a contrary view, see E Warren, 'Bankruptcy Policymaking in an Imperfect World' (1987) 92 Michigan Law Review 344.

¹⁴¹ H Millar, 'Is Chapter 11 Bankrupt?' (2005) 47 Boston College L R 129.

¹⁴² Employee ownership of the company can address the problem of longer-term loyalty on the employees' part in such sectors as professional services companies. Department for Business, Education and Skills, 'The Employee Ownership Advantage' (2012) last downloaded at https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/31668/12-929-employee-ownership-advantage-benefits-and-consequences.pdf on June 30th, 2015. The difficulty for employers in knowledge-based markets is that these markets exhibit different amounts of interfirm information and different degrees of labour mobility. The labour mobility of these knowledge workers is protected by law. Research conducted by one company may, moreover, have a higher value for another company. Measurement difficulties will also cause the contracts for the delivery for R&D to be incomplete. T R Lewis and D Yao, 'Innovation, Knowledge Flow and Worker Mobility' (2006) Working paper last downloaded at <http://www.people.hbs.edu/dyao/lewisyaomobility.pdf> on June 30th, 2015. Lewis and Yao offer the following observation:

These features of the economic environment preclude a contracting resolution of the conflict between employees who seek job mobility and firms wishing to protect their investment in R&D. Firms

passé.¹⁴³ One possible reply to this criticism is that when transactional costs are considered, matters can look very different to the picture presented by the critics. It is simply not the case that corporate entities can be demolished or built up without much care or effort. This is especially so when the network of relations with other business entities is considered; these relations will have been built up painstakingly over many years and are not easily replaced. Besides, it is not the case that manufacturing entities have all but disappeared in mature economies: very often it has been the new technology companies which have collapsed rapidly and in large numbers.¹⁴⁴

Corporate rescue law has for some years been subject to an intensive process of review and re-examination by both legislators and academics in several European countries as well as in the United States. It is, moreover, the subject of major studies by global bodies because of its international ramifications. In individual countries it is being recast. In both the UK and Germany, to take two examples, interested parties are being encouraged to think proactively regarding both formal and informal rescue in cases where corporate distress may in the given instance become a discernible and practical possibility.¹⁴⁵ These broad initiatives have very significant implications for company law generally in these countries and particularly for that relating to corporate governance. The emphasis today is upon the professional management

moderate undesired worker separations by decreasing the “openness” of the research arrangement through restrictions on the employee’s access to outside information and enforcement of legal sanctions for unauthorised use of IP. The openness of the research arrangement that the firm commits to determines its ability to attract qualified researchers and this, in turn, is determined by the parties’ relative ex ante bargaining power

¹⁴³ D G Baird and R K Rasmussen, ‘Chapter 11 at Twilight’ (2003) 56 *Stanford Law Review* 673.

¹⁴⁴ It remains the case that some companies are worth more when kept in being with the existing management team at the helm than when their assets are sold as scrap or where a new management team is put in place. This may be due to their managements’ hard-won knowledge or because of existing investment in fixed costs. See D Baird and R Picker, “A Simple Non-cooperative Bargain Model of Corporate Reorganizations” (1991) 20 *J Legal Studies* 315.

¹⁴⁵ See V Finch, “The Recasting of Insolvency Law” (2005) 68 *The Modern Law Review* 51 for an analysis of the UK experience to date and S Sax, ‘Consultation Paper on German Insolvency Law Reform – the Key Points “Corporate Rescue and Insolvency,” December 2010.

of risk and on early intervention in cases of difficulty¹⁴⁶This manner of rethinking the fundamentals will have a substantial impact on current and future practice.

The informal approach to corporate rescue also needs to be considered.¹⁴⁷ It would appear that this kind of private arrangement between a company and its major bankers is suitable only for large corporate entities. The indicia related to “turnarounds” (that is companies in need of restructuring where that restructuring is undertaken with the consent of major creditors) suggest the companies are invariably large ones. The creditor banks involved in such negotiations have major stakes in the turnaround candidate. Some commentators suggest as much. A standard turnaround candidate has been defined as “a company or business entity faced with a period of crisis sufficiently serious to require a radical improvement in order to remain a significant participant in its major industry.”¹⁴⁸ In an era of very complex loan arrangements available to corporations in a globalised marketplace, the “London approach” – that is, an informal rescue model having its origins in the City of London- is important but relatively uncommon.¹⁴⁹ A weakness of this kind of arrangement is that it is vulnerable to rejection by one or other creditor; this, in turn, can bring about the corporation’s dissolution. Nevertheless, the informal rescue arrangements for medium-sized companies may have much to offer. The Dutch system in this regard has proven successful and has some application in the Irish context.¹⁵⁰

¹⁴⁶ This subject has been taken up by Vanessa Finch. See V Finch, ‘The Recasting of Insolvency Law’ (2005) 68(5) *The Modern Law Review* Wiley, London at 713. The author takes the view that these new approaches indicate a pattern of increased audit and performance appraisal by government and other actors, These questions range from the usefulness of institutionalising a code of conduct for informal reorganisations to the role of mediation in such matters.

¹⁴⁷ For a good example of this see J A A Adriaanse, *Restructuring in the Shadow of the Law: Informal Reorganisations in the Netherlands* (Kluwer 2005). See also J Armour, ‘The Law and Economics of Corporate Insolvency: A Review’ WP197 (2001) ESRC Centre for Business Research, University Of Cambridge,

¹⁴⁸ F M Zimmerman, *The Turnaround Experience: Real World Lessons in Revitalising Corporations* (McGraw Hill, 1991) 5.

¹⁴⁹ G Meyerman, “The London Approach and Corporate Restructuring” (2000) The World Bank last downloaded on 12th December, 2015 at http://www1.worldbank.org/finance/assets/images/DL_2_3.pdf

¹⁵⁰ The Dutch scholar J A A Adriaanse. *Restructuring in the Shadow of the Law: Informal Reorganisations in the Netherlands* (Kluwer 2005) has written an insightful book on informal reorganisation.

SECTION 1.3: HISTORY OF CORPORATE RESCUE LEGISLATION

A reading of the history of corporate rescue law in both the United States and the UK in recent decades yields a number of unexpected insights. It will be remembered that these two countries provided the inspiration for the reform initiatives in Ireland which are being investigated in this thesis. A quick review of the corporate rescue legislative context in the two countries and the related practice yields results which are somewhat unexpected in so far as they suggest a context in each country which is much less rescue-friendly than might initially seem the case. For instance, in the UK, the Insolvency Act of 1986 and even more so the Enterprise Act, 2002 has the wealth maximisation of creditors as its top priority.¹⁵¹ This goes against the ostensible purpose of the legislation or at least the purpose discernible to a casual reader of both Acts.¹⁵² In the United States, while it remains the case that corporate rescue is still a significant objective of the Chapter 11 legislation, that objective is now subordinated to the interests of creditors who provide emergency financial assistance to the ailing corporation.¹⁵³ Mechanisms are now in place – such as contingencies related to the funding of financially distressed corporations- that are likely to produce results which favour big creditor interests.¹⁵⁴ It is possible to talk about a convergence of thinking by legislators in both the United States and the UK about corporate governance matters. Whatever their differences in details, in both countries a creditor wealth maximization model prevails and the business culture is characterised by short-term thinking and is market driven in a narrow

¹⁵¹ See 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” and the comments by the relevant Minister, Lord McIntosh of Haringey, in HLDebates col 766, 29 July 2002.: “We would not want the administrator to rescue the company if it is to the detriment of creditor value”.

¹⁵² See G McCormack, ‘ Apples and Oranges? Corporate Rescue and Functional Convergence in the US and the UK’ (2009) 8 Int Insolv Rev 109 for a thorough analysis of these matters.

¹⁵³ See ‘Section D, “The Position of Secured Creditors in Restructuring” in G McCormack, “ Apples and Oranges? Corporate Rescue and Functional Convergence in the US and the UK” (2009) 18 Int Insolv Rev.

¹⁵⁴ See G McCormack, ‘ Apples and Oranges? Corporate Rescue and Functional Convergence in the US and the UK’ (2009) 18 Int Insolv Rev 109.

way.¹⁵⁵ There is not, however, a convergence of the corporate bankruptcy systems in the two countries, although creditor wealth maximization is central also in the corporate bankruptcy systems.¹⁵⁶ They remain substantially different, so far as principle is concerned and also in detail.¹⁵⁷

1.3.1: THE UK EXPERIENCE

The UK case will be considered first, as it more profoundly influenced thinking in Ireland about corporate rescue law. That law is an outgrowth of insolvency law that was for most of its history significantly penal in nature.¹⁵⁸ There were some details in the insolvency legislation in the earlier part of the twentieth century which allowed for recourse to procedures which served to mitigate this harshness.¹⁵⁹ They were, however, employed uncommonly and were in themselves relatively modest in nature.¹⁶⁰ One of the most

¹⁵⁵This degree of convergence between the US and UK corporate governance structures should not, however, be exaggerated. For instance, there are differences in corporate ownership structures; that is, in the level to which ownership is concentrated or dispersed. What prevails in the Anglo-American corporate governance contexts contrasts markedly to that which prevails in most continental Europe and Asian countries. Countries differ with regard to corporate law, financing techniques and capital market structures. L A Bebchuk and M Rowe, 'A Theory of Path Dependence in Corporate Ownership and Governance' (1999) *Stanford Law Review* 35.

¹⁵⁶ See Jeffrey Gordon and Mark Roe (eds), *Convergence and Persistence in Corporate Governance* Cambridge, CUP, 2004 and C Pochet, 'Institutional Complementarities within Corporate Governance Systems: A Comparative Study of Bankruptcy Rules' (2002) 6 *Journal of Management and Governance* 343; J Franks and W Torous, 'A Comparison of English and American Bankruptcy Procedures' in Joseph McCahery and others eds, *Corporate Governance Regimes: Convergence and Diversity* (Oxford University Press 2002). Although it is possible to think of a functional convergence in recent times between the corporate rescue legal mechanisms in the two countries, it is probably better to identify their differences and to accept that their designers started out from considerably different presuppositions.

¹⁵⁷ They are different in so far as corporate rescue is emphasised in the US context whereas business rescue is emphasised in the UK context. G McCormack, 'Apples and Oranges? Corporate Rescue and Functional Convergence in the US and the UK' (2009) 18 *Int Insolv Rev* 110. G McCormack in the same paper does, however, challenge the contention that the two systems remain substantially different and are likely to remain so. While acknowledging the differences McCormack considers that they are moving towards convergence.

¹⁵⁸ For an examination of the history of bankruptcy legislation in the UK, see M Hunter, 'The Nature and Functions of a Rescue Culture' (1999) *Journal of Business Law* 491.

¹⁵⁹ Hunter notes that that section 26(4) of the Bankruptcy Act 1914 provided discharge provisions. These could be availed of in cases where the bankrupt could prove that his bankruptcy was not due to misconduct on his part. Under section 26(4) the bankrupt would apply for "a certificate of misfortune." Such certificates were very seldom granted. Only six were granted between 1914 and 1986. see M Hunter, 'The Nature and Functions of a Rescue Culture' (1999) *Journal of Business Law* 491.

¹⁶⁰ The English courts had, on certain occasions, employed insolvency law to attain the purpose of company or more correctly business entity rescue. That is to say that the judges sometimes employed a provision that is now contained in section 425 of the UK Companies Act 1985.¹⁶⁰ Section 425 could be availed of, whether or not a company was insolvent. It made it possible under a scheme of arrangement for shareholders or creditors to reorganise and restructure the company or to pare down the amount owing to creditors so as to make it possible

important developments for the purposes of this thesis was the establishment of the Insolvency Law Review Committee – chaired by Sir Kenneth Cork- in early 1977.¹⁶¹ The Cork Committee had the following terms of reference:

- (i) to review the law and practice relating to insolvency, bankruptcy, liquidation and receiverships in England and Wales, and to consider what reforms are necessary or desirable;
- (ii) to examine the possibility of formulating a comprehensive insolvency system, and the extent to which any existing systems might, with advantage, be harmonised and integrated;
- (iii) to suggest possible less formal procedures as alternatives to bankruptcy and company winding-up proceedings in appropriate circumstances; and
- (iv) to make recommendations.

Chapter 4 of the Cork Report introduced a new perspective on insolvency law objectives. These were:

“(i) to recognise that the effects of insolvency are not limited to the private interest of the insolvent and his creditors, but that other interests of society or other groups in society are vitally affected by the insolvency and its outcome, and to ensure that these public interests are recognised and safeguarded.

- (j) to provide means for the preservation of viable commercial enterprises capable of making a useful contribution to the economic life of the country.”¹⁶²

In addition, the Cork Committee gave expression to and provided some support for the fundamental premises of corporate rescue law:

“203. The business or commercial insolvent presents an entirely different picture [from the private or consumer insolvent]. The failure of such an insolvent has wide repercussions, not only upon those intimately connected with the conduct of the business, such as directors, shareholders and employees, but on other interests, such as suppliers, etc. The effect of the failure upon the realisable value of stock, plant and goodwill can be disastrous, and not infrequently there is a general feeling of

for the business entity to continue operating. The mechanism was, however, very vulnerable to adverse responses by creditors where the scheme had not already been confirmed by the court. assets.

¹⁶¹ *Report of the Review Committee on Insolvency Law and Practice* (1982) Cmnd 8558, London at para 198, sub paras (i) and (j).

¹⁶² *Report of the Insolvency Law Review Committee* 1981, Cmnd. 1982.

desperation which needs to be resolved. A modern manifestation of this is the sit-in by workers seeking by their physical presence to ensure that their jobs will not be lost, by having some new organisation carry on the business.

204. We believe that a concern for the livelihood and well-being of those dependent upon an enterprise, which may well be the lifeblood of a whole town or even a region, is a legitimate factor to which a modern law of insolvency must have regard. The chain reaction consequent upon any given failure can potentially be so disastrous to creditors, employees and the community, that it must not be overlooked.”¹⁶³

Paragraph 204 of the Cork Report would be understood as a reference to the stakeholder model.¹⁶⁴ Stakeholder theory is most often employed in the context of corporate governance.¹⁶⁵ A stakeholder can be defined as any person or group which can affect or be affected by a business. It includes employees, customers, suppliers, creditors and even the larger community. It contrasts with shareholder primacy model as championed by A A Berle¹⁶⁶ and later by M Freedman.¹⁶⁷ Its core concept is that the ultimate objective of a company is to maximise wealth for shareholders. The principle argument in favour of this approach is that shareholders are the “residual claimants” when the company is solvent. The view is taken by Berle and others that as equity investors, shareholders have the greatest stake in the success or otherwise of the company. It can be contended that the employee contribution to the company is at least as great as that of shareholders. What often prevails today is the Enlightened Shareholder Value (ESV) approach, although it is heavily criticised.

¹⁶³ *Report of the Insolvency Law Review Committee* 1981, Cmnd. 1982 at paragraphs 203 and 204.

¹⁶⁴ Stakeholder theory is most often employed in the context of corporate governance. R E Freeman, *Strategic Management: A Stakeholder Approach* (Pitman Boston 1984). A stakeholder can be defined as any person or group which can affect or be affected by a business. It includes employees, customers, suppliers, creditors and even the larger community. It contrasts with shareholder primacy model as championed by A A Berle in ‘Corporate Powers as Powers in Trust’ (1931) 44 *Harvard Law Review* 1049. and later by M Freedman, *Capitalism and Freedom* (University of Chicago Press 1992) 132. Its core concept is that the ultimate objective of a company is to maximise wealth for shareholders. The principle argument in favour of this approach is that shareholders are the “residual claimants” when the company is solvent. The view is taken by Berle and others that as equity investors, shareholders have the greatest stake in the success or otherwise of the company. It can be contended that the employee contribution to the company is at least as great as that of shareholders. What often prevails today is the Enlightened Shareholder Value (ESV) approach, although it is heavily criticised. This allows for the subordination of directors’ activities to rational commercial goals while at the same time taking proper account of a range of relevant considerations. These considerations include sustaining long-term relations with employees, customers and suppliers as well as the impact of the company on the community. There are some parallels between ESV thinking and modern company rescue law which will emerge by stages in this thesis.

¹⁶⁵ R E Freeman, *Strategic Management: A Stakeholder Approach* (Pitman Boston 1984), introduction.

¹⁶⁶ A A Berle in ‘Corporate Powers as Powers in Trust’ (1931) 44 *Harvard Law Review* at 1049.

¹⁶⁷ M Freedman.¹⁶⁷ *Capitalism and Freedom* (University of Chicago Press 1992) at 132.

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Stakeholder theory when applied in the context of insolvency law is different from that found in other aspects of corporate governance. In insolvency law the stakeholder groups remain the same as when the theory is applied in other contexts, excepting for one important detail. In insolvency, the creditor interest, particularly the major creditors have interests opposed to that of the stakeholder group. The difficulty with stakeholder theory is that it is not easy to establish a consensus regarding those who can be who can be reasonably included within the given stakeholder group and those who cannot. That is its great weakness.¹⁶⁸

The Cork Committee recommended that a new mechanism be put in place that would help to promote these objectives.¹⁶⁹ This prompted the UK government to initiate new legislation: the Insolvency Act 1986 and with it the establishment of the role of administrator.¹⁷⁰ With regard to the general purposes of administration, Section 8(3) of the Insolvency Act sets it out as follows:

The survival of the company, and the whole or any part of its undertaking, as a going concern;

The approval of a voluntary arrangement;

¹⁶⁸R F Freeman, *Stakeholder Management: A Stakeholder Approach* (Pitman 1984); T Donaldson and L Preston, "The Stakeholder Theory of the Corporation: Concepts, Evidence and Implications" 20 *Academy of Management Review* 1 65-91; S Mansell, *Capitalism, Corporations and the Social Contract* (CUP 2013).

¹⁶⁹ This became operative under the Insolvency Act, 1986. See ss10(1), 11(3) and Sch B of the Act in particular.

¹⁷⁰ *Insolvency Act, 1986* C45 Office of Public Sector Information, London, 1986. This history has been covered very ably by G Moss, 'Comparative Bankruptcy Cultures: Rescue or Liquidation? Comparison of Trends in National Law- England' (1997) 13 *Brooklyn J Intn'l* 1 115 and R Parry *Corporate Rescue* Thomson Sweet and Maxwell, London, 2008.

The sanctioning of a compromise or arrangement between the company and its creditors; and

A more advantageous realisation of the company's assets than would be effected on a winding up.

The chief characteristics of administration are these. It offers a moratorium under Schedule B of the Insolvency Act 1986 which acts as a shield against creditors.¹⁷¹ This temporary reprieve makes it possible for the company to repair its fortunes under the stewardship of a trained administrator and to put together a robust business plan so as to come out of administration. The company under administration continues to trade during this period and the legal rights of the existing creditors are not to be tampered with.¹⁷² The overall objective in most cases is to accommodate a company buy-out or something similar.¹⁷³ Despite its ostensible strengths, the administration process has fundamental weaknesses. It involves much in the way of court supervision and is therefore long drawn out and costly.¹⁷⁴ A floating charge holder can veto any appointee to administratorship. The statutory objectives as detailed above do not allow for any prioritisation of one objective over another. In addition, the moratorium arrangements can be breached in certain instances.¹⁷⁵

The drafters of the Enterprise Act 2002 have sought to make administration a far more flexible and practical arrangement in the UK in comparison to what obtained in the past.¹⁷⁶

¹⁷¹ Insolvency Act, 1986, Part 2, sections 10-11.

¹⁷² Insolvency Act, 1986, Part 2, section 11.

¹⁷³ See V Finch, 'The Recasting of Insolvency Law' (2005) 68 *The Modern Law Review* 5 at 714. See also R Parry, *Corporate Rescue* (Thompson Sweet and Maxwell 2008) 9 for a detailed description.

¹⁷⁴ V Finch, *Corporate Insolvency Law* (CUP 2002) 1st edition 283. Costs, which vary considerably, are due to the court being involved not only in the appointment being appointed but also determining matters before the administrator can interfere with private rights. The court often has to consider matters in depth.

¹⁷⁵ There are two exceptions to the rule blocking creditor actions against the company in administration. Firstly, the administrator must agree to the action being taken. This may be the case where some of the company's machinery is held under a hire purchase agreement and where the administrator has no use for the machinery and the owner wants to repossess. Secondly, in cases where the administrator does not agree with a claim, that creditor may apply to the court and gain the right to take action. The leading case is *Re Atlantic Computer Systems plc* ([1992] Ch 505). These matters are covered in detail in the following text: A Keay and P Walton, *Insolvency Law: Corporate and Personal* (Jordans 2012) 3rd edition 113.

¹⁷⁶ See, in particular, the Enterprise Act, c40, Office of Public Sector Information, London, 2002 at Part 10. For a consideration of government thinking in the late nineteen nineties on matters related to insolvency law policy and company rescue practice see *A Review of Company Rescue and Business Reconstruction Mechanisms* The Insolvency Service HMSO 1999, *A Review of Company Rescue and Business Reconstruction Mechanisms*:

The Enterprise Act 2002 Act does not, however, pioneer a new way of thinking about corporate rescue law; rather than that, its drafters have sought to implement more effectively the principles of rescue which were already outlined in the Cork Report.¹⁷⁷ The main purposes of the Enterprise Act 2002 are the abolition in large part of the administrative receivership process,¹⁷⁸ the reconstitution of administration, the removal of the Crown's priority status and the establishment of a ring fenced fund. This fund is sourced from the proceeds of the corporate assets subject to the floating charge. It is distributed among the company's unsecured creditors.¹⁷⁹ What did not change was that the Administration process continued to bring about results which substantively favour the interests of secured creditors.¹⁸⁰

In recent years, the United Kingdom revised its corporate reorganisation procedures to deal with small business bankruptcies. This has taken the form of the introduction of company voluntary arrangements (CVAs) with a moratorium for small companies under the Insolvency Act 2000.¹⁸¹ The relevant provisions, however, did not come into force until 2003.

Report by the Review Group, The Insolvency Service HMSO, 2000; Productivity and Enterprise: Insolvency - A Second Chance, The Insolvency Service, Cm 5234, 2001).

¹⁷⁷ See S Frisby, 'In Search of a Rescue Regime: the Enterprise Act' (2002) 67 *The Modern Law Review* 2 G McCormack, 'Apples and Oranges? Corporate Rescue and Functional Convergence in the US and the UK' (2009) 18 *Int Insolv Rev* 109.

¹⁷⁸ Not all administrative receivership processes are being abolished. The exceptions relate to lending far removed from the mainstream. ¹⁷⁸ S Frisby, 'In Search of a Rescue Regime: The Enterprise Act 2002' 67 *Mod L Review* 255. Administrative receivership as distinct from administration involved the appointment of a financial specialist, that is an insolvency practitioner, on behalf of a creditor who held debentures in a defaulting company to undertake a viability review of it. For a straightforward description of this see <http://www.businessrecoveryadvice.co.uk/html/insolvency/admin.asp> last downloaded on September 18th, 2013.

¹⁷⁹ S Frisby, 'In Search of a Rescue Regime: The Enterprise Act 2002' 67 *Mod L Review* 268. Section 176(A) 3 of the Enterprise Act 2002 requires the administrator to make available a "prescribed part of the company's net property for the satisfaction of unsecured net debts, with the charge holder only entitled to any amount in excess of such debts. This duty does not apply where the net assets is less than £ 10,000 and the administrator "thinks that the cost of making a distribution to unsecured creditors would be disproportionate to the benefits."

¹⁸⁰ It is still widely perceived as an insolvency procedure rather a rescue procedure. See G Yeoward, 'Encouraging Company Rescue: what changes are required to UK Company Law?' *Law and Financial Markets Review*, November, 2009 518.

¹⁸¹ The company voluntary (CVA) procedure is set out in the Insolvency Act 1986, Part 1 as amended by the Insolvency Act 2000 and the Insolvency Rules 1986, Part 1 as amended by Insolvency act Rules 2010.

Looking at matters from a wider perspective, it is perhaps accurate to say that there has been a major change in thinking among business and government agents about company insolvency in the UK since the mid-nineties. Management today is expected to be proactive as regards the possibility of insolvency and to intervene in defined ways when difficulties first present themselves.¹⁸² This development should be seen within the context of a greater commitment by government to the enforcement of corporate auditing practices and the professional management of corporate risk.

1.5.2 : CORPORATE RESCUE IN THE UNITED STATES: A BRIEF HISTORY

The relevant company rescue legislation in the United States is the Chapter 11 legislation (US Bankruptcy Code 11) of 1978 together with the BAPCPA (Bankruptcy Abuse Prevention and Consumer Protection Act) of 2005. The present legislation began with the rethinking of receiverships. Receiverships were frequent among railway companies in the railway era of the nineteenth century.¹⁸³ In contrast to the UK tradition, receivership often involved reorganisation rather than impending liquidation, although this practice was confined to the railway companies. Somewhat later, the Bankruptcy Act, the Chandler Act, of 1938 was passed to reform bankruptcy law in Depression-era America. As originally conceived, this legislation stipulated that existing management in a failing company should be displaced by an appointed trustee who could put forward a reorganisation plan. The Act contained two chapters: Chapter 10 and Chapter 11. Chapter 10 related to big, complex cases; Chapter 11 related to small ones.¹⁸⁴

¹⁸² V Finch, *The Recasting of Insolvency Law* (2005) 68 *The Modern Law Review* 5 714.

¹⁸³ The most famous case of this era was *Central Trust Co v Wabash* (1886) 29 Fed 618.

¹⁸⁴ Rostow and Cutler, in a celebrated paper, wrote as follows: “ Chapter 11, on the other hand, has about it the grubbiness of bankruptcy. It provides a cheap and practical method of settlement based on the history of composition in bankruptcy for poor debtors whose estates cannot afford the expense of elaborate public ceremonial. No one will look to Chapter 11 as a theatre for the glamour and high language expected of spectacular proceedings under Chapter 10.”E Rostow and L Cutler, *Competing Systems of Corporate Reorganisation: Chapters 10 and 11 of the Bankruptcy Act* 48 *Yale L J* 1334 1938-1939; D Skeel, ‘Icarus in the Boardroom: The Fundamental Flaws in American Business and where they came from’ (OUP 2005) 96.

While there were deficiencies in the Bankruptcy Act 1938,¹⁸⁵ the legal and business culture was more forgiving of commercial failure in comparison to that of the UK.

Over a period of decades it became evident that the flaws in the legislation had ever more burdensome consequences. The entitlements of secured creditors and the interests of shareholders could not be altered in the absence of consensus. There were, however, no legal mechanisms which would facilitate a manoeuvre through which such a consensus could be reached.¹⁸⁶ In addition, public and middle-sized companies chose Chapter 11 of the Bankruptcy Act 1938, as it left the company's managers in position. Chapter 11 became the dominant Chapter. The major difficulty with this was that Chapter 11 of the Bankruptcy Act 1938 did not allow for cramdown. This was a critical failure in a context where the candidates going forward were larger companies and the legal questions were more complex. The negotiation process for these companies with their creditors was particularly troublesome

¹⁸⁵ One weakness of the Bankruptcy Act 1938, as inherited from the Bankruptcy Act 1898, was the splintered jurisdictional scheme. This resulted in bankruptcy referees – later called bankruptcy judges in the Bankruptcy Act 1978 – could only hear core matters. One important reform of the Bankruptcy Act 1978 was to make it possible for the bankruptcy judge to hear virtually any relevant case. This was widely seen by the representatives on the relevant committees of the House of Representatives and the Congress as a very welcome development. S Rep No 989 15-16, reprinted in 1978 U.S.C.C.A.N. 5801-5802. In addition, the experts who worked for eight years in designing the Bankruptcy Act 1938 did not provide a mechanism which would help to determine which cases should be heard under Chapter 10 and which under Chapter 11. E Rostow and L Cutler, *Competing Systems of Corporate Reorganisation: Chapters 10 and 11 of the Bankruptcy Act 1938-1939*. In addition, Chapter 11 failed to provide for cramdown. G McCormack, *Corporate Rescue Law- an Anglo-American Perspective* (Edward Elgar 2008) 92.

¹⁸⁶ What happened in practice was the community interest objective in chapter 11 was circumvented. Chapter 11 operated by means of formal negotiation with a significant involvement by lawyers and extensive court proceedings. (See Chapter 3, subchapter 1 of Chapter 11, Title 11 of the US Bankruptcy Code for an indication of matters to be considered by the court.) Market forces – in the form of debtor-in-possession financiers – were the ones who drove change. For an analysis of this, see, for example, Karen Gross, *Failure and Forgiveness: Rebalancing the Bankruptcy System* (Yale University Press, 1997); Elisabeth Warren, 'Bankruptcy Policy' (1987) 54 U Chicago L Rev 775; Elisabeth Warren, 'Bankruptcy Policymaking in an Imperfect World' 1993 92 Mich L Rev 336. See also Donald R Korobkin, 'Contractarianism and the Normative Foundations of Bankruptcy law' 1993 71 *Texas Law Review* 541; Axel Flessner 'Philosophies of Business Bankruptcy Law: An International Overview' in Jacob Ziegel (ed.), *Current Developments in International and Comparative Corporate Insolvency Law* (Clarendon Press 1994); Lynn Lopucki, 'A Team Production Theory of Bankruptcy Reorganization' 2004 57 *Vand L Rev* 741.

as the debtor company's management could not threaten the creditors with a liquidation which would result in the creditors receiving a smaller return than otherwise.¹⁸⁷

The Chapter 11 legislation of 1978 addressed these matters.¹⁸⁸ It was very evidently the precursor of many other corporate rescue legislative initiatives.¹⁸⁹ More particularly, its designers were ambitious in so far as they sought to preserve or to reconstruct the corporation that found itself insolvent as an entity in itself.¹⁹⁰ The legislation also constituted a precedent in the insolvency law tradition in that it suggested an encompassing vision: shareholders and indeed society in general were held to be interested parties,¹⁹¹ though such interests remained subordinate to that of creditors. The whole mechanism was focused upon negotiating and bargaining: this was to allow classes of creditors and shareholders together with management to come up with a survival plan while the corporation was in its court-approved protection period. In addition, the existing management continued in position and new financing for the ailing corporation was enabled. The process involved much negotiation and court appearances.

In its turn, Chapter 11 was subject to sustained and detailed criticism. The major criticism was that the process took much too long and that it was prohibitively expensive. It did not

¹⁸⁷ This history is detailed in G McCormack, *Corporate Rescue Law- an Anglo-American Perspective* (Edward Elgar 2008) 92.

¹⁸⁸ 11 USC ¶ 362a.

¹⁸⁹ This is not to suggest, however, that corporate rescue systems in the various jurisdictions are not substantively different, one from another. See also K Gromek Broc and R Parry (eds), *Corporate Rescue: An Overview of Recent Developments* (2edn Kluwer Law 2006).

¹⁹⁰ It will be recalled that Chapter 11 proceedings can be employed also by solvent corporations. Such tactics often amount to an abuse of the existing legislation.

¹⁹¹ This is communitarian thinking, the very opposite of the creditor maximisation approach. In the event of an insolvency, communitarians would argue that those who direct the corporate rescue mechanism should weigh the interests of a broad range of constituents who are directly impacted by threatened closure. Specifically, communitarians support a redistribution of values in insolvency with the result that high-priority claimants would yield their position in part to others who have lesser or no bargaining power. This would include the community in which the corporation operates. E Warren, *Bankruptcy Policymaking in an Imperfect World* 1993 93 Mich L Review 356. US House of Representatives HR Rep No 95 -595 220 (1977). It is not suggested that the deliberations leading to the enactment of Chapter 11 were in very large part influenced by communitarian thinking.

suit in cases of small business bankruptcies.¹⁹² It was also suggested that the Chapter 11 process favoured shareholders and management, but not creditors.¹⁹³ With time, Chapter 11 has been subject to multiple amendments. There have been amendments in 1984, 1994 and 2005.¹⁹⁴ Perhaps, the key amendment was this: the promotion of the maximum returns to creditors (which is to say the outright sale of the corporation) rather than its revival.¹⁹⁵ Chapter 11 can no longer be employed by management as a shield against takeover threats.¹⁹⁶ The change is both fundamental and absolute. What is happening today in the United States is that distressed companies are playthings in the corporate control and asset sale markets. Purchasers have no long-term interest in the viability of these corporations. Another critical element of change relates to the impact on distressed corporations of debtor- in-possession (DIP) finance. The effect of this is that lenders now have clauses inserted in contracts by their legal representatives that fundamentally determine the corporate governance arrangements in bankruptcy.

The most important development in recent years regarding Chapter 11 has been the publication by the American Bankruptcy Commission (ABI) of their commission report to

¹⁹² The BAPCPA legislation – which caters for small companies in distress- is discussed in chapter 2 of this thesis

¹⁹³ M Bradley and M Rosenzweig, ‘The Untenable Case for Chapter 11’ (1992) 101 Yale Law Journal 1043

¹⁹⁴ Bankruptcy Amendments and Federal Judgeship Act 1984; Bankruptcy Reform Act 1994 , section 524(d) of Title 11; and Bankruptcy Abuse Prevention and Consumer Protection Act 2005 Pub. L No 109-8 119 stat 23.

¹⁹⁵ See s 363(b) of the Bankruptcy Code. A s 363 sale refers to the sale of the debtor’s assets. Sale of assets under s 363 can range from the sale of office furniture by a Chapter 7 trustee or the sale of substantially all assets of a Chapter 11 debtor. Generally , when bankruptcy practitioners refer to a s 363 sale they are referring to a sale of substantially all the assets of a Chapter 11 debtor. The more prominent sales of this kind in recent years are those relating to General Motors, Chrysler and Lehman Brothers. 11 U S Code § 363 – Use, sale or lease of property last downloaded at <https://www.law.cornell.edu/uscode/text/11/363> last downloaded on 9th August, 2015.

¹⁹⁶ Chapter 11, as traditionally understood, involved classes of creditors and shareholders negotiating as classes with a view to putting together a restructuring plan. This way of thinking about chapter 11 is no longer applicable in many cases. What often happens in practice is that this Chapter is frequently used to effect a splitting up and sale of corporate assets. The room for manoeuvre available to management may be circumscribed by powerful creditors. In addition, management may receive significant cash incentives from these powerful creditors to agree a solution speedily. DIP financing may come with strings attached for the defaulting corporation. Pre-packaged solutions, which may or may not be to the corporation’s advantage, are sometimes put together prior to the Chapter 11 application. See G McCormack, ‘UK Apples and Oranges? Corporate Rescue and Functional Convergence in the US and the UK’ (2009) 18 Int Insolv Rev 109 for an elaboration of this argument.

study the reform of Chapter 11.¹⁹⁷ The commissioners observed that whether it was by design or chance, efforts to review and assess U.S. business reorganization laws were undertaken approximately every 40 years.¹⁹⁸ This had resulted in US federal legislation effecting meaningful revisions to business reorganization laws in 1898, 1938, and 1978. They took the view that four decades is the maximum amount of time that any financially driven regulation can remain relevant.¹⁹⁹ As they saw it, markets and financial products, as well as industry itself, often evolve far more quickly than the regulations intended to govern them.²⁰⁰ For them, the general consensus among restructuring professionals is that the time has come once again to evaluate U.S. business reorganization laws.²⁰¹ The commissioners undertook three years of work for the project. They formed thirteen advisory committees and unanimously issued two-hundred-and-forty recommendations.²⁰²

¹⁹⁷ American Bankruptcy Institute, *Commission to Study the Reform of Chapter 11* (ABI 2014) Alexandria Virginia.

¹⁹⁸ American Bankruptcy Institute, *Commission to Study the Reform of Chapter 11* (ABI 2014) Alexandria Virginia at 2.

¹⁹⁹ American Bankruptcy Institute, *Commission to Study the Reform of Chapter 11* (ABI 2014) Alexandria Virginia at 2.

²⁰⁰ American Bankruptcy Institute, *Commission to Study the Reform of Chapter 11* (ABI 2014) Alexandria Virginia at 2.

²⁰¹ American Bankruptcy Institute, *Commission to Study the Reform of Chapter 11* (ABI 2014) Alexandria Virginia at 2. A particularly good example of this relates to the perceived lack of application of Chapter 11 in relation to small companies in financial distress. The management of such companies simply avoided Chapter 11 or BAPCPA because of their complexity, expensiveness or unhelpful nature as appropriate in the given case. The written statement of D Dooley at the ASM Field Hearing before the ABI field hearing on 19th April, 2013 is revealing: “It is widely understood and agreed in the insolvency community that Chapter 11 is no longer a cost effective process in the middle market.....Chapter 11 is now viewed as too slow and too costly for the majority of middle market companies to do anything other than sell its going concern assets in a 363 sale or to simply liquidate the company ...usually almost exclusively for the sole benefit of the secured lender.” Quoted in American Bankruptcy Institute, *Commission to Study the Reform of Chapter 11* (ABI 2014) Alexandria Virginia at 277. The Commission issued a plethora of recommendations including those relating to pre-petition finance. On this key issue, they recommended placing limitations on rollups of prepetition debt. They also suggested (in Chapter 4B(1) curtailing the use of post-petition financing milestones within the first 60 days of a case. With regard to the determination of cramdown interest rates, they recommended (in Chapter 5C) a more favourable approach for secured lenders.

²⁰² Some of the recommendations are discussed throughout this thesis. The written statement of D Dooley at the ASM Field Hearing

Written Statement of Daniel Dooley: ASM Field Hearing Before the ABI Comm’n

to Study the Reform of Chapter 11, at 2–3 (Apr. 19, 2013) (“It is widely understood and agreed in the insolvency community that

Chapter 11 is no longer a cost effective process in the middle market. . . . Chapter 11 is now viewed as too slow and too costly for the majority of middle-market companies to do anything other than sell its going concern assets in a 363 sale or to simply liquidate the company . . . [usually] almost exclusively for the sole benefit of the secured lender.”

More generally, looking at the history of formal company rescue legislation to date in the two countries where originally its advocates (and its many critics) were concentrated, it is difficult, on examining the evidence available to avoid the conclusion that the more commercial debtor-friendly objectives of formal corporate rescue law are infrequently met. This is so in the case of Chapter 11 because of the dominant position in many cases of certain creditors who provide debtor-in-possession finance. The room for manoeuvre of the debtor company is thus additionally circumscribed. In the UK, the position of the debtor company is no easier, but for different reasons. In an Enterprise Act 2002 context, it is probable that the insolvency practitioner in a given case will probably opt for securing a better return for creditors than rescuing the company. The insolvency practitioner will act in that manner for pragmatic reasons and because of the business and legal environment in the UK which is less rescue-friendly than elsewhere.²⁰³ On the other hand, the less structured rescue approaches, whether formal or informal, have often proven to have considerably more potential.

1.5.3: COMPANY RESCUE LAW IN IRELAND: A BRIEF HISTORY

Matters relating to insolvency and corporate rescue legislation in Ireland in our own time have proceeded in the following manner. The centrepiece of companies legislation in this jurisdiction for many years, the Companies Act, 1963 placed an emphasis on the efficient winding up of insolvent companies rather than on their rescue.²⁰⁴ It did, however, offer a standard scheme of arrangement procedure which would become operative if it were approved by a qualified majority of one class of creditors and by the High Court.²⁰⁵ This approach was very rarely employed as the Revenue Commissioners invariably objected to

²⁰³ D Skeel, *The Past, Present and future of Debtor-in- Possession Financing* (2003-2004) 25 Cardozo L Review 1905; S Frisby, *In search of a Rescue Regime: The Enterprise Act 2002* (2004) 67 Mod L Review 247.

²⁰⁴ This Act has now been replaced by the Companies Act, 2014.

²⁰⁵ Section 201 of the Companies Act, 1963. The Revenue Commissioners were prohibited by law from not making claims when taxes are due. In certain instances, they were prepared to consider instalment repayments. See also ss26, 27 (no39) Taxes Consolidation Act ,1997. The Companies Act, 2014 became operative in June, 2015. As already stated, it makes provision for both examinership (Part 10, ss 508 to 558) and the redesigned scheme of arrangement mechanism (Part 9, Chapter 1, ss 449 to 454). P Conroy, *The Companies Act 2014: An Annotation* (Crowe Horwath, 2015).

such arrangements, because of the reduced amount now deemed to be owing to them if and when the scheme was confirmed by the court.²⁰⁶

A formal corporate rescue mechanism, examinership, was enacted into Irish law by the Companies (Amendment) Act 1990. Section 2(2) of that Act provided for a court to make an order in cases where that was likely to facilitate the survival of the petitioning company or any part of it as a going concern. The drafters of the Act sought, where the circumstances allowed, to rescue *companies* rather than just *businesses*. This was confirmed by Fennelly J. :

The Act of 1990 made it possible to rescue troubled companies. It provides for a protection period, a temporary breathing space, provided that the court can be persuaded, on presentation of the petition, that there is a prospect of survival.²⁰⁷

The context in which the Companies (Amendment) Act, 1990 was introduced in the Dáil (the Irish Parliament) was unusual. The Companies (Amendment) Act 1990 was placed before the Dáil as part of a larger bill, the Companies Bill 1987. The greater part of it which did not relate to company rescue was later enacted as the Companies Act 1990. The parliamentarians had been actively planning for such legislation for at least three years. The context was this: as a direct result of the UN embargo of trade with Iraq at that time, the Goodman International Group and twenty-five related companies were on the threshold of insolvency. Iraq was a major market for Goodman International, a company that exported beef. In addition, Goodman International was by far the most important company in the beef industry in Ireland. In addition, the collapse of Goodman threatened the collapse or at least the impairment of major banking corporations both domestic and foreign. The Companies (Amendment) Act 1990 owed much to Chapter 11 legislation in the United States –in so far as examinership did not bring about the complete displacement of the incumbent management and in the commitment by the authorities to the rescue of the corporate entity

²⁰⁶ P Russell, “Examinership: A Practitioner’s Perspective” (October 2012) *Accountancy Ireland* Dublin 50.

²⁰⁷ *Re Gallium Limited trading as First Equity Group (“First Equity”)* 2009 IESC 8 at para 47.

rather than just the business.²⁰⁸In addition, the procedures were somewhat similar to the court administration process under the terms of the UK Insolvency Act, 1986. Thus there was considerable borrowing from both models. The purposes of the Companies (Amendment) Act 1990 was stated by McCarthy C J in *Re Atlantic Magnetics*²⁰⁹as being that of protection: protection of the company and consequently of its shareholders, workforce and creditors. In the view of the learned judge, the Oireachtas intended that the fate of a company in financial distress should not be under the control of one or more creditors. That could mostly serve to disadvantage those connected with the company who were less well protected.

In *Re Atlantic Magnetics* it was stated by CJ that there cannot be an onus of proof on the petitioner to establish as a matter of probability that the company is capable of surviving as a going concern. This has now changed. Examinership candidates must now prove, in accordance with what is now section 509(2) of the Companies Act 2014 that the company in question has a “reasonable prospect of survival” rather than some prospect. The court will not make an order under this section (section 509) unless it is satisfied that there is a reasonable prospect of the survival of the company and the whole or any part of its undertaking as a going concern.” The petitioner will have to show that under section 509(1) that:

- (a) the company is or is likely to be unable to pay its debts, and
- (b) no resolution subsists for the winding-up of the company, and
- (c) no order has been made for the winding-up of the company

In *Re Tuskar Resources plc*²¹⁰ McCracken J noted that there is an onus of proof on the petitioner at the initial stage to satisfy the court that there is a reasonable prospect of survival. That rule is a more demanding one in comparison to the one that applied prior to Companies (Amendment) (No2) Act 1999.

²⁰⁸ Section 2(1) Companies (Amendment) Act, 1990 on the appointment of the examiner and on the examiner’s duties to the company. This is now contained in the Companies Act 2014, s509(1) to (11).

²⁰⁹ *Re Atlantic Magnetics* [1993] 2 IR 561 at 578.

²¹⁰ *Re Tuskar Resources plc* [2001] 1 IR 668, [2001] 2 JIC 2601 section of judgment on the law at present.

This change came about in large part also for the following reason. The Company Law Review Group advised the Government in 1994²¹¹ that the legislation regarding candidates for examinership should become more stringent. In their view, the point and purpose of this process was to offer temporary support to what were fundamentally healthy companies who were experiencing trading conditions which were adverse. Examinership should not be used as a means of delaying what would be an inevitable collapse. They offered very many practical suggestions also, not all of which were implemented in subsequent legislation. For instance, they sought the use of ‘cram down’ by majority decision of creditors. “Cram down” arises in a company re-organisation context. It enables the court to alter the terms of existing loan contracts over the objections of some creditors in order to facilitate a result that would be better for all parties than any other available. This would have favoured the largest creditors and would not have been equitable. The First Report had a very significant impact, however, in that the great majority of the report’s suggestions were implemented in the Companies (Amendment) (No2) Act, 1999.²¹²

It is nevertheless the case that the Irish court has maintained its commitment to the communal dimension of corporate rescue, once a company has entered examinership. For instance, Clarke J in *Re Traffic Group Ltd and the Companies Acts* described the objective of examinership as follows:

“... [i]n an appropriate case, (the examinership process should enable) an enterprise to continue in existence for the benefit of the economy as a whole and, of equal, or indeed greater, importance (should) enable as many as possible of the jobs which may be at stake in such enterprise to be maintained for the benefit of the community in which the relevant employment is located. It is important both for the court and, indeed, for examiners, to keep in mind that such is the focus of the legislation. It is not

²¹¹ CLRG 1st Report last downloaded on 14th December, 2015 at <http://www.clrg.org/publications/clrg-report-1994.pdf>

²¹² For a description of what a formal regime company reorganisation might contain at minimum, see UNCITRAL *Legislative Guide on Insolvency Law* (UN 2005).

designed to help shareholders whose investment has proved to be unsuccessful. It is to seek to save enterprise and jobs.”²¹³

In contrast to the prevailing trends in the UK and to a significant extent in the United States and in spite of the 1999 Amending Act, Irish judges in the exercise of their discretion have in some cases articulated a commitment to a vision wider than that of commercial values where it has been proven that the examinership candidate has a probable capacity to survive.²¹⁴ In more recent years commercial values would again seem to be hegemonic in these cases.²¹⁵ Mostly, however, extreme prudence has been exercised. For instance, Fennelly J in *Gallium Limited and the Companies Amendment Act 1990*²¹⁶ stated that:

“... [t]he entire purpose of examinership is to make it possible to rescue companies in difficulties. The protection period is there to facilitate examination of the prospects of the rescue. However, the protection may prejudice the interests of some creditors. The court will weigh the existence and degree of any such prejudice in the balance”.²¹⁷

The examinership process has been subject to much criticism from certain quarters. For instance, it has sometimes been argued that the focus in the legislation on saving the company rather than the underlying business is simply wrongheaded in so far as it does not allow for a more practical outcome where needed. The practical outcome might involve the reduction of the business into a more viable proposition in a context of a receivership.²¹⁸ An equally serious charge has been that the examinership process can be abused by business people who wish to protect their own interests rather than those of the companies they direct.²¹⁹ In any event, the examinership process has remained contentious. The drafters of extensive amendments which were introduced in the Companies (Amendment) (No 2) Act, 1999

²¹³ *Re Traffic Group Ltd and the Companies Acts (2007)* 3IR [2008] 253 at 260 .

²¹⁴ *Re Vantive Holdings* [2009] IESC 384 at 386; *Re Irish Car Rentals* [2010] IEHC 235 *ex tempore*.

²¹⁵ *Re Missford Ltd* [2010] IEHC 11 page number not available downloaded on 2nd December, 2015 at <http://www.justis.com.elib.tcd.ie/document.aspx?doc=f7jsrUrxA0LxsKjIo5aJn1KtmYWIvLerIOJikL0qJidmXaZiWeZiYaZiWeJiSiIs1jxAZrWAJrxAV5wsKjIoW0ha&relpos=0>

²¹⁶ *In the matter of Gallium Limited and the Companies Amendment Act 1990* [2009] 2 JIC 0301 at para 47.

²¹⁷ IESC 8 (2009). Gallium was part of the Zoe group. On the matter of the application of more stringent criteria for the admission to and the successful passage through examinership see B Kirwan, ‘Aspects of Examinership’ 2009 16(10) Commercial Law Practitioner 219.

²¹⁸ See I Lynch, J Marshall and R O’Ferrall, *Corporate Insolvency and Rescue* (1st edn Butterworth 1996) Chapter 11 generally.

²¹⁹ See I Lynch, J Marshall and R O’Ferrall *Corporate Insolvency and Rescue* (1st edn. Butterworth 1996) 303.

following the recommendations of the Company Law Review Group report in 1994 were fully cognizant of the fact that examinership theretofore had not been effective in facilitating viable companies in returning to financial health or in defending the interests of creditors.²²⁰

In addition, the Company Law Reform Group in their annual report for 2012 made nine recommendations regarding the examinership procedure.²²¹ They believed that this was necessary so as to entice small companies to avail of the procedure.²²² The goal was to allow small companies to go forward as examinership candidates to the Circuit Court. This would serve to reduce costs substantially. The CLRG identified another method which would dispense with the courts at the initiation stage of examinership. In this recommendation, the courts would be replaced at the initiation stage of examinership by an administrative agency such as the Insolvency Service.²²³ There was some debate within the CLRG about whether or not an agency such as an Insolvency Service or some comparable agency could take on that administrative burden in addition to their existing duties. In addition, the Revenue Commissioners objected to the passing over to an administrative agency of examinership at the initiation stage.²²⁴ The Revenue Commissioners believed that the CLRG recommendation would lead to something that would serve them less well than what currently obtained. In the event, the Government opted for a legislative model consisting of Circuit Court processing of

²²⁰ The Company Law Review Group, *First Report* (1994). The CLRG criticised the “some prospect” of returning to financial health standard as unduly lenient at page 6 of their report. They took it that the purpose of examinership was to facilitate a viable company in overcoming temporary difficulties. The group considered that the old standard was more likely to postpone the demise of the given commercial entity at the expense of others (in page 6 of their report). In their opinion a “reasonable prospect” test would serve better to promote the interests of more viable companies.

²²¹ The Company Law Review Group, *Annual Report*, 2012 at 15-24.

²²² The Company Law Review Group, *Annual Report*, 2012. 11 recommendation could be implemented in the shorter term

²²³ The Company Law Review Group, *Annual Report*, 2012 at 17.

²²⁴ The Company Law Review Group, *Annual Report*, 2012 at 16.

sme-type examinership cases.²²⁵This was to become what is now known as ‘examinership lite.’²²⁶

SECTION 1.6: THE LITERATURE

INTRODUCTION

This literature review has the following structure. The first part examines current thinking on what is meant by corporate rescue and what the rescue culture entails. Corporate rescue is placed within the larger context of corporate insolvency law and a review is offered of the contributions by the major contending parties in that debate. Critical terms and concepts are explained as they are introduced. A comparative analysis is then offered of the writings on existing corporate rescue mechanisms operating outside Ireland. The historical context is allowed for and the connexion between property rights and corporate restructuring is established. The third part reviews what has been written in the United States and Britain on formal company rescue processes (that is court-based processes) applied to small companies. The next part considers the literature on the examinership mechanism and connected matters in this country. It provides a perspective on the current options available to companies in this jurisdiction who might be facing financial distress. What has been written to date about examinership is with rare exceptions relatively meagre or not of recent origin. No comparative perspective has been employed in the existing studies and there has been little or

²²⁵ The Companies (Miscellaneous Provisions) Act 2013. All provisions related to examinership (both standard examinership and examinership lite) are now contained in Companies Act 2014, Part 10.

²²⁶ The Companies (Miscellaneous Provisions) Act 2013. The CLRG in their Annual Report for 2012 at 11 stated that the Minister for Jobs, Enterprise and Innovation had requested of them that they examine and make recommendations on the feasibility of amending the Companies Acts to introduce a new structured and non-judicial debt settlement and enforcement scheme for insolvent companies. Their recommendations –as seen above- fell short of this. The CLRG recommendations have, nevertheless, led to significant reductions in costs. The Review Group believed that their recommendation could be implemented in the shorter-term in spite of the practical difficulties already referred to. The Review Group also considered a totally non-judicial debt settlement scheme for insolvent companies, but dismissed this as an unviable option. Their reasoning was as follows: such an approach would require the consent of all creditors. They thought that consent was unlikely to be present in most cases. They were conscious of the constitutional provisions regarding the defence of property rights (ie Articles 34, 37 and 43). They therefore considered that the judicial processing of such cases was unavoidable. For a model specifically focused on the law relating to small company rescue in Ireland and that employs somewhat different premises, see Chapter 5 of this thesis.

nothing in the way of theoretical debate here about the nature of corporate rescue mechanisms in a small open economy and whether or not such mechanisms are indeed worthwhile. This, however, is not altogether surprising. It is true that the literature internationally on corporate rescue law applied to larger companies has become very large over recent decades; but that is not the case when the literature on the formal rescue of smaller companies is considered. Nevertheless, there are some useful studies by academic economists which have cast some light on the dynamics of small company activity in Ireland²²⁷.

Moreover, the existing company rescue legislation is no longer new to Ireland: the data resulting from court activity is now extensive.²²⁸ In addition, the very difficult trading circumstances at this time have caused all matters relating to the efficacy of corporate insolvency and corporate rescue law to become pressing: this, in turn, has generated a non-academic literature for a larger audience.

Corporate rescue law in most instances is described as a method of whatever kind having legal, financial and business implications which enables the continuation of a business entity that is threatened with insolvency. In certain instances, the objective may be the preservation of the corporate entity, in others just that of the business.²²⁹ More generally, the culture of corporate rescue has a number of dimensions: it can be protective, but it can also be punitive. It can be punitive towards company directors who in the given circumstances have not fulfilled their fiduciary duties. It impacts at both the legislative and judicial levels. It has implications so far as statutes are to be construed by judges: that is to say that, where a corporate rescue interpretation is employed, statutes can be construed so as to encompass a

²²⁷ Tax Policy Group, "Economic Assessment of SME Sector in Ireland" (2012) last downloaded on 13th December, 2015 at <http://taxpolicy.gov.ie/wp-content/uploads/2012/11/Economic-Assessment-of-SME-Sector-in-Ireland.pdf>

²²⁸ For instance, CSO data on examinerships. Deloitte Dublin also keep relevant statistics.

²²⁹ Belcher A, *Corporate Rescue* 1st edn Sweet and Maxwell London 1997.

larger number of concerned parties who will be directly affected by the impending closure of a given corporate entity, rather than a narrow band of creditors and others. According to this way of thinking, judges may generally interpret relevant legislation in a way that assists the preservation of companies rather than their liquidation.²³⁰

Corporate rescue law is a branch of corporate insolvency law. There is a lack of consensus about the goals of the latter.²³¹ This lack of consensus is operative at various levels. There is no agreement about the appropriate values and goals of insolvency law at a practical level. There is also no agreement at the normative level. The same applies with regard to matters of implementation. These issues have been debated for at least thirty years and have brought about a fundamental divide in thinking about insolvency law. On one side are those who favour creditor interests and who see the task of insolvency law as being that of securing for the creditors the market value of what remains of the failed company's assets. On the other side are those who would favour to a greater or a lesser degree an approach that would take more account of the wider community and who would have a broader notion of what insolvency law could have as its objectives.

1.6.1: INSOLVENCY LAW AND THE THEORETICIANS

One way of thinking about corporate insolvency is to consider the dominant aspect of it as being contractual.²³² In this view, the fundamental feature of corporate insolvency is the contractual agreement between the creditors and the corporate entity.²³³ If these initial premises are accepted, it follows logically that the primary objective of the corporation is to maximise shareholder wealth and give full returns to creditors. In the event of an insolvency,

²³⁰ M Hunter, "The Nature and Functions of a Rescue Culture"(1999) 104 *Journal of Business Law* 426.

²³¹ J Armour, "Who should make Corporate Law? EC Regulation versus Regulatory Competition"(2005) Institute for Law and Finance Working Paper No41 last downloaded on 13th December, 2015 at http://www.ilf-frankfurt.de/fileadmin/migrated/content/uploads/ILF_WP_041.pdf

²³² D G Baird and T H Jackson, "Corporate Reorganisation and the Treatment of Diverse Ownership Interests: a comment on adequate protection of secured creditors in bankruptcy"(1984) 51 *U Chi Law Review* 97, 105.

²³³ T H Jackson, *The Logic and Limits of Bankruptcy Law* (Harvard University Press 1986)

the primary objective becomes that of securing creditor returns to the greatest extent possible. For those who are persuaded by this way of thinking, the creditors bargain model promoted by Jackson, stands as an intellectual citadel. Its central assertion is that insolvency law can be viewed most clearly as a reflection of a notional agreement which both the creditors and the debtor corporation engage in prior to any financial transactions. The model allows for the collective nature of insolvency law. It seeks to identify the solution to the insolvency problem by introducing a putative ex ante bargain that would include the possibility of insolvency in any given case. The methodology employed owes much to the law and economics school. It takes its inspiration from Coase.²³⁴ It applies law and economics methodology to the study of legal outcomes and it emphasises economic efficiency throughout.

From the perspective employed in the creditors bargain model, the insolvency process is fundamentally a system by which debts are collectivized. The objective of the exercise, according to Jackson, is to coordinate the claims of all creditors with a view to extracting the maximum from the debtor's assets. This kind of cooperation or bargain with regard to claims enforcement on the part of creditors is how the model gets its name. The claim is made on behalf of this model that if the creditors had the possibility of agreeing to how they should prosecute their interests, they would probably agree to the Jacksonian approach, rather than any other option. From a business perspective, this approach is economically efficient. On the other hand, its logic demands that stakeholder interests other than those of creditors are automatically excluded.²³⁵ The model has proven its resilience; even if one of its more severe critics has conceded that the model constitutes the "only sustained attempt at a principled analysis of the law governing bankrupt companies."²³⁶

²³⁴ R H Coase, 'The Problem of Social Cost' (1960) 3 *Journal of Law and Economics* 1. 44.

²³⁵ V Finch, *Corporate Insolvency Law: Perspectives and Principles* (CUP 2002) .

²³⁶ R Mokal, *Corporate Insolvency Law* (OUP 2005).

The Jackson model, moreover, is not without a significant number of critics. Briefly stated, they range from the broad-based contractarian school²³⁷ (as opposed to the narrow contractarianism of Jackson) to the farther reaches of communitarian thinking.²³⁸ The distinctions between these schools whose representatives are critical of the Jackson model can be exaggerated as they all tend to share a communitarian vision. Of the broad-based contractarians, another leading representative Mokal.²³⁹ Trebilcock notes that the hypothetical status of the creditors' bargain model undermines its claims to enable the autonomy of the agreeing parties: this is because agents to a hypothetical bargain cannot meaningfully affirm anything.²⁴⁰ Finch argues that creditors and other stakeholders differ in their capacities, knowledge and in their ability to undertake burdensome legal costs. For them, the creditors' bargain approach is not useful. Much of this thinking has its roots in the philosophy of Rawls²⁴¹ and Dworkin.²⁴² In the broad-based contractarian view, those who need to be included in any negotiations of whatever kind about a failing company include a broad range of parties encompassing former employees and managers, but also members of the impacted local community. Communitarian thinking has come in waves. The first group of communitarian thinkers to arrive were Warren and Westbrook.²⁴³ They favour outcomes

²³⁷ For instance, D Korobkin, 'Contractarianism and the Normative foundations of Bankruptcy Law' (1992) 71 Tex Law R 541. Korobkin designed the 'bankruptcy choice model'. This model is quite unlike the Creditors' Bargain theory model in that it does not adopt the Posnerian form of the contractarian argument. It takes its inspiration from the influential text by John Rawls, *A Theory of Justice* (HUP2005) reissue edition.

²³⁸ The multiple value/ eclectic approach is most often associated with Warren. Its adherents view insolvency processes which include the following goals: the distribution of the consequences of financial failure among a broad range of participating parties; the establishment of priorities between creditors; an openness to the possibility of corporate rescue and the consideration in a substantive way of the interests of employees. E Warren, 'The Untenable Case for the Repeal of Chapter 11' (1992) 54 U Chic L Rev 775.

²³⁹ R Mokal, 'The Authentic Consent Model: Contractarianism, Creditors' Bargain and Corporate Liquidation' (2006) Begpress Legal series Paper 1374.. Mokal's Authentic Consent Model – which serves to justify insolvency law- has as a founding premise that. only those who are affected directly by the issues pertinent to insolvency law have a right to choose which principles will govern their rights and obligations in the given case. In the Authentic Consent Model, these parties are given equal weight irrespective of the characteristics which identify them.

²⁴⁰ P Halpern, M Trebilcock and S Turnbull, 'An Economic Analysis of Limited Liability in Corporation Law' (1980) 30 University of Toronto Law Journal 117.

²⁴¹ John Rawls, *A Theory of Justice* (Harvard University Press, 2005) reissue edition.

²⁴² R Dworkin, *Law's Empire* (Hart Publishing 1998) new edition.

²⁴³ Warren E, 'Bankruptcy Policymaking in an Imperfect World' (1993) 92 Mich. L. Rev. E Warren and L Westbrook, *Law of Debtors and Creditors* (Aspen Publishing 2008) 8th edition

which are biased in favour of the community in general rather than having matters decided upon at the will of secured creditors. Another form of communitarianism that emphasises corporate social responsibility arrived in the nineteen-nineties. That form is advanced by Gross²⁴⁴ and Bradley, Schipani, Sundaram and Walsh.²⁴⁵ They have been influenced primarily by Etziane²⁴⁶ the prominent communitarian thinker. They seek to promote legislation which would mandate that the interests of parties other than creditors be considered in the event of a corporate insolvency.²⁴⁷ Bradley, Schipani, Sundaram and Walsh²⁴⁸ view distributive outcomes which are in their terms equitable as having greater importance than contractual efficiency. Corporate governance for its part is traditionally defined as the mechanism that “deals with the ways in which suppliers of finance to corporations assure themselves of getting a return on their investment”²⁴⁹ For Bradley, Schipani, Sundaram and Walsh the range of concerns for corporate governance is wider: it covers “employees, creditors, suppliers, customers, host communities and relationships within these constituencies themselves.”²⁵⁰ Bradley, Schipani, Sundaram and Walsh advocate a variety of corporate constituency statutes which would be significantly tailored to the requirements of any given case.

Much of corporate governance scholarship in recent years addresses the question: are corporations to be thought of as a nexus of contracts agreed by individuals or are they a legal

²⁴⁴ K Gross, ‘Taking Community Interests into Account in Bankruptcy: An Essay’ (1994) 72 Washington University Law Quarterly 1031.

²⁴⁵ M. Bradley, C. Schipani, A Sundaram and J. Walsh, ‘The Purposes and Accountability of the Corporation: Corporate Governance at a Crossroads’ 14 (1999) 62 *Law and Contemporary Problems*.3

²⁴⁶ A Etziane, ‘The Spirit of Community’ (Crown 1993).

²⁴⁷ Three of the purposes identified in the paper by Bradley, Schipani, Sundaram and Walsh are these : to chart the changes in business enterprise in the US in recent years; to review and critique four broad responses to this as found in the theory and practice of corporate governance and to identify the necessary conditions for a system of corporate governance that can take account of these changes. M. Bradley, C. Schipani, A Sundaram and J. Walsh, ‘The Purposes and Accountability of the Corporation: Corporate Governance at a Crossroads’ 14 (1999) 62 *Law and Contemporary Problems*.3.

²⁴⁸ M. Bradley, C. Schipani, A Sunderam and J. Walsh, ‘The Purposes and Accountability of the Corporation: Corporate Governance at a Crossroads’ (1999) 62 *Law and Contemporary Problems* 3.

²⁴⁹ N Barberis, A Schleifer and R Vishny, ‘A Model of Investor’ (1998) Working paper last downloaded on September 19, 2013.

²⁵⁰ M. Bradley, C. Schipani, A Sunderam and J. Walsh, ‘The Purposes and Accountability of the Corporation: Corporate Governance at a Crossroads’ (1999) 62 *Law and Contemporary Problems* 3 34.

entity with rights and responsibilities as a natural person.²⁵¹The central concern is how the conflicts of interest between the corporation's stakeholders can most effectively be kept in check. That is the conflict of interest between the corporate managers and stockholders, given the separation of ownership and control in a large corporation. There are two categories of viewpoint that in some ways parallels that found in insolvency law scholarship. On the one side there are contractarians²⁵²who view the corporation as simply a nexus of contracts and on the other there are the communitarians who view the corporation as having the rights and obligations of a natural person.²⁵³ Plainly, they have very different public policy implications.²⁵⁴

Bradley, Schipani, Sundaram and Walsh's²⁵⁵critique of narrow contractarianism is expressed as follows:

Because contractarianism relies on the sanctity of contracts, the most damaging insolvency law critiques of the position emphasise situations where contracting is costly or impossible. Contractarians presume that contracts can be written to contemplate all possible contingencies. Unfortunately this is an ideal that never can be reached. There always will be inevitable contractual incompleteness due to ambiguities in language, inadvertence, unforeseen circumstances and disputes concerning observability, parties precontracting intentions, measurability, and verifiability of contract terms and outcomes.²⁵⁶

If contracts are inefficient and incomplete, the pure contractarian position is untenable, but information asymmetries, transaction costs, and outright fraud are insurmountable obstacles

²⁵¹ This point is made by M. Bradley, C. Schipani, and J. Walsh, 'The Purposes and Accountability of the Corporation: Corporate Governance at a Crossroads' (1999) 62 *Law and Contemporary Problems* 3 34.

²⁵² Contractarians do not view the corporation as being a separate unto itself. M. Bradley, C. Schipani, and J. Walsh, 'The Purposes and Accountability of the Corporation: Corporate Governance at a Crossroads' (1999) 62 *Law and Contemporary Problems* 3 34.

²⁵³ Communitarians consider that without legally enforceable rules would be accountable to neither the stockholders nor the public in general. M. Bradley, C. Schipani, and J. Walsh, 'The Purposes and Accountability of the Corporation: Corporate Governance at a Crossroads' (1999) 62 *Law and Contemporary Problems* 3 34.

²⁵⁴ M. Bradley, C. Schipani, and J. Walsh, 'The Purposes and Accountability of the Corporation: Corporate Governance at a Crossroads' (1999) 62 *Law and Contemporary Problems* 3 34.

²⁵⁵ M. Bradley, C. Schipani, and J. Walsh, 'The Purposes and Accountability of the Corporation: Corporate Governance at a Crossroads' (1999) 62 *Law and Contemporary Problems* 3.

²⁵⁶ S H Schwartz, 'Universals in the Content and structure of Values: Theory and empirical tests in 20 countries' in: M. Zanna (Ed.), 25 *Advances in Experimental Social Psychology* 1.65 (Academic Press 1992).

to efficient contracting solutions.²⁵⁷ For example, contractarians assume that the agency problem between stockholders and corporate managers can be solved through contracting.²⁵⁸ However, a plethora of theoretical and empirical papers demonstrates the inability of contracts to eliminate the agency costs of the corporate form.²⁵⁹ Critics also point out that serious imperfections and impediments in the market for corporate control belie the notion that outside forces exert pressure on corporate managers to maximise shareholder wealth.²⁶⁰ Indeed, evidence testifying to the efficiency of top management discipline born of this market is equivocal at best.²⁶¹ This last mentioned view can, however, be contested.²⁶²

Another limitation of the contractarian view is that it does not recognise the many individuals who are affected by, but are not directly party to, the corporate contract. Put simply, a contract between the two parties may harm a third. For example, a contract between a firm and a creditor may create externalities for other creditors directly by altering priority rules or indirectly by altering managerial incentives.²⁶³ Thus, so-called externalities or third-party effects vitiate the claim that the freedom of individuals to enter into voluntary, mutually beneficial contracts will result in the optimal allocation of society's resources.

²⁵⁷ S H Schwartz, 'Universals in the Content and structure of Values: Theory and empirical tests in 20 countries' in: M. Zanna (Ed.), 25 *Advances in Experimental Social Psychology* 1.65 (Academic Press 1992).

²⁵⁸ M Harris and A Raviv, 'Control of Corporate Decisions : Shareholders and Management' (2010) 23(11) *Review of Financial Studies* 415 41.

²⁵⁹ M Harris and A Raviv, 'Control of Corporate Decisions : Shareholders and Management' (2010) 23(11) *Review of Financial Studies* 415 41.

²⁶⁰ M C Jensen and WH Meckling, 'Theory of the Firm: Managerial Behaviour, Agency Costs and Ownership Structure' (1976) 4 *Journal of Financial Economics* 305-360. See also N Barberis, A Schleifer and R Vishny, 'A Model of Investor Sentiment' (1998) Working paper last downloaded on December 13th, 2015.

²⁶¹ J P Walsh And J W Ellwood, "Mergers, Acquisitions, and the Pruning of Managerial Deadwood". (1991) 12 *Strategic Management Journal* 3,201.

²⁶² The agency costs can be reduced by monitoring and enforcing detailed contracts. M Jensen and W Meckling. 'Theory of the Firm: Managerial Behaviour, Agency Costs and Ownership Structure' (1976) 3(4) *Journal of Financial Economics* 305. If this approach fails, the stock price will suffer. This decline in the stock price, where it occurs, creates a incentives for a different management team to take over the company H Manne, 'Mergers and the Market for Corporate Control'(1965) 73(2) *Journal of Political Economy* 110. Jensen argues that this reduces manager principal agent conflicts. M Jensen, 'The Takeover controversy: The Restructuring of Corporate America' (1987) *Vital speeches of the Day*, march 17th 426. P Nippel, 'The Market for Corporate Control' 2010-2011) *Institut fuer Betriebswirtschaftslehre*, Kiel.

²⁶³ J Tirole, *The Theory of Industrial Organisation* (MIT Press 1988).

There has been, in turn, a negative reaction by some scholars to these critics of contractarianism. Scholars from the law and economics school such as Armour²⁶⁴ have analysed the arguments of Korobkin²⁶⁵ Rasmussen²⁶⁶ and Gross²⁶⁷ and identified some weaknesses. For instance, Korobkin would seek an arrangement following insolvency whereby the law would take account and protect the interests of vulnerable non-creditors who were directly affected. Korobkin accepts, however, that his propositions of a distributionist nature still need to be developed much more, given their current imprecise nature. Armour finds this unacceptable.²⁶⁸ Korobkin's approach, moreover, has not gained acceptance from his colleague Rasmussen who would be counted among the critics of Jackson, but would himself be more Rawlsian in approach. That is to say that Rasmussen would not favour redistribution simply through a messy insolvency law arrangement; for him, taxation and direct transfers would be more acceptable. In addition, it might be added that at the level of political theory any programme of redistribution of even a Rawlesian²⁶⁹ stamp would find formidable intellectual foes in such commentators as de Jasay²⁷⁰ and Schmidtz.²⁷¹

Armour and Frisby again take aim at the critics of Jackson in the following comment:

²⁶⁴ J Armour and S. Frisby, 'Rethinking Receivership' (2001) 21 Oxford Journal of Legal Studies 73.

²⁶⁵ D Korobkin, 'Rehabilitating Values: A Jurisprudence of Bankruptcy' (1991) 91 Columbia Law Review 717.

²⁶⁶ R Rasmussen, 'An Essay on Optimal Bankruptcy Rules and Social Justice' (1994) University of Illinois Law Review 1.

²⁶⁷ K Gross, 'Taking a Interests into Account in Bankruptcy: An Essay' (1994) 72 Washington University Law Quarterly 1031. One criticism of Gross has been as follows. How can the community interest – as perceived by Gross- be defined ? Various communities may perceive community interests differently. If a judge were to decide case on the basis of perceived community interests as a matter of policy, that decision could be challenged in a superior court. Schermer considers that these conflicting viewpoints at policy level could result in the breakdown of the *stare decisis* system. 'B Schermer,'Response to Professor Gross: Taking the Interests of the Community into Account in Bankruptcy – A Modern-Day Tale of Belling the Cat' (1994) Open Scholarship, Washington University last downloaded on 15th August, 2015 at openscholarship.wustl.edu/cgi/viewcontent.cgi?ar

²⁶⁸ D Korobkin, 'Rehabilitating Values: A Jurisprudence of Bankruptcy' (1991) 91 Columbia Law Review 717.

²⁶⁹ The reference is to John Rawls. J Rawls, *A Theory of Justice* ((Belknap 1971). The book seeks to resolve the competing claims of freedom and equality. Rawls thinking has been influential in the social sciences for at least a generation.

²⁷⁰ A de Jasay, *Political Economy Concisely: Essays on Policy that Does not Work and Markets that Do* (Liberty Fund 2010). Anthony de Jasay is a prominent economist and political philosopher. He is a trenchant critique of all communitarian projects. His work is popular in libertarian circles.

²⁷¹ D Schmidtz, 'The Elements of Justice' (CUP 2006. David Schmidtz is a philosopher who writes about political, economic and environmental issues. His perspective is that of a libertarian.

A second normative starting point is to begin with the law's imminent values, and thence to argue that the values which are reflected in the law are the ones which ought to continue to be so reflected Warren (1993). This claim would neatly solve the problems of implementation which are common to other normative theories. The prescriptions of this position would be perfectly congruent with the law as it stands. However, this does not affect any independent grounds for promoting any one, let alone all, of these values. It seems more like an ad hoc assumption that because these are reflected in the law, they ought therefore to be implemented: a classic non sequitur. Furthermore, such a claim gives us no idea of the relative importance of these values, and consequently has no answers to the difficult questions raised by conflicts between them in the application of the law to hard cases.²⁷²

Armour Deakin and Konzelman²⁷³ examine from a law and economics perspective private “workout” (that is renegotiation) methodologies in the UK through which bankers and the management of large corporations in financial distress negotiate solutions. The workout mechanism operates outside of the formal insolvency process. They determine that cost determines whether one or other of these approaches will be chosen in any given case.

There have been other significant writings to a greater or a lesser degree critical of the Jacksonian position. There have, for instance, been substantial critiques offered of the creditors bargain theory by both LoPucki²⁷⁴ and Mokal.²⁷⁵ Under LoPucki's team production theory, corporate boards are held to exercise a broad measure of discretion in determining corporate objectives and in the allocation of profits (when available).²⁷⁶ The view is taken

²⁷² J Armour and S. Frisby, 'Rethinking Receivership' (2001) 21 Oxford Journal of Legal Studies at 73.

²⁷³ J Armour, S. Deakin and S. Konzelman, 'Shareholder Primacy and the Trajectory of UK Corporate Governance' (2003) 41 British Journal of Industrial Relations 531.

²⁷⁴ L M Lopucki “A Team Production Theory of Bankruptcy Reorganisation” 57 Vanderbilt Law Review April, 2004.

²⁷⁵ R Mokal, *Corporate Insolvency Law* (OUP 2005).

²⁷⁶ L M Lopucki “A Team Production Theory of Bankruptcy Reorganisation” (2004) 57(3)Vanderbilt Law Review 742. The Team Production Theory as a contractarian theory has very significant implications for insolvency theory. For LoPucki, the interests of the shareholders and creditors do not take precedence over that of any other interested parties. The shareholders and creditors are merely part of the production team that is the corporation. They agree to subordinate themselves to the team production contract. In Team Production Theory it is postulated that the corporation should honour team production obligations –such as protecting the range of employee interests- by giving those interests precedence over legal obligations which might have more powerful advocates. In LoPucki's view, the existing management is best placed to champion the interests of all parties who are subject to the team production contract. LoPucki's model is in some part derived from M M Blair & L A Stout “A Team Production Theory of Corporate Law” 85 Virginia Law Review March, 1999 at 247. In contrast to those who argue that directors should be more accountable to shareholders, Blair & Stout take the view that hold to a mediating hierarchy doctrine.

that corporate boards are best placed to defend the investments (of varying kinds) in the corporation of not only shareholders and creditors but also employees and the larger community.²⁷⁷ In addition, team production theory is found to be of significant value because it provides a very good fit for a great deal that is not well covered in creditors' bargain theory. LoPuchi expresses it as follows :

Features that make no sense in the Creditors' Bargain theory – including the debtor-in-possession, protection of the board from domination by the holder of the residual interests, the board's central role in the negotiation of a plan, the persistent insistence that reorganization benefits society by saving jobs and companies, and the very existence of reorganization – are all explained comfortably in Team Production Theory.²⁷⁸

While it is contractarian, team production theory offers a sustained challenge – at a theoretical level- to traditional contractarian theory of the kind found in creditors bargain theory. Corporate reorganization becomes no longer a matter that is determined by legislators - although it may be something that government can facilitate- and instead becomes a contract term acceptable to creditors and shareholders, so as to keep a given company in being.

There has been significant research published that is broadly supportive of the team production theory position. For instance, Rajan and Zingales²⁷⁹ have demonstrated that property rights (and, by extension, the privileged status of shareholders in corporate governance) can be a source of problems in a team production enterprise. They consider that there are likely to be situations in which the owner of assets used in the corporation can extract a larger share of the gains from production by selling the assets rather than making

²⁷⁷ For an analysis of the concept of team production and its connectedness to the earlier work of Coase see A Alchian and H Demsetz (1972) "Production, Information Costs, and Economic Organization" 62 *The American Economic Review* 5 at 777. O E Williamson has argued -in *Markets and Hierarchies: Analysis and Antitrust Implications* (The Free Press 1975) - that team production as a concept has quite a narrow range of application because it presupposes that output can be related to individual inputs. In Williams view, that assumption is unwarranted. This claim is vigorously contested by team production theory partisans.

²⁷⁸ L M Lopucki "A Team Production Theory of Bankruptcy Reorganisation" (2004) 57 (3) *Vanderbilt Law Review* 743.

²⁷⁹ R Rajan and L Zingales, "Power in the Theory of the Firm" (1998) 113 *Quarterly Journal of Economics* 387.

their own specialised contribution to the corporation. The awareness of this is likely to act as a disincentive to the other members of the corporate team.²⁸⁰ This serves to demonstrate that the “ownership” concept may have unintended consequences. Rajan and Zingales suggest that the optimal structure for at least some business enterprises might be for a complete outsider to become a party to the enterprise. In that capacity they would have the right to hire and fire the teams, to buy and sell assets and to allocate the surplus generated by the enterprise to the team members. The outsiders – in this case, the board- would not have the right to take those assets for themselves.²⁸¹

Rock and Wachter offered a theory of the relation between legal and non-legally enforceable rules and standards in a corporation which is at least indirectly supportive of team production theory.²⁸² They use their theory to analyse a number of prominent features of corporate law. Specifically, they draw on key developments in the theory of the firm to identify key problems facing participants in the corporation. In developing their approach, they combine the property rights strand in the theory of the firm with the transactions cost approach. They conclude this part of their investigation by saying that the main issue is solving the related problems of coordinating activities, choosing the corporation’s assets and developing appropriate incentives for specific investments. From this initial base, they go on to deduct that the corporation, so understood, should be governed by “norms.” By that, they mean non-legally enforceable rules and standards (“NLEERS”). In their view, the point and purpose of

²⁸⁰ R Rajan and L Zingales, “Power in the Theory of the Firm” (1998) 113 *Quarterly Journal of Economics* 387 at 408.

²⁸¹ The claim that outsiders or rather those who would form the board would necessarily act in a wise manner has been contested by Millon. He states given that TPT is a normative theory and given the board’s lack of insulation from extra-legal pressures (as distinct from legal ones), political pressures could influence the board’s decision making as much as legal rules would. In Millon’s view, distributional outcomes in such contexts would not necessarily be different in kind from what they would be, if they were dictated by the shareholder primacy principle. D Millon, “New Game Plan or Business as usual: A Critique of the Team Production Model of Corporate Law” (2000) 86 *Virginia L R* 1001 at 1004. On the other hand, they are not the agents of or under the control of any party and they do have the capacity to act autonomously. Moreover, no other party in the corporate context has a greater claim to represent all interests, if the corporation is seen in a team production context.

²⁸² E Rock and M Wachter, “Islands of Conscious Power: Law Norms and the Self-Governing Corporation” (2001) 149 *University of Penn L R* 1619.

corporations is to replace the legal/contractual governance of corporations with NLERS. From this perspective, corporate law can be understood as a sophisticated mechanism for facilitating governance by NLERS. Management is used to determine the assets over which the corporation must have residual rights of control and to develop a governance structure for protecting the match-investments in these assets. Legal rules provide the default settings through which management operate and prohibit non-pro-rata distributions (a combination of ex ante rules and the ex post duty of loyalty) which drives the controlling shareholders to maximise the value of the corporation.

Mitchell, in turn, has identified a need for a new model of corporate governance and of the board of directors.²⁸³ He has suggested that this would have the potential to enhance corporate welfare by helping to create a more realistic body of corporate law. Considering the adverse consequences of the corporate takeover boom in the United States in the 1980s, he thinks that this has led to a reconsideration of the structure and substance of US corporations. The difficulty, in his view, lies in the privileged status of the shareholders vis-à-vis other parties connected to the corporation and the assumptions borrowed from neoclassical economics which are found in corporate governance, He calls for new thinking, which would allow for a reconceptualization of the appropriate role of the board. He takes the view that the current structure of corporate governance excludes, in an unrealistic manner, a number of constituent groups who are vital to the corporations survival. He considers that this forced exclusion also has the consequence of impairing the long-term business judgment of the board. To his mind, this narrowness of focus has led to an emphasis on short-term objectives by management in American corporations.

²⁸³ L Mitchel, "A Critical Look at Corporate Governance" (1982) 45 Vanderbilt L R 1263.

Millon, although critical of TPT,²⁸⁴ has noted the legislative developments at state level within the United States which effectively weaken if not displace the commitment to shareholder welfare as the primary responsibility of corporations.²⁸⁵ In addition and more significantly, in Millon view, these statutes authorise management to consider the interests of various non-shareholder constituencies. (These would include employees, creditors, suppliers, consumers and local communities). The directors' duties statutes, in particular, alter the grounds available to shareholders for overcoming the business judgment rule's presumption in favour of management, provided that the particular activity of management is not tainted by self-interest.²⁸⁶

A window on Millon's approach is provided by the following paragraph:

“The manner in which shareholder property rights are defined as a manifestation of the states' general power to specify the content of property rights in order to promote justice and utility. So called private property rights always exist in order to give expression to public values; the survival of a given property law depends ultimately on its social utility. Once a particular legal doctrine is thought of as obsolete, it can and will be replaced by a new one. The directors' duties statutes are an example of this process at work.

Lan and Heraklious²⁸⁷ are broadly supportive of team production theory, but they see it as being of lesser value when applied to corporations in what were traditionally Anglo-Saxon states compared to corporations in the Far East and in the Russian Federation.²⁸⁸ They highlight the contested nature of agency theory's assumptions and the failure of empirical research to support agency theory tenets. They suggest that there is a need to amend it methodologically. They draw from legal theories of the firm, derivative views of corporate

²⁸⁴ See note 279 supra.

²⁸⁵ These legislative developments have followed as a consequence of the takeover boom in corporate life in the United States in the 1980s and have served to fend off such activity. D Millon, “Redefining Corporate Law” (1991) 24 Indiana L R 223 at page 224.

²⁸⁶ D Millon, “Redefining Corporate Law” (1991) 24 Indiana L R 223 at pages 254-255.

D Millon, “Redifining Corporate Law” (1991) 24 Indiana L R at pages 273.

²⁸⁷ L Lan and L Herakleous, “Rethinking Agency Theory: The View from Law” (2010) 35 The Academy of Management Review 294.

²⁸⁸ ²⁸⁸ L Lan and L Herakleous, “Rethinking Agency Theory: The View from Law” (2010) 35 The Academy of Management Review 294 at page 310.

governance, and corporate law principles and cases so as to challenge and recast fundamental tenets underlying classic agency theory as applied to corporate governance.

Team production theory has, however, been subject of significant criticism. Meese rejects one of its fundamental propositions of team production theory: that is the mediating hierarch model as developed by Blair and Stout.²⁸⁹ Meese concludes his argument as follows:

At any rate, even if a mediating hierarch model could reduce the prospect of opportunism and enhance a firm's ability to attract team-specific investment, such an approach to firm governance would entail significant ownership costs, costs that would likely outweigh any purported benefits of such a model. By vesting ultimate control over the public corporation in disinterested arbiters, the mediating hierarch model would deprive society of many of the benefits ordinarily associated with the corporate form. Precisely because they are disinterested, hierarchs would lack the sort of hands-on expertise that normally characterizes many corporate directors. More importantly, mediating hierarchs would have no claim to the team's residual product, and they would not be accountable to anyone who did. Thus, they would have little incentive to maximize anything other than their own welfare and therefore would not be effective monitors of the team under their supervision.

Mokal's view of the creditors bargain model is lacking in cogency. Its notion of 'consent' is flawed. It does not allow for the time factor in creditors' decision-making in an insolvency. Post-insolvency in any given case, most would opt for a moratorium, but according to the theory that would not correspond to their original preference. The difficulty is that creditors' bargain theory postulates that creditors' decisions are a function of time; it does not, however, offer a means of pinpointing a time that is non-arbitrary. The argument falls because of this.

²⁸⁹ M Blair & L A Stout "A Team Production Theory of Corporate Law" 85 Virginia Law Review March, 19. A J Meese, 'The Team Production Theory of Corporate Law: A Critical Assessment' (2002) 43 William and Mary Law Review 1629. Meese observes that the principal-agent model is the most highly regarded model in corporate law. Having noted that the mediating hierarch model of corporate governance is presented by Blair and Stout as a model similar in status to that of the principal-agent model, he weighs the supporting evidence from the business world in support of the first mentioned model. He claims that Blair and Stout claim to have evidence in support of the mediating hierarch model from corporate law as practiced in the state of Delaware. He disputes this. He states that there is no evidence that non-shareholders participants in large corporations are at greater risk of opportunism from more powerful interests than their counterparts in private companies. In his view, the legal position of the non-shareholder participants is more secure in practice in the context of the principal-agent publicly held corporation. He presses home the point that shareholders in private companies are, if anything, than those invested in a public corporation. His conclusion is that there are no cogent reasons to depart from the currently dominant principal-agent model. For a response to Meese's criticisms see M Blair, 'Team Production Theory and Corporate Law'(2001) 27 Nordic Journal of Political Economy 88. As a result, there is no apparent reason why the law of public corporations should depart from the single-owner approach that characterizes private firms.

In addition, creditors' bargain theory has no defence against the charge that it is oppressive of weaker parties.²⁹⁰

Mokal sees insolvency law in terms that owe much to both Rawls²⁹¹ and Dworkin.²⁹² In the Mokal view, the impacted parties are equal in status and seek solutions by means of cooperation. Insolvency law is part of an elaborated legal tradition that seeks to bring about the values of equality as determined within the Rawlsian system. Fairness is demonstrated by a reciprocity between participants which allows these participants to pursue their goals constrained only by rules that make for a cooperative social project.²⁹³

Mokal offers the Authentic Consent Model - his own design - as a more useful approach to resolving insolvency matters. Central to it is that the parties directly impacted by the insolvency, but only these, should have a right to choose the principles which will guide decisions about their rights and obligations. In this model, the parties are to be given equal status irrespective of the attributes that would otherwise serve to differentiate them. These parties are to be regarded as free, equal and reasonable.

Hahn holds that the two contending schools of thought on insolvency law and corporate reorganisation - that is, the law and economics school and the communitarian-vision school - have both positive and negative features.²⁹⁴ In his view, neither is demonstrably superior to the other. What is important, in Hahn's view, are the specificities of the legal and business context in any given jurisdiction. Hahn continues :

In different markets the various players in the market, namely the corporate debtors, creditors and equity holders possess different bargaining power and leverage over one another in the pre-bankruptcy period. Moreover, countries differ in the structure of corporate governance of their corporations. Based on this understanding, (it is argued

²⁹⁰ Mokal R J, "The Authentic Consent Model: Contractarianism, Creditors' Bargain and Corporate Liquidation" (2001) 21 *Legal Studies* 403.

²⁹¹ J Rawls, *A Theory of Justice* (OUP 1972).

²⁹² R Dworkin, *Law's Empire* (Harvard University Press, 1986).

²⁹³ J Rawls, *A Theory of Justice* (OUP 1972).

²⁹⁴ D Hahn, 'Concentrated Ownership and Control of Corporate Reorganisations' (2004) 4 *Journal of Corporate Legal Studies* 119.

that)... the structure of corporate governance and the bargaining power of the various players active in a national market strongly affect the desirable model for reorganisation law in that country. In jurisdictions where corporate law is influenced by the Berle-Means corporate model, that is, where the control by management is separated from the equity holders' ownership of the firm, management can be relied on to continue controlling the debtor firm through the bankruptcy case and co-operate with the creditors. On the other hand, in jurisdictions where the equity holders closely control the firm, allowing management to keep control of the debtor firm jeopardises the creditors and leaves them vulnerable to equity holders' manipulation.²⁹⁵

Berle-Means Theory focuses on the foundations of United States corporate law. The theory's authors, Berle and Means, argue that those who legally have ownership over the corporation have been separated from its control.²⁹⁶ Hahn, for his part, dismisses such mechanisms as examinership (in the Irish context) for corporations where equity holders closely control the firm. His argument applies strictly, however, to such closely controlled firms. Proposing what he calls "a codetermination model", he advocates an approach which combats the equity holders manipulation of risk on the one hand, yet does not automatically oust management from office upon the inception of reorganisation."²⁹⁷ The retention of existing management is something that he is willing to accept, because it enables the application for formal company rescue –examinership in the Irish case- by companies which can be reasonably expected to regain financial health. The Hahn co-determination model proposes that in markets where closely controlled companies predominate, it would be advisable that a trustee be appointed to the management team in the event of a rescue exercise being attempted for a financially distressed firm. The trustee would have veto power. In his judgment, this is a more equitable approach.

Hahn sums up in the following terms:

Under this proposal, the filing for reorganisation and the appointment of a trustee would not oust management. Rather, the trustee will operate the debtor corporation,

²⁹⁵ D Hahn, 'Concentrated Ownership and Control of Corporate Reorganisations' (2004) 4 Journal of Corporate Legal Studies 119.

²⁹⁶ A Berle and G Means, 'The Modern Corporation and Private Property' (Harcourt 1932).

²⁹⁷ D Hahn, 'Concentrated Ownership and Control of Corporate Reorganisations' (2004) 4 Journal of Corporate Legal Studies 149.

negotiate with the creditors and draft a reorganisation plan in conjunction with management.the exclusive power to negotiate with the creditors and draft a reorganisation plan would be vested in the trustee. Should the trustee conclude that the debtor does not merit reorganisation, the trustee would have the exclusive power to decide on the debtor's liquidation.²⁹⁸

Through membership on the board, as well as through its formal and informal communication with the debtor's top executives, the trustee would participate in the actual decision-making as an *active* player. The trustee would be an *ex officio* board member. This level of involvement cannot be achieved through the mechanics of the bifurcated codetermination proposal.²⁹⁹ Under that proposal, the trustee does not become an *ex officio* member of the board. Under the integrated co-determination proposal,³⁰⁰ by contrast, the trustee joins the board. In addition, the integrated codetermination proposal improves the crafting of the reorganisation plan. Unlike the bifurcated proposal, the integrated proposal – as viewed by Hahn- causes management to participate alongside the trustee in the negotiations, bargaining and drafting of a reorganisation plan. Preparing reorganisation plans requires not only a sound mastering of the legal rights of all creditors and equity holders and an understanding of the comprehensive structure of reorganisation law, but also a close familiarity with the business of the debtor. No reorganisation plan can be made effective if it deals only with the business projections of the debtor and neglects the legal adjustment and treatment of the creditors' claims. Conversely, a reorganisation plan which merely allocates value to the various claimants based on their respective legal rights and fails to address the operational and financing plans of the debtor is destined to result in liquidation. In Hahn's view, a feasible reorganisation plan must map both the business prospects of the debtor and the legal treatment of claims based thereon. While a trustee, as an independent objective party,

²⁹⁸ D Hahn, 'Concentrated Ownership and Control of Corporate Reorganisations' (2003) Working Paper Legal No 6-03 Bar-Ilan University Faculty of Law 43.

²⁹⁹ This refers to the reorganisation model detailed in C Adams, "An Economic Justification for Corporate Reorganisations" 20 Hofstra Law Review 117. This is detailed in the main text above.

³⁰⁰ This is the model as found in D Hahn, 'Concentrated Ownership and Control of Corporate Reorganisations' (2003) Working Paper Legal No 6-03 Bar-Ilan University Faculty of Law 42-52.

contributes to the integrity of the process of bargaining with the creditors and to the proposal of a balanced treatment of claims under the plan, it is management which has the advantage in business planning for the debtor, the argument continues. A reorganisation plan that is the joint work-product of the trustee and management is one which enjoys the relative advantages of each.

Adam's codetermination model,³⁰¹ in contrast, applies not just to closely held companies.³⁰² The Adams' Codetermination Model bifurcated governance mechanism takes the following form: at a day-to-day level, existing management have the right solely to operate the business while the trustee does the negotiating with creditors and puts together the reorganisation plan. The model also provides a methodology which facilitates robust decisions about whether or not a given company should seek reorganisation or be liquidated. These models may throw much light not just on what needs to be remedied in the Irish context, but on how reform exercises (at least in part) might proceed.

1.6.2: COMMENTARY ON CORPORATE RESCUE CULTURE

It is impossible to study a subject like insolvency law without considering the climate of opinion which in one way or another has influenced the key influencers and decision makers in the given context. The literature cited here will in the first instance refer to the UK context and then to that in the United States.

For Hunter³⁰³ the characteristics of an effective rescue mechanism in the UK would of necessity have included the following. It would have:

- (1) the capacity to exercise judicial pressure on a petitioning creditor or an execution creditor, to accept a reasonable composition or scheme proposed by the debtor;
- (2) an enforceable means of collectively binding creditors;.....

³⁰¹ C Adams, "An Economic Justification for Corporate Reorganisations" 20 Hofstra Law Review 117.

³⁰² J Wagner, 'One-third codetermination at company supervisory boards and firm performance in German manufacturing industries: first direct evidence from a new type of enterprise data' (2009) University of Lüneburg Working Paper Series in Economics No. 136.

³⁰³ M Hunter, 'The Nature and Functions of a Rescue Culture' (1999) Journal of Business Law.

- (3) a more efficient qualification and control regime for insolvency practitioners, to administer all insolvent estates;
- (5) a greater degree of protection for the debtor's family home, and more extended rights of occupation for the family;
- (6) the institutionalisation of bankers' contributions to rescues, both for small businesses and for major enterprises;
- (7) collaborative and positive policies on the part of the Inland Revenue and the Customs & Excise, when participating, as major creditors in most insolvencies, in proposed "rescue operations";
- (8) the harmonisation of financial rights and duties between the employees of an insolvent business and the administrative receiver and the administrator;
- (9) the public interest in the preservation and salvage, wherever practicable, of productive entities and enterprises; and
- (10) the provision of, or the funding for, adequate legal representation (*e.g.* by legal aid) to enable rescue procedures to be mounted, in the absence of immediately realisable assets or other rescue working capital.³⁰⁴

In comparing the US and UK systems of formal corporate recovery, Carruthers and Halliday make the observation that given the similarities in capital market structure and the parties such as companies and financial institutions operating in both the United States and the UK, it might be expected that the corporate reorganisation rules would be very similar. This is not the case. The dissimilarities are due to deeply rooted economic, institutional and cultural frameworks.³⁰⁵ They add:

Since the English were well aware of Chapter 11, and yet chose explicitly to reject it, the English case suggests how models of corporate governance in bankruptcy derive from cultural forces and ideologies. The English divergence grew out of intermediate level theories of firm failure and macro-economic and social ideologies about the market as an effective institution.³⁰⁶

Rescue culture has been the subject of detailed academic consideration by Davies,³⁰⁷ Phillips, and Mokal, and Milman the last two specifically addressing the thinking behind the

³⁰⁴ M Hunter, 'The Nature and Functions of a Rescue Culture' (1999) *Journal of Business Law* 499 .

³⁰⁵ Bruce G Carruthers and Terence C Halliday *Rescuing Business: the Making of Corporate Bankruptcy Law in England and the United States* Clarendon Press, Oxford 1998 297.

³⁰⁶ Bruce G Carruthers and Terence C Halliday *Rescuing Business: the Making of Corporate Bankruptcy Law in England and the United States* Clarendon Press, Oxford 1998 297.

³⁰⁷ P Davies, 'Employee Claims in Insolvency: Corporate Rescue and Preferential Claims' (1994) 23 *ILJ* 141. M Phillips, *The Administration Procedure and Creditors' Voluntary Arrangements* (1996) Centre for Commercial Law Studies; R J Mokal, 'The Authentic Consent Model: Contractarianism, Creditors' Bargain and Corporate Liquidation' (2001) 21 *Legal Studies* 400, 443 and D Milman and D Mond, *Security and Corporate Rescue* (Hodgsons 1999).

Enterprise Act, 2002. Frisby³⁰⁸ has also examined the approach to rescue culture as found in the UK Enterprise Act, 2002. She has observed that the Enterprise Act is not a development on the existing thinking from the 1980s. The developments in the Enterprise Act (2002) relate more to the effectiveness of existing mechanisms; specifically, the mechanisms which promote optimal accumulations in the company's estate and equitable returns to creditors. There have, however, been larger developments. Finch³⁰⁹ examining a broad canvas, entitles her paper 'The Recasting of Insolvency Law.' She states:

Over the last decade corporate insolvency laws and processes have changed in two important ways. There has been a philosophical shift away from *ex post* responses to corporate crises and towards influencing the way that corporate actors manage the risks of insolvency *ex ante*. In addition, there has been a revision of insolvency roles so that participants in corporate and insolvency processes are increasingly encouraged to see corporate decline as a matter to be anticipated and prevented rather than responded to after the event. In this development turnaround specialists have gained a new prominence. These are changes that reflect broader social and governmental trends to audit performance more actively and to see issues in terms of needs to manage risks. Such developments are important for corporate and insolvency lawyers - they recast a host of issues within new framing assumptions and they force a re-thinking of corporate insolvency law's challenges and agendas.³¹⁰

This is a theme that will be developed elsewhere in the thesis.³¹¹

McCormack disputes the traditional distinction that insolvency law in the United States reflects much more of a bias towards corporate rescue or that it is at least pro debtor whereas insolvency law in the UK is pro-creditor.³¹² His is an iconoclastic view. He maintains the view that following the Enterprise Act 2002 the creditor interest has still got primacy in any formal reorganisation in the UK. The more usual practice remains that of disposals of businesses. His major conclusion is that there has been a convergence in UK and US

³⁰⁸ S Frisby, 'In Search of the Rescue Regime' (2004) 67 Modern Law Review 247 -242.

³⁰⁹ V Finch, "The Recasting of Insolvency Law" (2005) 68 Modern Law Review 5, 713.

³¹⁰ V Finch, "The Recasting of Insolvency Law" (2005) 68 Modern Law Review 5, 713.

³¹¹ Chapter 5, p 305.

³¹² McCormack G, "Apples and Oranges? Corporate Rescue and Functional Convergence in the US and the UK" (2009) 18 Int Insolv Rev

insolvency law and this is shown by the fact that in the United States the emphasis now is on disposals rather than on business rescue.

Arguments in favour of the rescue culture and Chapter 11 in the United States have been presented by Warren³¹³ and Korobkin.³¹⁴ In Korobkin's terms insolvency law must be seen in 'economic and non-economic dimensions and the principle of fairness (can be seen) as a moral, political, personal and social value.'³¹⁵ Warren promotes what she calls 'a dirty, complex, elastic, interconnected view of bankruptcy from which I can neither predict Empirical work has been undertaken in the form of five year projected longitudinal analysis related to bankruptcy outturns is also of interest.'³¹⁶ Warren & Westbrook contend that a debate without data is a useless exercise. They provide a critique from an empiricist perspective of current academic thinking in insolvency (much of which, but by no means all, is critical of Chapter 11-type processes.). For instance, they consider much of the literature in this area to be representative of a kind of academic speculation.

Frisby, however, introduces a cautionary note with regard to increasing the incidence of rescue attempts.³¹⁷ She considers that the choice between getting a better return for creditors and attempting rescue should be determined in favour of the former. This is, in her view, because of the lack of evidence about the benefits of rescue in the UK context. In Frisby's view, it is necessary to provide evidence that companies that survive beyond the rescue stage can do so into the longer term. In the case of examinership, things are slightly different. The examinership legislation is about the provision of balance: the balancing of the interests of creditors and the public interest in the protection of ailing, but viable companies. Since the

³¹³ E Warren, "Bankruptcy Policy" (1987) 54 U Chicago L Rev 775, 811.

³¹⁴ D R Korobkin, "Rehabilitating Values: A Jurisprudence of Bankruptcy"(1991) 91 Columbia Lar Review 717.

³¹⁵ D R Korobkin, "Rehabilitating Values: A Jurisprudence of Bankruptcy" (1991) 91 Columbia Lar Review 717.

³¹⁶ J L Westbrook and E Warren, "Searching for Reorganization Realities" (1994) 72 Washington University Law Quarterly 1257; T Sullivan, E Warren and Westbrook, "Empirical Studies On Bankruptcy" (1994) 121 Law Journal 1258.

³¹⁷ S Frisby, "In Search of the Rescue Regime: The Enterprise Act" (2002) 67 The Modern Law Review 2.

Companies (Amendment) (No 2) Act 1999, the balance would appear to have shifted slightly in favour of the creditors. For example, there is probably an increased prospect of creditor involvement in the petition stages of examinership and the entire process. In addition, the independent accountant is unlikely to be able to produce his/her report without first consulting the creditors.³¹⁸

1.6.3: COURT-BASED CORPORATE RESCUE PROCESSES AND SMALL COMPANIES

A number of scholars in the United States and Britain have addressed this topic. Critics such as Baird and Rasmussen consider that the focus of company reorganisation – the going concern surplus- is often ill judged:

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.³¹⁹

This point is brought home more fully in small company cases: it is reasonable to assume that such companies have no business specific assets or networks which cannot be reproduced elsewhere.³²⁰ In addition, the BAPCPA rescue system for small companies in the United States is burdensome for small companies.³²¹ The benefits of the streamlined arrangement introduced by BAPCPA are outweighed by the procedural obstacles which candidates now face.³²² It is now more difficult for small companies to obtain reprieve through a formal rescue arrangement in a Federal Court. At least eighty per cent of distressed companies avoid the Federal Bankruptcy Law procedures and opt for state-based systems such as the

³¹⁸ B Foley, "Court Protection over Ailing Companies: The Law of Examinership in the Republic of Ireland" (2002) 23(11) BLR 267.

³¹⁹ Douglas G. Baird and Robert K. Rasmussen, "The End of Bankruptcy" (2002) 55 Stan. Law Review 751.

³²⁰ G McCormack, "Rescuing Small Businesses: Designing an "efficient" Legal Regime" (2009) Journal of Business Law 317.

³²¹ R Lawless, "Small Business and the 2005 Bankruptcy Law: Should Mom and Apple Pie be worried?" (2007) Southern Illinois University Law Journal 585.

³²² J Haines and P Hendel, "No Easy Answers: Small Business Bankruptcies after BAPCPA" (2005) 47 Boston College Law Review 71, 73.

assignment for the benefit of creditors, because they are much less costly.³²³ In the UK, the Insolvency Act, 1980 which introduced a cva and moratorium system for small distressed companies has been a failure, because of the costs involved.³²⁴ It has not been much used. It has been superseded to an extent by the mechanisms available to small companies under the Enterprise Act.³²⁵

The one observation by commentators that was remarked upon in the ABI Commission Report on Chapter 11 regarding ailing small companies was that the US Bankruptcy Code (in particular, the BAPCPA part) does not help to rehabilitate small companies.³²⁶ There is the discernible risk that commentators in this jurisdiction may say the same about examinership in the future. What makes this slightly more likely than not is that corporate insolvency work requires the skills of professionals who have built up expertise in this area over many years. As long as the processes and skills required to place a company into examinership remain unchanged, the costs are unlikely to decline very significantly. This might prompt consideration of a system in this jurisdiction that was less court-based. This could, for instance, along the lines of Administration and Company Voluntary Arrangements in the UK. It can be argued that both Administration and Company Voluntary Arrangements provide flexible, cost-effective and more successful approaches to formal company rescue compared to examinership, although they may have their imperfections. This, however, is to move ahead too far and will be taken up later in the thesis.

³²³ E Morrison, "Bankruptcy Decision-Making: An Empirical study of Small-Business Bankruptcies" Columbia Law Working Paper No 239 last downloaded at <http://ssrn.com/abstract=461031> last accessed on 1st September, 2015.

³²⁴ G McCormack, "Rescuing Small Businesses: Designing an "efficient" Legal Regime" (2009) *Journal of Business Law* 303.

³²⁵ G McCormack, "Rescuing Small Businesses: Designing an "efficient" Legal Regime" (2009) *Journal of Business Law* 303.

³²⁶ American Bankruptcy Institute, *Commission to Study the Reform of Chapter 11* (2014) ABI Alexandria at 277.

1.6.4: LITERATURE ON EXAMINERSHIP

The written commentaries by academics and members of the other professions on examinership in Ireland are few in number. A significant contribution to the literature was, however, offered by Lynch-Fannon, Marshall and O’Ferrall.³²⁷ They noted that the corporate rescue legislation in operation at the time – the Company Law (Amendment) Act, 1990 - caused major disagreement among interested parties. The very trenchant comments offered by the authors, together with the recommendations of the Company Law Reform Report on examinership in 1994,³²⁸ may have helped to bring about the legislative reforms in the Companies (Amendment) (No 2) Act, 1999. (Under this last, examinership effectively became an option only for more commercially robust candidates. In addition, creditor interests in examinership were given greater protection). Lynch_Fannon et al almost anticipating the later legislation or even prompting it, were very plain in their comments: they thought that examinership was suitable only for a very limited number of companies. These companies were likely to be suffering from trading rather than financial difficulties and their awkward challenges were likely to be of a short-term nature.³²⁹ Lynch-Fannon, Marshall and O’Ferrall were direct in their comments also about the uselessness of examinership for candidates who could meet only the undemanding entry criteria of the Companies (Amendment) Act, 1990 as originally drafted.³³⁰ In their view, the examinership process in such instances was likely only to help to deplete a given company’s financial resources prior to the inevitable liquidation. In addition, the legislative circumstances could help to promote professionally questionable business practices by people lacking in scruples.

³²⁷ I Lynch-Fannon, J Marshall and R O’Ferrall, *Corporate Insolvency and Rescue* (1st edn Butterworth 1996).

³²⁸ CLRG 1st Report last downloaded on 14th December, 2015 at <http://www.clrg.org/publications/clrg-report-1994.pdf>

³²⁹ Such companies were likely to be fundamentally healthy and to be in business sectors that were growing. The assumption here is that they were being buffeted by adverse trading conditions of a temporary nature.

³³⁰ I Lynch-Fannon, J Marshall and R O’Ferrall, *Corporate Insolvency and Rescue* (1st edn Butterworth 1996).

Lynch-Fannon, Marshall and O’Ferrall identified very many difficulties with the Companies (Amendment) Act, 1990: they classified them as being substantial, procedural or commercial.

³³¹They viewed the 1990 Act as being similar to those earlier criticised by Baird whom they quoted as follows:

In a re-organisation, the bargaining is not only over substantial non-bankruptcy entitlements but also over special bankruptcy procedural rights the participants can either waive or invoke. To the extent a re-organisation promotes bargaining over rights that do not exist elsewhere, it may promote bargaining over the wrong thing. Nothing is gained by bargaining about anything other than substantial rights, yet much of the bargaining in a reorganisation is over procedural rights that exist nowhere else. Such bargaining is a cost of the re-organisation not a justification of it³³²

Lynch-Fannon, Marshall and O’Ferrall³³³ regarded the above statement as broadly speaking an accurate description of the examinership process in Ireland in the early 1990s. To them, the process reduced itself to litigation that had arisen as a direct result of poorly drafted legislation. This deflected attention away from the proper goal of corporate rescue. The process as it was then operated, in their view, caused unnecessary expense. Lynch-Fannon, Marshall and O’Ferrall³³⁴ also observed that the 1990 Act was ambiguous in its terms ‘in certain vital parts.’ The authors stated that this ambiguity allowed the Supreme Court to further its own policy objectives: it would have been better if matters were referred back to the legislature.

The most challenging comments offered by Lynch-Fannon, Marshall and O’Ferrall began as follows:

The Companies (Amendment) Act, 1990 is probably the single most controversial piece of commercial legislation introduced in the State. The controversy is fuelled by

³³¹ I Lynch-Fannon, J Marshall and R O’Ferrall, *Corporate Insolvency and Rescue* (1st edn Butterworth 1996) 516. Essentially, as explained in the main text, their argument was that imperfections in the legislation had given rise to unnecessary complications in courtroom proceedings. The reference to commercial matters is self-explanatory.

³³² D G Baird, ‘The Uneasy Case for Corporate Reorganisations’ (1986) 15 *Journal of Legal Studies* 127

³³³ I Lynch-Fannon, J Marshall and R O’Ferrall, *Corporate Insolvency and Rescue* (1st edn Butterworth 1996) 516.

³³⁴ I Lynch-Fannon, J Marshall and R O’Ferrall, *Corporate Insolvency and Rescue* (1st edn Butterworth 1996) 515.

concerns of creditors, secured or otherwise, who view the legislation as threatening their legitimate business interests. Events subsequent to the Act have altered the position of parties in relation to freely entered into commercial contracts (in some case pre-dating the passing of the Act itself).....In particular, a concern has been expressed that foreign banks may become reluctant to lend to Ireland. The interest in saving business and companies and consequently jobs which have been clearly articulated by the High Court and the Supreme Court must be balanced against anxiety felt in business circles.³³⁵

A partial answer to the concern with saving businesses and jobs is the argument that a successful receivership (and in some cases liquidation) will also deal appropriately with a healthy underlying business. This was recognised in the Cork Report where the administration procedure was seen as having been devised in the first instance as a means of dealing with companies where a floating charge had not been created and where therefore a full receivership was not possible.³³⁶ If the underlying business was successful, Lynch, Marshall and O’Ferrall continued, there would be jobs available under the operation of the new owners. Those who are really disadvantaged in a receivership of this kind are the existing shareholders and management. Trade creditors are likely to be disadvantaged in both receiverships and examinerships.

Lynch, Marshall and O’Ferrall also added the following:

Not all liquidations or receivership inevitably result in the break up of a business or the subsequent loss of employment. The preliminary question to be addressed in relation to examinations...is whether the business as incorporated in the present entity can make a profit and be self-sustaining over time. If yes, the examination will benefit both creditors and shareholders. If no, then in view of developments under the Companies (Amendment) Act, 1990 serious questions ought to be asked as to whether the drastic restrictions and erosion of rights involved in examinations ought to be countenanced by the courts when there is no long-term benefit.³³⁷

There is a significant literature internationally that is broadly supportive of the cautious and somewhat sceptical position on formal company rescue initiatives adopted by Lynch-Fannon,

³³⁵ I Lynch-Fannon, J Marshall and R O’Ferrall, *Corporate Insolvency and Rescue* (1st edn Butterworth 1996). 317.

³³⁶ K Cork, “Report of the Review Committee on Insolvency Law and Practice” (1982) Cmnd 8558, para 496.

³³⁷ I Lynch-Fannon, J Marshall and R O’Ferrall, *Corporate Insolvency and Rescue* (1st edn Butterworth 1996) 320.

Marshall and O’Ferrall,³³⁸ these are Gertner & Scharfstein Jensen Adler, Eberhart and Weiss and Bebchuk.³³⁹ The fact remains, however, that in a period characterized by privatisation and globalisation, most governments have considered it wise to reconstitute their insolvency systems and to develop corporate rescue legislation. This is because policymakers have determined that in a global context where privatisation principles are often dominant, it makes sense to rethink matters regarding insolvency law in order to avoid both domestic and systemic risk on a global scale.³⁴⁰ According to Westbrook there is no empirical support for the theories put forward by the academics cited in the early part of this paragraph; in addition, governments and commercial constituencies at a global level do not support the views of these academics.³⁴¹

It is necessary, in any event, to address the objections introduced by Lynch-Fannon, Marshall and O’Ferrall more fully.³⁴² O’Donnell accepted that in cases where examinership had been unsuccessful it was in most cases due to the inherent unsuitability of the candidates themselves³⁴³

Murphy detailed the reforms in the examinership process that followed the enactment of the Companies (Amendment) (No2) Act, 1999³⁴⁴ Murphy having noted the more stringent test as regards the appointment of an examiner together with the increase in creditor protection, observed:

The amendment to the 1990 Amendment Act should reduce the number of companies which, having enjoyed court protection, ultimately finish by being wound up. While

³³⁸ I J Lynch-Fannon Marshall and R O’Ferrall *Corporate Insolvency and Rescue* (1st edn Butterworth 1996).

³³⁹ R Gertner and D Scharfstein, ‘A Theory of Workouts and the Effects of Reorganization Law’ (1991) 46 *The Journal of Finance* 4, 1189. M C Jensen, ‘Corporate Control and the Politics of Finance’ (1995) *Journal of Applied Corporate Finance* Fall. B Adler, ‘An Equity-Agency Solution to the Bankruptcy-Priority Puzzle’ (1993) 22 *Journal of Legal Studies*. A C Eberhart and L Weiss, ‘The Importance of Deviations from the Absolute Priority Rule in Chapter 11 Bankruptcy Proceedings’ (1998) 27 *Financial Proceedings* 106. L Bebchuk, ‘A New Approach to Corporate Reorganizations’ (1988) 101 *Harvard Law Review* 775-804.

³⁴⁰ J L Westbrook, ‘The Globalization of Bankruptcy Reform’ (1999) *N.Z. L.Rev.* 401.

³⁴¹ J L Westbrook, ‘The Globalization of Bankruptcy Reform’ (1999) *N.Z. L.Rev.* 401 409.

³⁴² I Lynch-Fannon Marshall and R O’Ferrall *Corporate Insolvency and Rescue* (1st edn Butterworth 1996).

³⁴³ J L O’Donnell, *Examinerships: The Companies (Amendment) Act, 1990* (Oak Tree Press 1994).

³⁴⁴ D Murphy, ‘Examinerships after the Companies (Amendment) (no2) Act, 1999’ *Bar Review* 2000

this is to be welcomed, the necessary consequence will undoubtedly be further to reduce the proportion of ailing firms to which examiners are appointed.³⁴⁵

Kirwan also analysed salient cases in examinership in recent years with the purpose of throwing light on the more obscure aspects of the legislation³⁴⁶ He noted the prevailing approach adopted by the judiciary which was ‘the rigorous scrutiny of petitions for examinerships.’ The author illuminated significant details of the legislation. For instance, he identified a significant imperfections in the 1999 Act:

The legislation does not appear to specifically provide that a company must be solvent in order to have a reasonable prospect of survival. None of ss.18, 22 and 24, dealing with the examiner's report, the contents of a scheme of arrangement and confirmation of such a scheme respectively, specify solvency as a minimum requirement. This raises the question of whether a company could be capable of survival as a going concern although insolvent. A further question is what is meant by “solvency”; does it mean an ability to pay debts as they fall due or something more than that?

1.6.5: MOKAL’S CRITICISM OF RECEIVERSHIPS

More generally, as regards receivership being a useful option for financially distressed companies, Mokal considered that commentators had misperceived things. The critical point about receivership was that it enables the secured creditor class, usually the banks, to dislodge the management.³⁴⁷ It very often caused the valuation of the distressed company to plummet in value. Mokal used the word ‘perverse’ in relation to the receivership system. His reasons for doing so were that receivership cut out many impacted parties who would otherwise have gained admittance to the bargaining arena in the more generous Authentic Bargaining Model or other contractarian arrangement. Mokal also noted that the job of receivership was fundamentally not to bring about the rescue of the company; rather, it was to rescue the business.³⁴⁸ The logic of this was plain: receivership was triggered when a

³⁴⁵ D Murphy, ‘Examinerships after the Companies (Amendment) (no2) Act, 1999’ Bar Review 2000 285.

³⁴⁶ Kirwan B, ‘Aspects of Examinership’ (2010) 17Commercial Law Practitioner.4.

³⁴⁷ R Mokal, *Corporate Insolvency Law* (OUP 2005).

³⁴⁸ R Mokal, *Corporate Insolvency Law* (OUP 2005).

company was hopelessly insolvent. If it should have happened, Mokal continued, that the company's financial condition was not irretrievable, the announcement of receivership would have collapsed the value for existing shareholders.

Mokal pressed home his argument as regards the inadequacy of receivership in certain instances in the following review:

Further, the receiver owed duties to protect and further the interests of his appointer. Other than in the context of obtaining a 'proper market price' for the charged assets, these duties overwhelmed and reduced to virtual insignificance his duties towards the distressed company and its unsecured creditors. This was problematic because the appointing bank was oversecured in over half of receiverships. This meant that the receiver, acting for the bank, would have little or no incentive to attempt a going concern sale of the company's business, even if the company was merely financially distressed, so that its assets would have yielded more value as a going concern than by being sold off piecemeal. The bank also had the benefit of guarantees from the company's directors, which weakened the receiver's incentives to maximise the value of the distressed business even in those cases where, as a matter of proprietary security over the company's assets, the bank was not oversecured. Third and for the same reason, the bank had no incentive, when it was oversecured, to control the costs of the process of receivership. These costs were borne by the distressed company's junior claimants, who nevertheless had no right to hold the receiver to account. And finally, the banks provided credit services to the SME sector (small-to-medium enterprise) in a significantly monopolistic market. This dulled their incentive to compete with each other, whether on costs, innovation or reputation.³⁴⁹

It is difficult not to find this argument persuasive. It points to the extraordinary power of credit institutions and the inability or unwillingness of governments to challenge them. It must, of course, be accepted that the prudent flow of credit by banks and other such institutions is central to the health of an economy and any legislative enactment or carelessly thought out intervention in the market by government can have unforeseen consequences which are at least adverse or even detrimental.

Mokal also considered that formal rescue exercises –examinerships, in the Irish case- provide incentives to managers and shareholders more readily to request rescue. The appointment of an agent such as an examiner raised the company's valuation at the time of

³⁴⁹ R Mokal, *Corporate Insolvency Law* (OUP 2005).

appointment closer to the book valuation of the company. Among other additional things, the appointment freed the examiner, in the Irish case, from being in thrall to the banks and changed his or her focus onto that of a wider set of interests identified in the Authentic Bargaining Model. Mokal also had observations on the administrative process (post the Enterprise Act, 2002) relating to the role of monitor undertaken by the administrator in the UK context, which might have lessons for corporate rescue initiators in Ireland:

...it would often be beneficial for all the parties interested in a company's undertaking for the company's management to be monitored by an outsider. The benefits would accrue if there was some incentive for the management to provide the monitor with information about the company's prospects and about the strategies that it favours for running the company. The monitor in turn should have the resources and accumulated expertise to judge both the prospects of the firm and the quality of its management. It should also have sufficient investment in the debtor company for it to be worth its while to exercise this expertise. *If the monitor considers, on the basis of the information available to it, that the debtor's management should be displaced, then it should have the legal competence to do so without having to verify the bases of its judgment to the court or some other party, and without having to wait for the debtor to become insolvent.** This would increase the probability that a firm which had been reduced to financial distress because of poor management would have a better chance of rescue, and that an economically distressed firm would be consigned more quickly to a formal insolvency proceeding. (*italics mine).³⁵⁰

In Ireland, it is usually the management of the distressed company that seeks examinership. At present, there could be only a limited incentive on the management's side to support the above proposal. If, however, it became part of the corporate rescue code in Ireland and in the context of a selectively increased remit for the examiner, matters would be very different.

Mokal also provided comments on the following aspects of administrator's duties:³⁵¹

The administrator's duty to act rationally

The administrator's duty to determine upon a set of objectives for the administration and where a preference order was to be established

A further defensive line on the flank for those who wished to promote corporate rescue legislation was thus established

³⁵⁰ R Mokal, 'The Authentic Consent Model: Contractarianism, Creditors' Bargain and Corporate Liquidation' (2001) 21 Legal Studies 400, 443.

³⁵¹ R Mokal, *Corporate Insolvency Law* (OUP 2005)

1.7: THE RESTRUCTURING RECOMMENDATION OF THE EUROPEAN COMMISSION: A CRITICAL REVIEW

Eidenmüller and van Zwieten in their working paper³⁵² observe that two events are currently changing the landscape for business restructurings in the European Union: the “Restructuring Recommendation”³⁵³ of the European Commission, issued in 2014, and the 2015 recast of the European Insolvency Regulation.³⁵⁴ They critically review the EU Restructuring Recommendation and consider it in the context of the redesigned EIR. Briefly stated, they consider that the EU Commission’s narrow focus on restructuring proceedings ignores important aspects of the complicated interaction between the EU member states formal insolvency laws and the planned EU restructuring mechanism. Eidenmüller and van Zwieten’s analysis of and particularly their criticism of the Preventative Restructuring Framework in the EU Restructuring Recommendation are, however, of more immediate significance for the purposes of this thesis. Looking at the Preventative Restructuring Framework, they consider the six principles which are intrinsic to the framework. These principles are: early recourse to the restructuring process before factual insolvency; minimised court involvement; the use of the debtor-in-possession method in company restructuring; the use of moratoria; the arrangement by which dissenting creditors would be subject to the restructuring plan and the protection of new finance that might be channelled to the debtor company.

³⁵² H Eidenmüller and K van Zwieten, “Restructuring the European Business Enterprise: The EU Commission Recommendation on a new Approach to Business Failure” (2015) Law Working Paper No: 301/2015 ECGI last downloaded on 17th November, 2015 at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2662213

³⁵³ EU Commission, “Commission Recommendation on a New Approach to Business Failure and Insolvency” (2014) Brussels last downloaded on 17th November, 2015 at http://ec.europa.eu/justice/newsroom/civil/news/140312_en.htm

³⁵⁴ EU Commission, “Proposals for a Regulation of the European Parliament and of the Council amending Regulation (EC) No 1346/2000 on Insolvency Proceedings” last downloaded on 17th November, 2015 at COM/2012/0744 final – 2012/0360 .

They accept the proposition that companies should only be restructured, if their going concern value exceeds their liquidation value. In addition, they take the view that, restructuring laws must be designed to conform to fundamental principles of insolvency law reform to fundamental principles of the insolvency law such as the prevention of an unwarranted wealth transfer from one creditor or stakeholder group to another.

Regarding the principle of early recourse to the restructuring process before factual insolvency, Eidenmüller and van Zwieten consider that companies which are economically viable should be entitled to petition for restructuring provided it can be proven by a court-appointed expert that the given company is acting in good faith. They do, however, identify what is for them the main weakness of the model detailed in the Commission Recommendation as allowing for the possibility of aggressive institutional investors seeking to enrich themselves at the expense of outside creditors and the company itself.

1.9: STRUCTURE OF THE THESIS

The thesis takes the following form. Chapter 1 is an introduction to corporate restructuring law. It includes a literature review. Chapter 2 consists of a comparative study of the plan drafting process in corporate restructuring in the three countries chosen for analysis: the United States, the United Kingdom and the Irish Republic. This is followed in chapters 3 and 4 by a comparison of the approval and confirmation processes and the protection period and pre-petition financing respectively in the three countries. The United States, through Chapter 11, provided the inspiration for the designers of the examinership model. Both the wider economic and social context and the content of each model – that is Chapter 11 (as modified for small companies by the BAPCPA legislation of 1994) and Examinership - are very different, but a comparative study can throw light on both systems. Britain, in its formal corporate rescue vehicles – such as Administration and Company Voluntary Arrangements- offers a different subject for a comparative law exercise. Somewhat contrary to what obtains

in the US and the Irish Republic, corporate rescue law there – reducing matters to a questionable simplicity- remains creditor-oriented. A critique of questions central to examinership and schemes of arrangement together with a consideration of the merits and demerits of both formal corporate rescue models—with regard to small companies in financial distress- follows in chapter 5. Chapter 6 covers out-of-court company rescue arrangements of varying kinds. Chapter 7 presents the conclusions of the thesis.

CONCLUSIONS

This chapter has presented the central research question of this thesis together with related themes; that is, some important aspects of the theory and practice of the law relating to company rescue. The themes identified were these. The first was expressed in the form of a question: to whom is examinership at present addressed and to what extent does it promote efficiency in Irish insolvency law? The others were: “the merits or otherwise of increasing the range of legal mechanisms designed to promote company rescue in Ireland: an investigation” and “the degree to which corporate rescue legislation should cater for small companies: an investigation.” The identification of a methodology for assessing rescue quality specific to formal corporate rescue in Ireland was seen as an objective of the thesis. The literature review sought to put in context the existing scholarship relating to corporate rescue law. With regard to insolvency law generally, the Creditors Bargain Model was presented as was the Authentic Consent Model and the Team Production Model. The fundamental assumptions at the base of the Creditors Bargain Model was found to be open to question, particularly those related to efficiency. The normative and prescriptive debate in insolvency law generally was noted as were the ad hoc assumptions from existing law on the part of some scholars. Criticisms of the existing examinership arrangements in this country were offered as was a defence of the principle of corporate rescue law in itself.

Having put the subject matter in context, the chapters which follow will examine how Ireland and other countries have approached the company rescue question and what can be learned from this.

Chapter 2

PLAN DRAFTING

INTRODUCTION

The purpose of this chapter is to consider plan drafting in formal reorganisation in each of the following jurisdictions: the United States, the UK and the Irish Republic. A focus will be placed on what works efficiently in each jurisdiction and what does not. The major objective here – consistent with the research question- is to identify what, if anything, would serve to improve the plan drafting process in this country. The processes are in important respects quite unlike one another. In the United States, the debtor-in-possession (at least ostensibly) drafts the plan.¹ In the United Kingdom and the Irish Republic, the plan drafter is an external agent: that is, respectively, the Administrator and the Examiner.² There is one major characteristic which the three processes have in common. They each have a moratorium for the purpose of avoiding immediate bankruptcy,³ but only under Chapter 11 is an exclusivity period available to the debtor company. During the exclusivity period, the debtor company has the sole right to draft the plan of reorganisation and seek to have it accepted. A reorganisation model of the Chapter 11 variety is available to corporations, sole proprietors and individuals in the United States, but those who file in most cases are corporations or businesses. In the UK and the Irish Republic, companies alone can file.

¹ A debtor-in-possession within Chapter 11 is a person or corporation who has filed a bankruptcy petition, but who remains in possession of property upon which a creditor has a lien or similar security interest. A corporation which continues to operate its business under Chapter 11 bankruptcy proceedings is a debtor-in-possession (DIP). Guidelines for DIPs at http://www.justice.gov/sites/default/files/ust-regions/legacy/2013/09/16/ch11_guidelines-dip.pdf last downloaded on September 8th, 2015.

² There is one exception. Within the CVA process –which is a process connected to Administration in the UK- a DIP (that is, a debtor-in-possession) arrangement may sometimes be operative.

³ The debtor company in a moratorium is protected from its creditors only for a limited time. Even in cases where a restructuring plan seems unlikely to succeed, the moratorium may serve to preserve the assets of the debtor until it is determined what course of action would be most suitable for the debtor company.

This chapter is structured as follows. Section 2 offers a cautionary note on planning practice in Chapter 11 today and re-introduces team production theory as team production theory is a good fit for interpreting central aspects of the Chapter 11 legislation such as the exclusivity period in plan drafting. Section 3 considers the Chapter 11 planning process. Section 4 looks at corporate restructuring law in the UK with a focus on the planning stage. An analysis of planning in examinership then follows in Section 5, together with suggestions for improvements. Section 6 offers a brief review of matters discussed in the chapter.

SECTION 2.1 SOME PRELIMINARY MATTERS

Before any substantive discussion of the plan-drafting process is undertaken, consideration must be given initially to the disparity between the spirit of the legislation on the one side and what happens at the court level on the other.⁴ The key Chapter 11 provisions -those relating to the central role of the debtor-in-possession, the protection of the board from major creditors or other external parties and the board's key role in developing a plan- indicate that this legislation is very different from standard bankruptcy legislation. There is an underlying assumption about Chapter 11 on the part both of its drafters and of its supporters that reorganisation serves society well by preserving jobs and companies.⁵ Following this line of reasoning, the reorganisation statute can be seen from a - perhaps somewhat elevated-theoretical perspective (such as that found in team production theory) as “a kind of contract term by which creditors and shareholders agree to subordinate their legal rights to the preservation of the going concern.”⁶ In practice, however, planning matters today are

⁴ This last is considered later in the chapter.

⁵ American Bankruptcy Institute, *Commission to Study the Reform of Chapter 11* (2014) Alexandria, Virginia at 2.

⁶ L M LoPucki “A Team Production Theory of Bankruptcy Reorganisation” (2004) *Vanderbilt Law Review* 743.

determined in large part, particularly in bigger cases, by the provider of debtor-in-possession finance⁷

Reflection on the nature of corporations prompts consideration of the almost unsurveyable complexity of inputs from a vast number of individuals. One of the great difficulties here is in determining in advance the entitlements of participants in what may sometimes be a very complex production cycle – such as the development of a new pharmaceutical product. Participants may come and go in such a context. While it is possible to choose a proprietorship model to solve the coordination problem⁸ in the case of individual proprietorships, it is not possible to think in those terms when considering corporations.⁹The monitoring roles, the decision-making roles and the residual claims roles are absolutely distinct. In fact, each of these roles is undertaken by teams of people rather than individuals and individuals come and go over the course of time. Fundamentally, ownership is separated from control in a modern corporation.¹⁰ Partisans of team production theory are like hawks who swoop on the critical detail: that is, the organisational problem that provides the rationale for the corporate form. For them, team production theory offers a particular and useful solution that is not otherwise available in corporate law or corporate governance

⁷ This is discussed later in the chapter. For a critical analysis see A J Meese, ‘The Team Production Theory of Corporate Law: a Critical Assessment’ (2002) 43 William and Mary Law Review Issue 4 Article 13; F H Easterbrook and D R Fischel, *Economic Structures of Corporate Law* (1991) Harvard University Press 1; H Hansman. *The Ownership of Enterprise* Harvard University Press 2000. For a sympathetic analysis of TPM see Symposium ‘Team Production in Business Organisations’ (1999) 24 Journal of Corporate Law 743

⁸ The concept is associated with the work of the the Austrian School economist F A Hayak. The book *Collectivist Economic Planning* (1935) Routledge and Keegan Paul London was influential Hayek provided the basis “for a radical alternative to the neoclassical model of efficient allocation with timeless production, perfect participation, timeless exchanges and almost instantaneous attainment of equilibrium and a world of no institutions.” G’Driscoll, *Economics as a Coordination Problem: The Contributions of Friedrich A Hayek* (1977) The Austrians employed subjective value theory in their studies in economics. Sheed, Andrews and McMeel Kansas.

⁹ See A. A. Alchian and H Demsetz (1972) “Production, Information Costs and Economic Organisation” 62 *American Economic Review* at 779 and O Hart and J Moore (1990) “ Property Rights and the Nature of the Firm” 98 *Journal of Political Economy* at 1119 for analyses of simple and more complex models which involve coordination and monitoring. These models relate to business entities which are less than corporations and solve the coordination problem by combining the monitoring role with that of the proprietor one. Blair contends that these models are not applicable to most corporations. M M Blair “Team Production Theory and Corporate Law” (2001) 27 *Nordic Journal of Political Economy* 88.

¹⁰ This follows the approach adopted by AA Berle and G C Means *The Modern Corporation and Private Property* 2nd edn Harcourt, Brace and World, New York 1967.

theory. It offers a non-conventional but workable solution to the challenges posed by contracting within the corporation.

In the legal entity known as the corporation, the legal arrangement is such that the original team members in addition to surrendering rights as regards inputs and outputs which relate to the corporation also surrender rights with regard to corporate decision-making: that role is assigned to a hierarchy of corporate decision-makers controlled by the board. The reason why all relevant parties relinquish control over all important decisions to the management hierarchy led by the directors is because – in the view of Blair and Stout- by doing so, those parties gain.¹¹ That is to say, team members give up their rights, because in so doing they can more effectively gain the cooperation of other team members. Thus, in bankruptcy, the board drafts the reorganisation plan.

SECTION 2.2: CHAPTER 11–THE DRAFT PLAN MODEL

2.2.1: STATUTE LAW

A debtor is obliged to file a plan at an early stage during the Chapter 11 case. Section 1121 of the Bankruptcy Code stipulates that the debtor (the debtor-in-possession or DIP) has the exclusive right to file a plan within 120 days after successfully filing the petition.¹² Thus, the creditors' claims are frozen in the shorter-term. The successful petitioning for Chapter 11 enables the management to continue in their positions and engage in their standard duties without hindrance. The DIP also has the exclusive right to seek out acceptances from the creditors for the plan within 180 days following the order for relief.¹³ The term 'exclusivity period' is applied to the 180 day period. Any creditor or equity security holder does,

¹¹ M Blair and I Stout "A Team Production Theory of Corporate Law" (1999) 85 Virginia Law Review 253. Blair and Stout express it as follows: "boards exist not to protect shareholders *per se*, but to protect the enterprise-specific investments of *all* the members of the corporate "team."

¹² 11 USC §1121(b)

¹³ 11 USC §1121(c) (3)

however, have a right to file a plan in circumstances where a trustee has been appointed¹⁴ or where the debtor has not filed a plan within 180 days after the order of relief was entered.¹⁵ Prior to the passing of the BAPCPA Amendment in 2005, the court could, in certain circumstances, reduce or increase the 120 day period or the 180 period, but this is no longer the case as regards the possibility of an increase.¹⁶ The court today will not extend the DIP's exclusivity period beyond a maximum of eighteen months¹⁷(The plan of debt reorganization divides the creditors into classes and specifies how much each class is to be paid once the plan is confirmed. The plan of reorganization also indicates how the plan will be implemented; for instance, through a sale of property, through new loans or new investments or profits from business operations).¹⁸

¹⁴ A trustee can be appointed in cases of fraud or mismanagement. 11 U.S. Code § 1104.

¹⁵ 11 USC §1121(c) The rule works in the following way. The Report of the Committee of the Judiciary (H R Rep No 95-598 at 406 explained the workings of 11 USC §1121 as follows:

1121. Who may propose a plan

Subsection (a) permits the debtor to file a reorganization plan with a petition commencing a voluntary case or at anytime during a voluntary or involuntary case. Subsection (b) gives the debtor the exclusive right to file a plan during the first 120 days of the case. There are exceptions, however, enumerated in subsections (c) and (d). If a trustee has been appointed, if the debtor does not meet the 120-day deadline, or if the debtor does meet that deadline, but fails to obtain the required consent within 180 days after the filing of the petition, then any party in interest may propose a plan. This includes the debtor, the trustee, a creditors' committee, an equity security holders' committee, a creditor, an equity security holder, and an indenture trustee. The list is not exhaustive. Finally, subsection (d) permits the court, for cause, to increase or reduce the 120-day and 180-day periods specified. Cause might include an unusually large or unusually small case, delay by the debtor, or recalcitrance among creditors.

¹⁶ 11 USC §1121(d) These matters are examined later.

¹⁷ 11 USC §1121(d) as amended in 2005. These last regulations apply to cases begun on or after October 17th, 2005. The United States Bankruptcy Code allows for the accommodation of both creditor and debtor interests – which are of necessity diametrically opposed- in as fair a way as possible. Bankruptcy courts have been obliged to take a flexible approach with regard to extending or reducing the exclusivity period, because of the particular circumstances of individual cases. The courts have found it impossible to affix one-size-fits-all solutions in exclusivity questions and have settled on the 18 month deadline.

¹⁸ Pre-pack Chapter 11 plans became particularly popular in the 25 year period following the early 1970s. The process involves the financially distressed company swapping trade debt for equity, so as to help reduce onerous interest rate payments. In such agreements, it is necessary to have the support of a large majority of the creditors. (That majority may be as high as 90%). The next step involves petitioning for Chapter 11. The company then makes a Chapter 11 filing. The positive aspect of this is that it is simpler and far cheaper: negotiations, distributions, disclosure statements and voting all take place before the bankruptcy case is filed in court. A company may emerge from pre-pack Chapter 11 on average after 21.6 months, as stated in E Tashjian *et al* "Pre-packs: An Empirical Analysis" (1986) 40 *Journal of Financial Economics* 135 at 142. Pre-packs were popular in the 1980s among US retailers in leveraged buyout cases, but are much less common today. Sometimes a company can emerge by means of a pre-pack very quickly: one example from 2010 was Cross Energy Corporation (Cross Canyon). It emerged successfully in 42 days. Data on this was retrieved from <http://www.tklaw.com/tk-guides-cross-canyon-energy-through-pre-pack-chapter-11-process> on 6th December, 2015

The relevant provision relating to small businesses is 11 USC §1121(e).¹⁹ This provision requires that the debtor company must file the Chapter 11 plan within 300 days of the petition date. This can create enormous practical problems, particularly with regard to the interpretation of the legislation. For instance, it may be unclear if the §1121 provision may in a given case have application to parties other than the debtor company.²⁰ In addition, the Bankruptcy Code also does not address the consequences of failure to submit a plan by the 300-day deadline.²¹

2.2.2: PROVISIONS RELATING TO THE CONTENT BOTH OF DISCLOSURE STATEMENTS AND THE REORGANISATION PLAN

The disclosure statement is a document that the DIP is obliged to file with the court.²² It contains "adequate information" concerning the assets, liabilities, and business affairs of the debtor sufficient to enable a creditor to make an informed judgment about the debtor's plan of reorganization. In a typical Chapter 11 case, information that is provided in the disclosure statement includes, but is not limited to, the categories below:

Description of the business, including:

¹⁹A small business is defined as "a person engaged in commercial or business activities (but does not include a person whose primary activity is the business of owning or operating real property and activities incidental thereto) whose aggregate non-contingent liquidated secured and unsecured debts as of the date of the petition do not exceed \$2,000,000. *See generally* 11 U.S.C. § 101(51C) (2002) (as amended by Bankruptcy Reform Act of 1994, Pub. L. No. 103-394, 108 Stat. 4106, 4127.

²⁰ In a small business case

- (a) only the debtor may file a plan until after 180 days after the date of the order for relief, unless that period is extended as provided by this subsection, after notice and a hearing; or
- (b) the court, for cause, orders otherwise;

²¹ The Bankruptcy Code as amended by BAPCPA also requires that a debtor company's Chapter 11 plan be confirmed within 45 days of its filing. This objective is almost impossible to achieve. It may be possible, however, to obtain a continuance. The burden of proof for doing this may be quite high. This is so, because there is uncertainty about how the court may make the necessary determinations, given the tight timetables and substantial requirements involved. All of this may prove especially challenging for debtor companies which are commercially viable. All this is borne out by witness testimony before the ABI Commission hearings. American Bankruptcy Institute, *Commission to Study the Reform of Chapter 11* (ABI 2014) Alexandria Virginia at 295.

²² 11 U.S.C. § 1125. For a fuller review of Disclosure Statement matters and their relatedness to Chapter 11 Reorganisation Plans see http://www.americanbar.org/publications/gp_solo/2011/july_august/chapter_11_bankruptcy_primer.html last downloaded on September 24th, 2014

Date of formation/incorporation
Description of members/principals (with percentage of ownership)
Description of business pre-petition
Description of market/clients
Description of business just prior to filing
Description of business post-petition
Reason(s) for the bankruptcy filing
Financial information
Description of assets, their value and bases for the valuation
Source of funds
Description of post-confirmation management, including salaries
Disclosure of professional fees paid/to be paid
Statement regarding insider transactions/claims (if none, a negative statement is required)
Description of pending or contemplated litigation (if none, a negative statement is required)
Tax consequences (e.g., capital gains, if the property has been sold).

As stated by the American Bankruptcy Association,²³ a plan must:

1. designate classes of claims and interests;
 2. specify the classes of claims or interests that are not impaired under the plan;
 3. specify the treatment of classes of claims or interests that are impaired under the plan;
 4. provide the same treatment for each claim or interest of a particular class, unless the holder of a particular claim or interest agrees to a less favourable treatment;
 5. provide adequate means for the plan's implementation:
6. in the case of a corporation, include in the charter of the debtor or its successors a prohibition on the issuance of non-voting equity securities. If there are several classes of securities which have voting power, the plan must provide for an appropriate distribution of voting power among the different classes, including in the case of preferred shareholders, adequate protection for the election of directors representing such preferred shareholders in the event of a default in the payment of dividends;

²³ 11 U.S.C. § 1123(a). For a fuller analysis of Chapter 11 Reorganisation Plans see ABI Chapter 11 Plans: Basic Programme last downloaded at <http://materials.abi.org/sites/default/files/2012/Sep/Chapter11Plans.pdf> on December 14th, 2015. This ABI document also covers the permissive provisions in 11 U.S.C. § 1123(a) open to a DIP.

7. contain only provisions that are consistent with the interests of creditors and equity holders and with public policy with respect to the manner of selection of any officer, director, or trustee under the plan and any successor to such officer, director or trustee; and

8. in a case in which the debtor is an individual, provide for the payment to creditors under the plan of all or such portion of earnings from personal services performed by the debtor after the commencement of the case or other future income of the debtor as is necessary for the execution of the plan.

In the case of small debtors, the candidates may use the Judicial Conference official forms or others approved of by the court.²⁴ The small business provisions of BAPCPA establish new deadlines and greater uniformity in financial reporting to enable cases to move quickly through the Chapter 11 process before assets are dissipated.²⁵

2.2.3 THE PLAN-DRAFTING PROCESS: AN ANALYSIS

Exclusivity on the part of the debtor-in-possession is central to Chapter 11, because it drives the process of formal reorganisation forward to a greater extent than any other component of the legislation.²⁶ The moratorium or “automatic stay” considered in Chapter 3 of this thesis is another incentive to the debtor-in-possession.²⁷ While moratoria are common in commercial cases in the three jurisdictions selected, this cannot be said of exclusivity. It causes the debtor company management to consider a declaration of insolvency at an earlier date and in a way

²⁴ 11 U.S.C. § 1123(b). For relevant cases post BAPCPA see D Grassgreen, “Individual Chapter 11 Cases after BAPCPA” (2006) *Norton Annual Survey of Bankruptcy Law*.

²⁵ C White, “Statement before the Sub-Committee on Commercial and Administrative Law2 (2006) United States House of Representatives at 8 last downloaded on 14th December, 2015 at <http://www.justice.gov/sites/default/files/ust/legacy/2011/07/13/testimony060426.pdf>

²⁶ This was recognised in the debates on the proposed Chapter 11 legislation. See H.R. Rep. No 95-595 232 reprinted in 1978 U.S.C.C.A.N. 5963, 6191. The record reads: “Proposed Chapter 11 recognises the need for the debtor to remain in control to some degree or else debtors will avoid the reorganisation provisions in the bill until it would be too late for them to be an effective remedy.” See also R Greene, “Recent Developments in Small Business Bankruptcy Law” (2003) 7 *Journal of Small and Emerging Business Law* 215 216.

²⁷ 11 U.S.C. § 362. An automatic stay is an automatic injunction that blocks actions by creditors, with certain exceptions, to collect debts from a debtor who has declared bankruptcy. Under section 362 the stay begins the moment the bankruptcy petition is filed.

that would be unthinkable, for instance, in a potential candidate for examinership under the Companies (Amendment) Act 1990 as amended.²⁸ That is its great strength.²⁹

2.2.4: THE EFFICIENT ELEMENTS OF THE EXCLUSIVITY PERIOD

This section analyses the efficient elements of the exclusivity period, on the basis of the preceding standards proposed by the team production theory (TPT), i.e. the necessity and the contribution of the exclusivity period to the collective procedure and efficient decision-making and the inefficient elements of the exclusivity period, if such exists. From the perspective of team production theory efficiency, “the debtor *should* remain in business, if the total benefits to team members from continued operation exceed the total benefits to team members from liquidation.”³⁰ That is to say, reorganization is a good idea when it benefits the members of the team in the aggregate. The company’s decisions will impact adversely on some people who are external to the team and thus some costs will be externalised, but the amount involved will be far below that which is permitted by the creditors bargain theory.³¹

The exclusivity period available to the debtor-in-possession (DIP) in Chapter 11 is what enables this efficiency. As already stated, its most important dimension is that it provides a strong motivation for the debtor to opt for a Chapter 11 solution at an early date.³² At least in theory, the debtor is in control of the reorganisation process for a limited time. If this option were not available within the Chapter 11 context, the argument continues, there would be

²⁸ Traditional examinership in this context is understood here not to include pre-pack examinership.

²⁹ There are basically three types of Chapter 11 case. In all three, those in control of the company usually continue running what’s left of it. These are: liquidating Chapter 11 cases, Chapter 11 sale cases and Chapter 11 re-organisation cases. The Chapter 11 Reorganisation sub-type is what is of concern in this thesis.

³⁰ L M LoPucki “A Team Production Theory of Bankruptcy Reorganisation” (2003) UCLA Law School Research Paper 3-12. Retrieved 9th September, 2012 from <http://ssrn.com/abstract=397801>.

³¹ L M LoPucki “A Team Production Theory of Bankruptcy Reorganisation” (2004) 57 Vanderbilt Law Review 741. This statement is made apodictically. LoPucki adds the following footnote at that point in his argument: “The Creditors’ Bargain Theory permits the firm to externalise the same costs as the Team Production Theory and, in addition, the costs incurred by team members other than creditors and shareholders to generate the entitlements that the Creditors Bargain theory will dishonour.” He also states the following: “The theory is an empirically testable hypothesis regarding the actual bargain among the constituent groups that compose the public corporation.” L M LoPucki “A Team Production Theory of Bankruptcy Reorganisation” University of California School of Law, Law and Economics Research Paper Series Research Paper No 3-12 at page 10.

³² N Petrovski “The Bankruptcy Code, Section 1121: Exclusivity Reloaded” (2003) 11 Am. Bankr. Inst. L. Rev.451 at 485

plan competition. If such was the case, the debtor would very largely lose control of the planning process, because any plan the debtor might propose could be rejected in favour of some other. Such a possibility would inhibit the existing debtor from opting for a Chapter 11 solution and cause the debtor to act in a tardy fashion prior to insolvency. It may be said, however, that this viewpoint can be seen as a little simplistic, at least when applied to the larger reorganisation cases. It is possible to argue that in the business world today, the larger reorganisations are dominated by a single creditor or a small group of powerful creditors. According to this contrary view, sophisticated creditor institutions invariably contract with debtors in advance “about who should exercise control over a firm’s assets in any particular state of the world.”³³ This last way of thinking entails reconsideration of Chapter 11 such as to view it at the practical level in terms of control rights.³⁴

These rights are exercised by the DIP lender who in real terms takes control of the reorganisation process when the company becomes financially distressed. If this is indeed the case, any reference to efficiency during the exclusivity period would make very little sense. Nevertheless, it can be claimed against the control rights proponents that the power of the DIP lender is often overstated and that the control rights argument is unpersuasive. This is so, because in a Chapter 11 process control rights are not absolute. They are relative, it is further argued, in that they are subject to the rights of other creditors and they are ambiguous in so far as it can prove difficult in big cases to identify a single DIP lender with overweening

³³ Douglas G. Baird & Robert K. Rasmussen, “The End of Bankruptcy”, 55 *Stanford Law Review* 751 (2002) at 1805. (This paper describes the influence of railroad bankruptcies on the reorganisation process); Douglas G. Baird & Robert K. Rasmussen, “Four (or Five) Easy Lessons from Enron”, 55 *Vanderbilt Law Review* 1787 (2002) at 1808 and David A. Skeel, Jr., “Creditors’ Ball: The “New” New Corporate Governance in Chapter 11”, 152 *University of Pennsylvania Law Review* 213 at 917. The Skeel paper considers the revamped Chapter 11 from a control rights perspective.

³⁴ The team production theory of insolvent corporate reorganization would allow for contracts between creditors and debtor companies to repossess assets owned by the company and employed in it prior to Chapter 11 being initiated. It would also allow for instances in which the creditor’s rights when asserted would be such as to close off any possibility of initiating any Chapter 11 petition. It would, nevertheless, be assumed that most credit institutions would not opt contractually to avoid US bankruptcy reorganisation law.

power.³⁵ Lubben, for instance, contends that were the control rights theorists to be right, it would remove the core objectives of Chapter 11; that is, maximising the value of the estate and decreasing the overall cost of business failure. He also states that the control rights theorists “have tended to gloss over the differences between maximizing the controlling creditors' interests and maximizing the value of the bankrupt firm.”³⁶ He sums up as follows:

In short, the growth of a control rights model of chapter 11 reduces transparency and leaves the utility of reorganization unsettled. All cases under the control rights model will feature controlling lenders who capture most of the debtor's value. In some cases the debtor's value will have actually increased as a result of chapter 11; in others the debtor's value will simply be shifted among the parties. The unknown (perhaps unknowable) empirical issue is which of the two cases dominates. Without answering that question, the benefits of the new face of chapter 11 are, at best, unclear.³⁷

Viewing matters historically with regard to Chapter 11, it may be said that the transformation of the corporate landscape (the transplanting of manufacturing corporations to the PRC and the other Asian Tiger countries together with the revolution in financial practices) had not yet occurred a generation ago. In a somewhat simpler context, Chapter 11 seemed initially -at least to some- to be efficacious as a forum for resolving competing claims and arriving at a consensus about a given company's future. This, however, is no longer the case. Contrary to Lubben's viewpoint, most members of the American Bankruptcy Institute (ABI) today, be they lawyers, academics, bankers or accountants, would take the view that secured creditors have regrouped and now dominate the planning process in restructuring.³⁸ The secured

³⁵ S J Lubben “The New and Improved” Chapter 11”93 Kentucky Law Journal 4(2005) at 844.

³⁶ S J Lubben “The New and Improved” Chapter 11”93 Kentucky Law Journal 4(2005) at 843.

³⁷ S J Lubben “The New and Improved” Chapter 11”93 Kentucky Law Journal 4(2005) at 843.

³⁸ The American Bankruptcy Institute is a critically important association. It is non-partisan in nature and is composed of professionals who are specialists in various aspects of US bankruptcy law and practice. See, for instance, the teleconference of 3rd December 2012 from the ABI Commission to Study the Reform of Chapter 11 at <http://commission.abi.org/> There were many submissions to the conference. The following is representative. Submission from the Commercial Finance Association to the ABI Commission to Study the Reform of Chapter 11, 3rd December, 2012. "Question raised: whether new procedural and substantive provisions should be developed to promote maximizing enterprise value through an expedited sale of the debtor as a going concern. *Reason for Study*: Significant academic, judicial and practitioner attention has focused on whether, and under what circumstances, §363 of the Code should be used to expedite sales of debtors as a going concern."

creditors can do this because they have leverage: they can provide badly needed finance to the debtor-in-possession and can therefore dominate proceedings.

The relevant statistics relating to Chapter 11 and other bankruptcy filings are these:

TABLE 2.1 U.S. BANKRUPTCY COURTS BANKRUPTCY CASES FILED, BY CHAPTER OF THE BANKRUPTCY CODE FISCAL YEARS 2008 - 2012

Year	Total	Chapter 7	Chapter 11	Chapter 12	Chapter 13	Other ¹
2008	1,042,806	679,898	8,785	332	353,739	52
2009	1,402,816	989,227	14,745	487	398,210	147
2010	1,596,355	1,146,511	14,191	707	434,839	107
2011	1,467,221	1,036,950	11,979	676	417,503	113
2012	1,261,140	874,337	10,597	541	375,521	144
Percent Change 2011 - 2012	-14.0	-15.7	-11.5	-20.0	-10.1	27.4

Source: www.uscourts.gov³⁹

Business Chapter 11 Filing Volume Over Time



Based on statistics compiled by the Administrative Office of the United States Courts.

Source: Skadden, Arps, Skate, Meagher and Flom⁴⁰

The Chapter 7 statistics relate to liquidation and Chapter 13 relates to bankruptcy cases where the debt is not discharged. Chapter 13 provides the debtor with the opportunity to set up a workable payment structure to help get out of debt in the foreseeable future. The far greater number of Chapter 7 cases is not surprising in view of the fact that it is a faster process. In many cases this type of bankruptcy case can be completed in a couple of months. Chapter 13 cases, on the other hand, cannot exceed five years. They usually take up to five years. There is no time limit on Chapter 11 cases. Chapter 12 bankruptcy is a relatively new addition to the US bankruptcy laws.⁴¹ It allows family farmers and family fisherman to restructure their finances and avoid liquidation or foreclosure. The majority of Chapter 11 cases are medium-sized businesses. Many other businesses of a similar size turn to bankruptcy-like proceedings under state law, rather than the federal bankruptcy proceedings, including those under

³⁹ Statistics last downloaded on September 30th, 2015 from <http://www.uscourts.gov/statistics/table/f-2/bankruptcy-filings/2015/06/30>

⁴⁰ Skadden, Arps, Skate, Meagher and Flom, LLP and Affiliates, “Trends in Chapter 11 Filings, Venue and Proposed Reforms” (2015) last accessed on 16th December, 2015 at https://www.skadden.com/sites/default/files/publications/Trends_in_Chapter_11_Filings_Venue_and_Proposed_Reforms.pdf

⁴¹ Chapter 12. 11 U.S.C. §§ 101(18), 101(19A), 109(f).

Chapter 11. Insolvency proceedings under state law are currently faster, less expensive, and more private, with some states not even requiring court filings proceedings.⁴²

The other positive feature of the exclusivity period from the perspective of efficiency is that it can speed up the process and promote efficient decision-making. It is very likely that if any party-in-interest were to be entitled to file a plan, matters would quickly become both interminable and intractable for the other participants and the court.⁴³ In addition, the costs involved would increase substantially.

2.2.5: THE INEFFICIENT ELEMENTS

There are inefficiencies in the planning process, but from a team production theory perspective they are of a lesser kind than its critics allow. Those critics often point to the slowness of the process and the dominant role of the debtor-in-possession in drafting plans.⁴⁴ What is less evident about these criticisms -which often originate from members of the creditors' bargain theory school- is that the reorganisation value in the creditors' bargain theory is available only as distributions to creditors and shareholders. This approach does not allow for distributions to parties other than shareholders and creditors; managers, workers, suppliers, customers, taxing authorities and communities.

A frequent additional criticism regarding inefficiency at the planning stage relates to the amount of time available to the DIP to design a plan. It is claimed that this affords the DIP a leverage position.⁴⁵ The adverse effect of this is to cause creditors to agree to reduced returns

⁴² Cases involving more than US\$50 million in assets are almost always handled in a federal bankruptcy court, rather than in lower courts. It is likely that the results for the coming years will be similar to those of 2011". The source of these statistics is http://www.uscourts.gov/News/NewsView/11-05-06/Bankruptcy_Filings_Up_Slightly_in_March.aspx last accessed on 31st September, 2015

⁴³ Novica Petrovski (2003), "The Bankruptcy Code, Section 1121: Exclusivity Reloaded", 11 Am. Bankr. Inst. L. Rev.451 at 462

⁴⁴ D Baird & R Rasmussen, "The End of Bankruptcy" (2002) 55 Stanford L. Rev. 751-89. For a very different view see E Warren, "The Success of Chapter 11: a Challenge to its Critics" (2002) 107 Michigan Law Review 603.

⁴⁵ The term is taken from the financial markets. Essentially it means the ability of a party to control a position larger than its own funds would allow.

that they would not otherwise agree to because of the DIPs' capacity to seek extensions from the courts for plan submissions. In the past it was claimed that such behaviour effectively depleted the given companies' resources and left creditors without recourse. This has all changed following the BAPCPA Amendment to § 1121.⁴⁶

Regardless of how well the bankruptcy case is progressing, bankruptcy courts no longer have any discretion to consider requests for an extension of exclusivity beyond 18 months after the petition date. Accordingly, after 18 months, any party in interest has the ability to file a competing plan of reorganization. This revised approach has had a very profound impact on the negotiating approach of the competing parties-in-interest and has altered their negotiating leverage. Not surprisingly, the volume of "pre-packaged" or pre-negotiated Chapter 11 cases has increased.⁴⁷ This would suggest that potential Chapter 11 debtors are increasingly striking deals with creditors and other stakeholders in advance of a bankruptcy filing as a way to avoid losing control of the negotiating process. The general effect of BAPCPA may have been in many cases to move the final results further away from the goal of team production theory as creditors may drive a hard bargain in the circumstances. In addition, competing plans in cases where they arise can add further complexity (both procedural and substantive) to the proceedings. For instance, the Tribune bankruptcy case⁴⁸ is probably the most

⁴⁶ "The Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (BAPCPA) (Pub.L. 109-8, 119 Stat. 23, enacted April 20, 2005)". See R Levin "Redline of Titles 11, 28, and 18, United States Code, from current law (as of January 1, 2005) as enacted by The Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 Pub. L. 109-8, 119 Stat. 23, enacted April 20, 2005 (Does not include amendments to other laws)", Skadden, Arps, Slate, Meagher & Flom LLP last accessed 6th December, 2015 from <http://www.flmb.uscourts.gov/reformact/documents/E>

⁴⁷ For instance, there were 91 Chapter 11 cases filed in the period 2004-2007; for the period 2010-2013, there were 165. Of the 91 cases in the first period, 77 were reorganised successfully. Of the 165 cases in the latter period, 118 were reorganised successfully. The average case duration, in days was 439 days in the first period and 210 in the later period. Data from <http://www.fticonsulting.com/~media/Files/us-files/insights/articles/the-changing-profile-of-large-chapter-11-cases.pdf> last downloaded on 1st October, 2015. The sharp decline in case lengths is mostly attributable to the larger proportion of case filings considered to be pre-negotiated/pre-arranged or pre-packaged Chapter 11 filings. Some 45% of large filings were categorized as such compared to 21% in 2004-2007. See N Devaney, L Hiestand and S Williamson "Prepacks Spike in US, UK following Bankruptcy Reform" last accessed on 14th December 2015 at www.turnaround.org/Publications/Articles.aspx?objectID=7798

⁴⁸ *In re Tribune, et al.*, 2011 Bankr LEXIS 4128 (Bankr. D. Del. Oct. 31, 2011).

prominent example to date of a post-BAPCPA case that became significantly more complex and protracted following the expiration of the debtors' exclusivity period. In that case, four plans of reorganization were filed by various creditor groups after the automatic expiration of exclusivity in August 2010, and efforts by a mediator to garner support for a single plan proved difficult.⁴⁹

The sharp decline in case lengths is mostly attributable to the larger proportion of case filings considered to be pre-negotiated/pre-arranged or pre-packaged Chapter 11 filings in the most recent four-year period. Some 45% of large filings were categorized as such compared to 21% in 2004-2007.⁵⁰ The average duration of these "pre" cases was 107 days, a significantly lower figure than a traditional reorganization without a pre-negotiated plan

A very radical critique of the existing arrangements might prompt consideration of pre-pack solutions. These arrangements are put in place before a corporation finds itself in a critical financial condition. In addition, they serve to increase the likelihood that the company will operate with sufficient financial resources to achieve its goals.

2.2.6: THE RESTRAINTS UPON THE DIP IN THE PLAN-DRAFTING EXERCISE

When a corporation obtains Chapter 11 status, the debtor-in-possession of the corporation still retains control of the assets and continues to determine its business activities. At a practical level, the debtor-in-possession is the principal actor in the case. From a team production theory perspective, but not in a legal sense, the DIP is the fiduciary for all parties in interest. As noted above, the DIP is obliged during this stage to make disclosures as well as to formulate and implement the business plan.⁵¹ It is sometimes suggested that, in addition to

⁴⁹ After more than three-and-a-half years of legal conflict, the judge in the Tribune case approved a plan to transfer ownership of the media company to a group of hedge funds and banks.

⁵⁰ N Devaney, L Hiestand and S Williamson "Prepacks Spike in US, UK following Bankruptcy Reform" last accessed on 4th April 2013 at www.turnaround.org/Publications/Articles.aspx?objectID=7798

⁵¹ LoPucki observes that the debtor-in possession plays the dominant role in proceedings. This becomes evident from the results of one study cited by him: in that study it was found that 81% of the professional fees

the restraining measures such as the limited time given to the debtor to formulate a plan, the creditors' committee device is of equal significance⁵² It is, however, important not to exaggerate the significance of creditors' committees. According to team production theory, the DIP is not an agent of the creditors and shareholders;⁵³ it is a fiduciary⁵⁴ entrusted by all the team members, including the creditors and shareholders.⁵⁵ The team members have agreed that the directors will determine the distributions of the team's rents and surpluses.

authorized by the court were incurred by the debtor-in-possession. The rest, the 19%, were incurred by the creditors' committees, indenture trustees, and equity committees. L M Lopucki "A Team Production Theory of Bankruptcy Reorganisation" UCLA Law School Research Paper 3-12 at page 36. Retrieved 6th December, 2015 from <http://ssrn.com/abstract=397801>. The empirical study is the following: Lynn M. LoPucki & Joseph W. Doherty, "The Determinants of Professional Fees in Large Bankruptcy Reorganization Cases", 1 J. Empirical Legal Studies 2003.

⁵² In view of their last-in-line position, general unsecured creditors are conventionally viewed as having the most to lose should a Chapter 11 debtor's reorganization fail. It is for this reason that unsecured creditors may be most benefited by a thorough monitoring – through an unsecured creditors' committee – of the debtor's affairs during the case. In the first day hearing of a Chapter 11 case, the debtor corporation may file a motion requesting that certain creditors' claims be treated differently than they might otherwise be treated in the priority scheme. Unsecured creditors' committees are established in almost all Chapter 11 cases. There are exceptions in some instances involving smaller companies (11 U.S.C. § 1102 (a)(3)) Additional committees may also be formed representing the interests of such groups as subordinated creditors, tort creditors, and equity security holders where an interested party requests the establishment of such a committee. (11 U.S.C. § 1102 (a)(2)) According to the regulations, the unsecured creditors' committee and equity holders' committee is obliged to include the holders of the seven largest claims or interests that the committee represents.

⁵³ L LoPucki expresses this as follows: "by leaving the board in full control, while at the same time limiting creditors and shareholders to their bankruptcy entitlements, the Team Production contract has, in effect, granted the non-legally enforceable entitlement of team member priority over the legally enforceable claims to creditors and interests of shareholders." L LoPucki, "A Team Production Theory of Bankruptcy Reorganisation" (2004) 57 Vanderbilt Law Review 742 at 758. LoPucki claims that this is so because of the bankruptcy distribution rights of creditors and shareholders. They relate to two separate provisions of the Bankruptcy Code: that is, the "best interest" test at 11 U.S.C. § 1129(a)(7) (2000) and the "cramdown" test at 11 U.S.C. § 1129(b)(2).

⁵⁴ The US Supreme Court has found repeatedly that a DIP has fiduciary duties to creditors (the estate's creditors) and especially its unsecured creditors. For instance, in *Commodity Futures Trading Comm'n v Weintraub*, 471 U.S. 343, 355 (1985) the US Supreme Court found that "[DIP's] directors bear essentially the same fiduciary obligation to creditors and shareholders as would the trustee." This case cited *Wolf v. Weinstein*, 372 U.S. 633, 649–52 (1963)); in *Wolf v Weinstein* at 651 an emphasis was placed upon the willingness of courts to leave debtors in possession being dependent upon "an assurance that the officers and managing employees can be depended upon to carry out the fiduciary responsibilities of a trustee"). US Courts have spoken in broad and general terms about fiduciary duties in this context; that is to say that directors must not consider their own collective best interest, but rather that of the estate and its members. Regarding this last see *In re APP Plus, Inc.*, 223 B.R. 870, 874 (Bankr. E.D.N.Y. 1998) It was observed in this case that the DIP fiduciary duty "runs to the diverse interests of the debtor, creditors and equity holders, alike" Cases cited in the judgment were *Comm. of Equity Security Holders v. Lionel Corp. (In re Lionel Corp.)*, 722 F.2d 1063, 1071 (2d Cir. 1983)) and *In re Rancourt*, 207 B.R. 338, 360 (Bankr. D.N.H. 1997) In *Rancourt* it was held that DIP counsel "has a duty to look to the interests of the estate and not to the interests of its principals, shareholders, officers or directors"). All these matters are considered in detail in S M Freeman "Are DIP's and Committee Counsel Fiduciaries for their Client's Constituents or the Bankruptcy Estate? What is a Fiduciary anyway?" (2009) 17 *ABI Law Review* 291.

⁵⁵ This presupposes that no prior contracts exist that give creditors leverage against the the fiduciary – in this case the DIP. L M LoPucki, "A Team Production Theory of Bankruptcy Reorganisation" UCLA Law School Research Paper 3-12 at 17. Retrieved 2nd December, 2012 from <http://ssrn.com/abstract=397801>. Otherwise, the business judgment rule applies as in *NLRB v. Bildisco & Bildisco*, 465 U.S. 513 (1984)

The reason that creditors and shareholders are represented by committees during the bankruptcy process is that they have both team production entitlements and legal rights against the team.⁵⁶ Insolvency changes these entitlements. The amount of change involved is not within the DIP's power. In asserting their legal rights, the creditors and shareholders rights may be in opposition to those which the DIP represents. That is the reason that creditors and shareholders have independent representation.

2.2.7: THE CHAPTER 11 PLAN-DRAFTING SYSTEM FROM DIFFERING THEORETICAL PERSPECTIVES

The Chapter 11 plan drafting system has two components. One is the aforementioned exclusivity period that affords the DIP the opportunity of designing a corporate reorganisation plan. The other is the restraining measures which today consist of the time limit for plan design and approval under BAPCPA⁵⁷ and of the trustee device.⁵⁸ It is difficult to find fault with these two measures. A key to determining the efficiency or otherwise of the plan-drafting system from a team production theory perspective is the following. Any significant defence of corporate reorganisation must be that the exercise involves "preserving the company" and protecting its "going concern value."⁵⁹ This is in contrast to traditional contract theory: advocates for traditional theory claim that nothing is lost by the sale of a financially distressed firm, because a company cannot be "more valuable in the hands of its

⁵⁶ LoPucki states that team production entitlements are entitlements to "rents and surpluses." It might be supposed that a firm that cannot meet its obligations to creditors under non-bankruptcy law has no rents and surpluses. That supposition, however, ignores the contract between debtor and creditors that permits resort to bankruptcy. Creditors have agreed to bankruptcy and, accordingly, to receive only that to which they are entitled under bankruptcy law and process. If the claims of creditors and shareholders are reduced to those minimums, rents and surpluses exist. Creditors and shareholders have distinct rights under bankruptcy law. L LoPucki, "A Team Production Theory of Bankruptcy Reorganisation" (2004) 57 *Vanderbilt Law Review* 742 at 763.

⁵⁷ Pub.L. 109-8, 119 Stat. 23, enacted April 20, 2005.

⁵⁸ In 11 U.S. Code § 1104 (a) (Appointment of trustee or examiner) it is indicated that at any time after the commencement of a case, but before the plan confirmation, the court may appoint a trustee for cause, including fraud, dishonesty, incompetence or gross mismanagement. The court may also appoint a trustee, if it is in the interests of creditors, equity security holders or other interests of the estate.

⁵⁹ This argument is detailed in Lynn LoPucki & W Whitford, *Corporate Governance in the Bankruptcy Reorganization of Large, Publicly Held Companies*, 141 *U. Pa. Law Review*. 669 at 694

current claimants than it would be in the hands of third parties.”⁶⁰ Thus, the argument goes, it would be preferable, if companies were sold as a going concern rather than reorganised. This line of argument is important because it can be used as a springboard for criticism of the reorganisation plan model – from the perspective of the creditors’ bargain theory. In contrast to this, team production theory can provide a robust defence of the reorganisation plan model, even in cases where the company could be sold for more than its reorganisation value. The explanation for this has two parts. First, the reorganisation plan creates a context through which the directors of the DIP acting as fiduciaries can meet the legitimate expectations of all members of the production team. If Chapter 11 were not available, those expectations would be frustrated. Second, the conventional concept of “reorganisation value” – in the team production theory view- is somewhat limited: the conventional approach considers only the earnings available to shareholders and creditors. Other parties directly affected –such as managers, workers, suppliers, customers and others- are not considered. Moreover, the reorganisation value viewpoint may encompass a company sale to a buyer who can pay more simply because that buyer can default on team entitlements. This way of thinking is significantly at variance with those tenets of corporate rescue law in the United States which emphasise creditors’ rights –such as the creditors’ bargain theory- but are consistent with those which emphasise the rights of other directly impacted parties.

SECTION 2.3: THE CORPORATE RESTRUCTURING PLAN IN UK INSOLVENCY LAW

2.3.1: THE STATUTORY POSITION

As noted already, insolvency law in the UK is probably the most sophisticated in Europe. The corporate rescue part of it is one objective among others within the company administration

⁶⁰ Thomas J. Jackson, *The Logic and Limits of Bankruptcy Law* Harvard University Press Harvard, 1986
Ipasim; (1986).D G Baird, “The Uneasy Case for Corporate Reorganizations”, 15 *Journal of Legal Studies*
(1986) at 127 .

law process, itself a subset of UK insolvency law⁶¹ Administration is a mechanism designed to shield a company from its creditors – by means of a moratorium- while a restructuring plan is being completed by an appointed administrator.⁶² The moratorium is effective for a default, but extendable, period of one year.⁶³ Under the terms of the Enterprise Act, 2002, the previous purposes of Administration (as found in the Administration Act, 1986) have been replaced by a new system consisting of a cascade of objectives.⁶⁴ The first objective is the rescue of the business (as distinct from the company). If this is not practicable or if a second objective would produce a better result for the company’s creditors as a whole, then the second objective applies. The second objective would be to achieve a better result for the company’s creditors than would be possible in a winding up.⁶⁵ If this is not feasible, then the third objective is pursued.⁶⁶ This is the valuation and sale of the company’s property with a view to making a distribution to one or more secured preference creditors. Where the third objective is pursued, many of the formal requirements of administration such as those relating to creditors’ meetings and reporting are dispensed with. Both the amended Insolvency Act 1986 and the Enterprise Act 2002 have prompted different responses from academic commentators.⁶⁷ Some of this is positive from a tem production theory perspective. The primary objective of the Enterprise Act, 2002 is to facilitate the rescue of viable

⁶¹ See Part 2 of the Insolvency Act, 1986, as amended.

⁶² There are three routes into Administration: (1) By court order; (2) by notice filed at court by the holder of a qualifying floating charge (for a charge to be a "qualifying floating charge" it must relate to the whole, or substantially the whole of the company's property) or (3) by notice filed at court by the company, or its directors. See Enterprise Act, Para 3 of Schedule B1.

⁶³As found in Schedule B1 (revised) of the Insolvency Act 1986 a moratorium is operative from the beginning of administration until its end. The ‘automatic stay’ mechanism is employed to achieve this. It has two distinct stages . Stage one is the interim moratorium which begins with the first steps towards administration until administration is formalised. Stage two covers the period of formal administration. In substance, the moratorium provisions are as those found in the original Insolvency Act, 1986. I F Fletcher “UK Corporate Rescue : Recent Developments - Changes to Administrative Receivership, Administration and Company Voluntary Arrangements – the Insolvency Act, 2000, the White Paper, 2001, and the Enterprise Act 2002” European Business Organization Law Review 5: 119-151

⁶⁴ Insolvency Act 1986 Sch. B1 para.3(1)(a).

⁶⁵ Insolvency Act 1986 Sch.B1 para.3(1)(b).

⁶⁶ Insolvency Act 1986 Sch.B1 para.3(1)(c).

⁶⁷ Regarding the Enterprise Act 2002, Rayak praised the then government for seeking out a middle ground between the hitherto insolvency regime in the UK and that of Chapter 11 in the US. Rajak H, “The Enterprise ct and Insolvency Law Reform”. (2003) 24 (1) Company Lawyer 3.

companies and where that is not possible to achieve a better result for the creditors as a whole in a context of legal certainty and fairness for all stakeholders.⁶⁸ Its fundamental principle is that:

(if there are) alternative courses of action, one of which will benefit creditors only, and another which, with little delay, will confer benefits on employees and shareholders without significant detriment to the creditors then it is a legitimate function of insolvency law to have regard to those wider interests.⁶⁹

On the other hand, it is possible to argue, as does Keay, that administration is not a rescue process as such, but rather a shelter regime. For Keay, administration may lead to rescue, but it also may not.⁷⁰

The process is distinct from administrative receivership,⁷¹ under the Enterprise Act 2002.⁷²

Administration was originally intended by the UK authorities to replace administrative receivership⁷³ as the de facto procedure for dealing with distressed companies, but matters

⁶⁸ Rayak praised the then government for seeking out the middle ground between insolvency law as practiced in the UK and that of Chapter 11 in the United States. H Rajak, "The Enterprise Act and Insolvency Reform" (2003) 24 *The Company Lawyer* 1. Milman contends that the Enterprise Act 2002 has revolutionised UK insolvency law. D Milman, "Moratoria on Enforcement Rights: Revisiting Corporate Rescue" (2004) *Conveyancer and Property Lawyer* March/April at page 1. Mokal agrees in part with Milman, but argues that the changes have been more modest. R Mokal, "Administrative Receivership and Administration – Bepress Legal Series Working Paper 1372 last accessed on October 3rd, 2015 at <http://law.bepress.com/expreso/eps/1372>.

⁶⁹ R Goode, *Principles of Corporate Insolvency Law* 3rd edn Thompson, London 2005 45

⁷⁰ A Keay, "A Comparative Analysis of Administration in Australia and the United Kingdom." in: P J. Omar, *International Insolvency Law: Themes and Perspectives* (ed),. 1st ed. Ashgate 2008 Chapter 5. Keay introduces his argument as follows: "It should be pointed out at the outset that neither administration nor voluntary administration is a rescue procedure *per se*. They certainly are shelter regimes, and they can be viewed as preliminary regimes to possible rescue, but a rescue process might not follow from administration or voluntary administration, and if one does follow, it will be totally separate from these regimes."

⁷¹ Administrative receivership arises in the following context. When a company breaches the terms of its borrowing from a creditor with a floating charge, the creditor may appoint an insolvency practitioner to recover the money it is owed. The Enterprise Act, 2002 considerably scaled back the possibility of using administrative receivership. Today it is the exception rather than the rule.

⁷² It is, however, possible to exaggerate this point. Mokal takes the view that most insolvency practitioners and academics view administration as a disguised form of administrative receivership. It was disguised to render it more acceptable: R Mokal, "Administrative Receivership and Administration - An Analysis" (2006) Bepress Legal Series Working Paper 13723 last accessed at <http://law.bepress.com/expreso/eps/1372> on December 14th, 2015.

⁷³ Normally, administrative receivers are appointed over all the assets of a company by virtue of an existing floating charge. See Schedule 1 of the Insolvency Act, 1986 together with ICAEW Statement of Insolvency Practice 17 at www.icaew.com/~media/Files/Technical/Insolvency/regulations-and-standards/sips/england/sip-17-e-and-w-an-administrative-receiver-s-responsibility-for-the-company-s-records.pdf last downloaded on September 25th, 2014. The Enterprise Act considerably scaled back any possibility of using administrative receivership. Today, its use is very much the exception rather than the rule.

have not turned out so simply.⁷⁴ Statutorily, an out-of-court appointment of an administrator may be made by a qualifying floating charge holder⁷⁵ or by the company or its directors, albeit on more restricted grounds⁷⁶ Unlike receivership, administration offers the real possibility of rescue. Ostensibly, the hierarchy of objectives detailed above prioritises rescue of the company as a going concern, although the rights accorded to creditors who could previously (and who in certain isolated instances still can) demand administrative receivership tends to weaken the rescue commitment substantively.⁷⁷ The ostensible goal of rescue as corporate restructuring can be misleading in a second way. Administration is not in itself a reorganisation procedure. As already noted, it is a temporary regime with a menu of possible gateways, including liquidation. Any reorganisation agreed as an exit to administration must be made under another procedure, such as a company voluntary arrangement⁷⁸ or a scheme of arrangement under s 425 of the Companies Act 1985.⁷⁹ The major task of an administrator is to prepare a statement setting out his/her rescue plan; an administrator is the only one who can put forward the rescue plan. An Administrator's actions are subject to review by the court, but only where they lie open to the charge of irrationality.⁸⁰ Looking at things more widely and from a comparative perspective, the two functions associated with Chapter 11, for instance –the moratorium on the enforcement of security and a mechanism for securing court approval of creditor negotiated reorganisation- remain split into separate procedures in English law. So any *tertium comparationis* between

⁷⁴ McCormack views the main functions of administration as making distributions to secured and preferential creditors. He considers that if this is done and the appointor is a floating charge holder, then the similarities between administration and old-style administrative receivership seems very strong. G McCormack, *Corporate Rescue Law - An Anglo-American Perspective* 1st ed. Cheltenham, UK: Edward Elgar Publishing Limited 2008 68.

⁷⁵ Insolvency Act 1986 Sch B1, paras 14, 22.

⁷⁶ Insolvency Act, Sch B1, paras 23, 25

⁷⁷ Insolvency Act, Sch B1, para 3.

⁷⁸ Insolvency Act 1986 (s 1 (3), Company Voluntary Arrangements

⁷⁹ Under the streamlined administration procedure. A system is in place for an orderly exit from administration into a creditors' voluntary liquidation; provision is also made for a movement from administration to dissolution in a given instance. Insolvency Act 1986, Schedule. B1, para.83 and 84.

⁸⁰ See IA 1986, Sch B1, para 49(2) for matters relating to rationality.

Chapter 11 and administration becomes much less straightforward, as any reorganisation effected under the English procedure will use privately negotiated workouts, CVAs or another court-sanctioned process, such as s895 (and the sections immediately following) of the Companies Act, 2006.⁸¹

2.3.2: ANALYSIS OF THE ADMINISTRATOR-DIRECTED RESCUE PROCESS IN ENGLISH LAW

The soil from which the Insolvency Act 1986 and the Enterprise Act 2002 sprang is very different from that which brought forth team production theory. For instance, one objective of the team production contract is to facilitate the debtor to remain in business at the time of bankruptcy. From a TPT efficiency perspective, the company should continue in business, if the combined benefits to the team members are greater than the costs. This is not the case with administration or at least not so in any simple way. As noted earlier, if an administrator, although having an ostensible commitment to company rescue and having reviewed the company's affairs, thinks that the second statutory option – that is, an arrangement in the context of the moratorium which would produce a better result for the company's creditors overall - he/she may choose that.⁸² In such circumstances, the administration process – at least on one reading that is somewhat different from that offered by Goode⁸³ referred to earlier- becomes a means by which a better result is sought for the creditors than would be likely to happen following a liquidation.⁸⁴ The main deduction that can be taken from this reading is that the legislation was designed to put the interest of creditors before those of any other party. The reason for this somewhat limiting deduction can be found in the wording of section 10 of the Enterprise Act, 2002. The purpose of the section is stated to be both to

⁸¹ It would, however, be wrong to make too much of this. A pre-packaged sale of the company's business has been accepted by the English courts as a legitimate purpose of administration and administration orders can be granted by the courts where a pre-pack sale is stated as one of the objectives of the administration. The relevant cases are *T&D Industries Plc* [2001] 1 WLR 646; *Transbus International Ltd* [2004] EWHC 932 (Ch), [2004] All ER 911; *DKLL Solicitors* [2007] EWHC 2067 (Ch).

⁸² An administrator may also opt for a liquidation.

⁸³ R Goode, *Principles of Corporate Insolvency Law* 3rd edn Thompson, London 2005 45.

⁸⁴ Enterprise Act, 2002, sections 3(1)(b) and 3(3)(a) and (b). This is the way most Administrations turn out. See Goode *Principles of Corporate Insolvency Law* Sweet & Maxwell, 4th ed. London, 2011 at 327.

facilitate company rescue and to produce better returns for creditors as a whole. It is not necessarily the case that there will be an inevitable overlap between the two objectives.⁸⁵ Creditor interests will not necessarily be compatible with management, worker and shareholder interests. Such an approach is absolutely at variance with team production theory principles.

In addition, the debtor company does not direct the planning process in administration. That task falls to the administrator.⁸⁶ Neither the administration application nor the statement of the proposed administrator requires an indication of the specific objective that will be pursued during administration. The Administrator's task is to put together a reorganisation plan proposal (assuming this is the course taken). The plan is appropriate in cases where the company is of a reasonable size and where it is possible to predict cashflows and profitability with a high degree of accuracy. The company must be insolvent or contingently insolvent. Upon appointment, the administrator will require one or more of the current or former directors or company officers to provide him/her with a statement of the company's affairs. This is a prescribed form which details the company's assets and liabilities including those assets that are subject to any fixed or floating charges. A copy of the statement of the company's affairs or a summary of it must be attached to the administrator's proposals. The administrator is obliged to provide regular progress reports to the creditors, the court and the registrar of companies covering each six-month period from the date that the company enters administration until the administration ends or until the administrator ceases to act. These reports provide full details of the progress of the administration, including a receipts and payments account and any other relevant information for the creditors. The moratorium that operates during administration is, moreover, not absolute in nature as both the administrator

⁸⁵ J Armour & R J Mokal, "Reforming the Governance of Corporate Rescue"(2004) Working Paper no 289 ESRC Centre for Business Research, University of Cambridge.

⁸⁶ *Pui-Kwan v Kam Ho and others* [2015] EWHC (Ch), [2015] All ER (D) 133 considers the implications for insolvency practitioners who agree to be appointed administrators out-of-court by a company or its directors.

and the court can agree to allow a given action against the company to continue or to be taken in the first instance.⁸⁷

2.3.3: THE EFFICIENT ELEMENTS OF THE ADMINISTRATOR-DIRECTED RESCUE PROCESS

The accelerated arrangement of the Insolvency Act, 1986⁸⁸ allows for an orderly and speedy exit from administration into a creditors' voluntary liquidation. It can also allow for transition from administration to dissolution of the company. An administrator's proposals must be made available to all creditors before the end of eight weeks from the date that the company enters Administration.⁸⁹ This compares very favourably with the administrative receivership process under the Insolvency Act, 1986. Administrative receivership has often been criticised, because it gives great power to creditors who are floating charge holders.⁹⁰ Such creditors have little incentive to rescue companies in financial distress and through their interventions can eliminate the possibility of a company rescue exercise. Fundamentally, the Administrator-Directed Rescue Process is, however, incompatible with team production theory.

2.3.4 THE INEFFICIENT ELEMENTS OF THE ADMINISTRATOR-DIRECTED RESCUE PROCESS FROM A TPT PERSPECTIVE

One difficulty is that the administrator is likely to have been parachuted into the administrative process at short notice and will lack important insights that would be available, for instance, to the company's directors or to the company's bank. If the bank is the appointer, the bank's officers are likely to have a significant influence on the administrator's

⁸⁷ *Re Atlantic Computer Systems Plc* [1992] Ch. 505; [1990] BCC 859. See also Fletcher *Insolvency* at 544-546

⁸⁸ "Entry to administration has been facilitated by allowing out-of-court appointments, both by the holders of floating charges—a sort of *quid pro quo* for the abolition of receivership—and by the directors of the company." J Armour and R J Mokal "Reforming the Governance of Corporate Rescue: The Enterprise Act 2002" (2004) ESRC Centre for Business Research, University of Cambridge Working Paper No. 289 at 3. This refers to paragraphs 14 and 22, schedule B1, of the Insolvency Act, 1986 (as amended). In many instances, the floating charge holder would be the bank most closely involved with the company. On account of the professional expertise available to the bank and because of its deep insight into the financial and business affairs of the distressed business, Armour and Mokal take the view that the bank in any given instance will take the lead – rather than the directors- in opting for administration where they see fit.

⁸⁹ Insolvency Act 1986, Sched. B1, para. 49(5) as amended.

⁹⁰ V Finch Corporate *Insolvency Law: Perspectives and Principles* 1st edn, CUP 2002 at 241.

thinking. More particularly, they can offer their view of the worthiness or otherwise of the company's management.⁹¹ This approach is clearly incompatible with TPT as it is driven by forces whose interests are not necessarily compatible with those of the team members. A second difficulty which relates specifically to streamlined administration, (an arrangement which is sometimes opted for by the directors) is that the cost of the out-of-court procedure can be much higher than what might be first thought possible. This is because the administrator must provide a statement (which accompanies the notice of his appointment) to the effect that the purposes of the administration are reasonably likely to be achieved.⁹² This requires a significant analysis of the company's affairs on his part and is necessarily costly.⁹³ A third factor that works against the success of the streamlined administrative procedure (however qualified that success may be from a TPT perspective) is that relating to the displacement of the directors: they effectively lose control of the company on the appointment of the administrator. It is notable that an administrator has the power to remove any director of the company and to replace the director with a person of his/her choice.⁹⁴ Thus, the administrator (while he/she may employ the services of the existing management so that the company may continue to function) has no obligation to them as such.⁹⁵

⁹¹ It should be noted that while it remains possible for banks to control the appointment process, when the administrator is appointed his/her duties extend to all creditors and he/she is obliged to act in accordance with the statutory hierarchy of objectives.

⁹² Insolvency Act 1986 Act 1986, Paragraph 11(b) of Schedule B1.

⁹³ Paragraph 11(b) of Schedule B1 to the Insolvency Act 1986 Act 1986 stipulate as one of the conditions for making an administration order that the court must be satisfied that the administration order is reasonably likely to achieve the purpose of administration. The affidavit from the administrator which accompanies the application for an administration order must in the circumstances provide enough information to satisfy the court. Rule 2.4(2)(e) of the Insolvency Rules- these Rules set out the detailed procedure for the conduct of all company and individual insolvency proceedings in England and Wales under the Insolvency Act 1986 – which requires of the administrator any and all information which “will assist the court in deciding whether to make such an order”.

⁹⁴ Section 14(2) of the Insolvency Act, 1986.

⁹⁵ The directors are not assured of having the administrator of their choice appointed if a creditor with a secured floating charge objects and the court judges that the arguments are substantive and in the interests of the creditors as a whole. It is worth noting, however, that while the administration process is in large part for the benefit of creditors as a whole, individual creditors' objections to an administration application may not always be successful and could result in an adverse costs order against the individual creditor who is objecting..In this regard see *Re Professional Computer Group Ltd* [2008] EWHC 1541 (Ch) For an example of the former see *The Oracle (North West) Ltd v Pinnacle Financial Services (UK) Ltd* [2008] EWHC 1920 (Ch).In the Oracle

An approach which might serve to prompt the directors of a financially distressed company to be more positive about the prospect of relinquishing power to the administrator would be as follows.⁹⁶ Given that company rescue can more easily be attained, if the company enters administration at an early stage in its distress, the cost/benefit calculus on the options available to directors in this predicament could be changed. In order to provide an incentive for the directors to take the administrative route, it could help if the power to dismiss directors currently available to an appointed administrator were subject to court approval.⁹⁷

SECTION 2.3.5: THE CVA PROCEDURE

In contrast to administration, the company's voluntary arrangement (cva) procedure allows for the management to remain in control of the company. It approximates most closely to the Chapter 11 procedure in the United States. It is very unlike the other insolvency and rescue arrangements in the UK. A CVA can be proposed by the directors and will be undertaken by a licensed insolvency practitioner who will also be a chartered accountant.⁹⁸ It can also be proposed by an administrator or liquidator in the context of a liquidation or administration.⁹⁹ The proposal requires the approval of more than three quarters or more (in value) of the creditors present in person or by proxy who are voting on the resolution.¹⁰⁰ A separate meeting of members is also held to vote on the proposals.¹⁰¹ If a proposal is approved, it

case the court held that the choice of which administrator should be appointed had to be determined having regard to the wishes of the creditors.

⁹⁶ *Closegate Hotel Development (Durham) Ltd and another v McLean* [2013] EWHC 3237 (Ch) considers the question of whether or not a director can challenge the appointment of an administrator.

⁹⁷ IA 1986, schedule B, para 61. Quite apart from examinership, the dismissal of a director is something that must be approached with great care, because of the potential legal pitfalls. From the director's perspective, the following may serve to prompt some optimism regarding his/her fate. What happens in practice is that prior to an appointment, a proposed administrator will usually have reviewed the company's position with regard to considering whether in his/her opinion it is reasonably likely that the objective of the administration will be achieved, as well as the timing and method of appointment. This may be a ground for hope for the director, if not for certainty. See I F Fletcher *The Law of Insolvency* Sweet & Maxwell 4th revised ed London 2009 518 in particular the supplement to the fourth edition (2011).

⁹⁸ Insolvency Act, 1986, P1 Section 1(1) as amended by the Insolvency Act, 2000.

⁹⁹ Insolvency Act, 1986, P1 Section 1(2) as amended by the Insolvency Act, 2000.

¹⁰⁰ Insolvency Act, 1986, Section 1A as amended by the Insolvency Act, 2000.

¹⁰¹ Insolvency Rules 1986 Chapter 5, Rule 1.18

binds all creditors who are entitled to vote on the proposals.¹⁰² The Insolvency Act 2000 brought about significant reform to the CVA procedure by introducing a moratorium of the ‘Chapter 11’ kind. The difficulty with the present arrangements is that the moratorium in the CVA process is only applicable to smaller companies.¹⁰³ Larger companies seeking to avail of the company rescue procedures must first enter administration. This limitation on access greatly reduces the efficacy of company voluntary arrangements.

2.3.6: GENERAL COMMENTS ON THE ENGLISH PLAN-DRAFTING SYSTEM

Those who have designed UK insolvency law has not opted for the American way of corporate rescue – which is characterised by moratoria and with debtor-in-possession as its core principle- but rather for a model in which creditor interests remain dominant. Indeed, it is the polar opposite of the Chapter 11 system as Chapter 11 was originally conceived. The long-term concerns of successive British governments has been to project a “business-friendly” and “city-friendly” image¹⁰⁴ and this tendency towards support of secured creditor interests has ensured that traditional arrangements have survived such as that of administrative receivership. Indeed, administrative receivership continues to have very significant importance. Moreover, the opportunities afforded floating charge holders under the amended administration procedures – such as the out-of-court appointment of an administrator of their choice- give a significant incentive to this class of creditors to continue in this market.

The possibility available to directors, however, to have their companies (irrespective of the size of those companies), enter administration without the costs of a court hearing is -subject to the provisos mentioned earlier - a good thing. It remains the case, nevertheless, that the

¹⁰² Insolvency Act, 1986, P1 Section 5(2)(b) as amended by the Insolvency Act, 2000.

¹⁰³ The Insolvency Act 1986, Schedule A1. Prior to this provision, the only means available to a small company to obtain comparable protection was for it to enter into Administration and to set up the CVA after the Administration order was made. This usually took several weeks and was much more costly than a stand alone proposal.

¹⁰⁴ D Smith, *Something will turn up: Britain's Economy, Past, Present and Future* (Profile Books 2015)

difficulties associated with all stages of administration from the company debtors' perspective have prompted many distressed UK companies at the present time to opt for pre-pack cva arrangements.¹⁰⁵

SECTION 2.4: EXAMINERSHIP- THE PLAN-DRAFTING STAGE AND COURT PROTECTION

2.4.1: THE ELEMENTS

The planning stage of examinership (or indeed what leads to examinership) consists of two components: the independent expert's report¹⁰⁶ and the examiner's scheme of arrangement. The purpose of all of this – following negotiations with creditors and others together with court appearances- is to secure a positive result for the company in the form of an examiner's report. The inclusion of the independent expert's report (which forms part of the petition) in the planning stage of examinership may seem just a little counter intuitive, - given that the independent expert is not the examiner- but this is the case.

Essentially, the independent expert's report must provide basic information to the court and give a view regarding whether or not proposals for a compromise or scheme of arrangement would offer a reasonable prospect of the company and all or parts of its undertaking as a going concern.¹⁰⁷ The report should indicate the changes or conditions necessary for the survival of the company. While these conditions are not binding on the examiner, it is important that they are carefully considered before being included in the report. The reason for this is that if one or more of the conditions are solely dependent upon a creditor's

¹⁰⁵ According to the UK Insolvency Service, There were 855 Administrations in the first and second quarters of 2015; 1910 Administrations in 2014; 2390 Administrations in 2013 and 1268 Administrations in 2012. This compares with figures of 767, 765, 726 and 587 for the years 2011, 2010, 2009 and 2008 respectively (full year statistics). The CVA figures are: 688 (for the first nine months of 2012) and 767, 765, 726 and 587 for the full years 2011, 2010, 2009 and 2008. The statistics are extracted from Tables 3b and 3 c from the statistical release dated November 2 of the Insolvency Service last accessed on December 16,th 2015 at <http://www.insolvencydirect.bis.gov.uk/otherinformation/statistics/201211/uksa/index.htm>

¹⁰⁶ Section 511, Companies Act 2014.

¹⁰⁷ Section 511(3), Companies Act 2014.

agreement and should it happen that agreement is not arrived at, the court may take the view that the examinership candidate's prospects are poor. Reviewing section 511(3) of the Companies Act 2014, it is evident that the expert is required to offer a professional opinion in five particular instances. Section 511(3)(h), however, requires something more. The expert is obliged to provide:

(h) recommendations as to the course he or she thinks should be taken in relation to the company including, if warranted, draft proposals for a compromise or scheme of arrangement.

The independent expert (usually an accountant) should say whether, in his or her view, an attempt to continue the whole or any part of the undertaking would be more advantageous to the members and the creditors as a whole than a winding up would be.¹⁰⁸ The report should also contain cash-flow projections to demonstrate the company's ability to trade during the protection period.¹⁰⁹ If the company's cash-flow is dependent on the support of one or more financial institutions (for example, by way of an invoice discounting agreement), it may be advisable to reach a preliminary agreement in advance of the presentation of the petition with the relevant institution that such funding will not be withdrawn. If the company has insufficient funds to continue trading during the protection period, an examiner will not be appointed.

Thus, other than the evidence of the petitioner, probably the most significant document to which the court will have regard in determining whether or not a company has a reasonable prospect of survival is the independent expert's report.¹¹⁰ The weight to be attached to the independent expert's report will vary depending upon "the degree and extent to which he

¹⁰⁸ Section 511(3)(g), Companies Act 2014.

¹⁰⁹ Section 511(3)(j), Companies Act 2014.

¹¹⁰ *Re Gallium Ltd* [2009] 2 ILRM 11; *Re Star Elm Framers Ltd* [2013] 2 IIESC 57.

supports that opinion by his or her own objective reasoning and the appraisal of material or factors relied upon for reaching his or her conclusions.”¹¹¹

With the increase in the number of unsuccessful examinerships, the court has, in certain cases, scrutinised the independent report in more detail.¹¹² This is particularly so where there is an objection to the appointment of an examiner by one or more of the company's creditors. Therefore, it is essential that all information in the report and, in particular, the conditions for survival and any projected cash-flows, are carefully considered and supported by accurate information and analysis.

Nevertheless, even where a judge is highly sceptical of certain conclusions of the independent expert, the case law indicates that the court may have little choice but to accept the contents of the report in the absence of creditor opposition.¹¹³

The requirement for the independent report to accompany the petition for examinership can be dispensed with for a ten-day period where there are exceptional circumstances outside the control of the petitioner and which could not have been reasonably anticipated by the petitioner.¹¹⁴ The appointment of a receiver will not of itself be an exceptional circumstance.¹¹⁵

Turning to the scheme of arrangement, the examiner's most important function is to attempt to formulate proposals for a scheme of arrangement which will facilitate the survival of the company and the whole or part of its undertaking as a going concern. A scheme of arrangement frequently involves a new investor acquiring all or substantially all of the shareholding in the company together with a write down of the company's debt across a range of classes of creditors. In certain circumstances, third party investment is not required.

¹¹¹ Murray J in *Re Vantive Holdings (No1)* [2010] 2 IR108 at introduction.

¹¹² *Re Gallium Ltd* [2009] 2 ILRM 11.

¹¹³ *Re Missford Ltd* [2010] 3 IR 756.

¹¹⁴ Section 513, Companies Act 2014.

¹¹⁵ Section 513(3), Companies Act 2014.

The examiner divided creditors into various classes, such as unsecured creditors, leasing creditors, retention of title creditors, floating charge holders, Revenue Commissioners, contingent creditors etc.¹¹⁶

As regards the classification of classes to be used, the following criteria have proven to be useful. In *Re Selco Ltd*,¹¹⁷ the Canadian case, the following was stated:

The principles to be considered in determining whether creditors have a common interest are (a) commonality of interest should be viewed based on the non-fragmentation test, not on an identity of interest test; (b) the interests to be considered are the legal interests of the creditor *qua* creditor toward the debtor corporation and not by their rights towards each other; (c) the commonality of interests should be viewed purposively, having regard to the fact that the objective statute is to facilitate restructuring if possible; (d) the court should resist classifications that could potentially jeopardise workable plans; (e) absent bad faith, the creditors' motivations to approve or reject the plan are irrelevant; (f) the classification should enable creditors to consult together regarding their legal entitlement as creditors.

The examiner is obliged to specify those classes whose interests or claims will be impaired and will not be impaired. A shareholder's interests are impaired if the value of the shares is reduced or the dividend is reduced or his/her interest in the entire fixed capital is diminished.

The examiner may specify that changes should be made to the management and direction of the company, where the examiner considers that this would improve the chances of the company's survival.¹¹⁸ The examiner may also indicate that specific changes be made to the company's memorandum and articles of association and make arrangements for the implementation of those changes.¹¹⁹

More generally, the only criterion regarding the merits of the scheme of arrangement is that equality of classes should be provided for. It is also important that the proposals in the scheme of arrangement should be consistent with the contents of the independent expert's

¹¹⁶ Section 539(1), Companies Act 2014.

¹¹⁷ *Re Selco Inc* 261 D.L.R. (4th) 368 (2005)

¹¹⁸ Section 539(1)(f), Companies Act 2014.

¹¹⁹ Section 539(1)(g) Companies Act 2014.

report. A statement of affairs, as of the date of the scheme of arrangement proposals must be attached to them. There must also be attached an estimate of how each class of creditor and member would fare in the event of a liquidation. Once proposals for the scheme of arrangement are formulated they are then circulated to each creditor and member.

Under s 534, Companies Act 2014 , the examiner is required to formulate his/her proposals as soon as practicable and to report to the court within 35 days or such longer period as the court will allow. It is unusual for the examiner to be in a position to report to the court within this time frame. The period may be extended for a further 35 days. If the proposals are still not ready for presentation to the court, a separate application to the court will be required in accordance with section 534.

The High Court has determined that no matter what amount of negotiation has taken place with investors prior to the filing of a petition for examinership, it will always be the duty of the examiner to ensure that the scheme she/he recommends to creditors and the court is the best scheme available for the company and its members and creditors.¹²⁰ This in turn necessitates the examiner unearthing all prospective investors and may mean that the investor identified before the company enters examinership will not necessarily be the successful investor after the examiner has followed the standard process.

2.4.2: EFFICIENCY AND THE PLANNING MECHANISM IN EXAMINERSHIP

Efficiency and the court protection period can be considered at both the practical and theoretical level. The theoretical aspects have been considered earlier. The practical aspect is as follows.

¹²⁰ *Re McSweeney Dispensers Ltd & Ors* [2011] IEHC 494.

2.4.3: PROVISION OF AN INCENTIVE TO FILE EARLY

On first consideration, the substantive reason why the examiner-directed plan provision (which also allows court protection) has value is because it provides an incentive for the management of an insolvent company in Ireland that is a good candidate for rescue to seek to be admitted to examinership at an early date. When an examiner is appointed, creditors' rights are limited by s.5 of the 1990 Amendment Act. The practical impact of the court protection arrangement is to preclude a liquidation from being undertaken or a receiver being appointed. In cases where a receiver has been appointed within three days prior to the appointment of the examiner, the receiver is obliged to cease his activities. Creditors cannot take legal action against the debtor company without the consent of the examiner. Nevertheless, the risk of losing total control may prompt the management to put off a decision about a petition for examinership. That delay could have disastrous consequences for the creditors and shareholders. On the other hand, this viewpoint need not necessarily be correct. Putting TPT to one side for a moment, it is possible to view things critically, in so far as the examinership procedure will allow the existing management to remain in office.¹²¹ It can, however, sometimes happen that the existing management bear some responsibility for the company's decline. Thus, while it is possible to highlight the benefits of decisive action regarding examinership petitions, it does not address some of the underlying weaknesses of the company. It is also possible that the examiner will not have sufficient power to carry out his duties without making court applications.

From the creditors' perspective, it is evident that an early petition for examinership makes good sense

¹²¹ This will be the case unless the examiner makes a s.9 application under the Companies (Amendment) (No2) Act, 1990 in a case where fraud is alleged. S.9 is used infrequently.

2.4.4: SPEEDING UP THE EXAMINERSHIP PROCESS

Almost invariably, the petition for examinership is put forward by the company's directors rather than its creditors or shareholders, although parties other than the directors can do so. It is possible to think in terms of a race between the creditors seeking to appoint a liquidator and a petition for examinership by management. All considered, the examinership arrangement must move at a brisk pace given the range of tasks that the examiner must undertake and the 100 day limitation. Nevertheless, a popular solution today for Irish companies who traditionally would have been candidates for examinership is to opt for a pre-pack liquidation arrangement.¹²² This involves a resale of the company to an identified purchaser prior to the liquidation. This is both speedy and efficient (at least from a creditor perspective). William Fry, the Dublin Law Firm, have noted that

“The usage of pre-pack insolvency sales is less developed in Ireland than in other jurisdictions, but there has been an increasing number of asset sales structured through pre-pack receiverships over the last year. The most recent successful example was the sale of the A-Wear retail chain In July 2011 the Superquinn grocery chain was sold to Musgraves by its receivers KPMG, in what was probably the largest ever pre-pack transaction in this market.”

It is, however, a poor fit from a TPT perspective in so far as the thinking behind the liquidation process is much better characterised by Creditors' Bargain Theory. Creditors Bargain Theory would compel the following approach: the firm should continue in operation only in those circumstances where that was in the interests of the creditors. In Team Production Theory, in contrast, every party who had a firm-specific input has rights in restructuring.¹²³

¹²² See “Pre-Pack Sales in Ireland” at <http://www.williamfry.ie/publication-article/pre-pack-sales-in-ireland.aspx> - last accessed on December 16th, 2015- in this connection.

¹²³ Critics of TPT might argue that the final outturn might not be in everyone's *best* interest.

2.4.5: HOW THE INEFFICIENT ELEMENTS OF THE EXAMINER DIRECTED PLANNING MECHANISM MIGHT BE LESSENERD

The design features of examinership have important similarities to Chapter 11 in the United States in addition to those already identified. While the examiner process seems ostensibly favourable to the debtor company, a balance is struck – at least in the mainstream of insolvency law thinking- that allows for parties such as the creditors to monitor the activities and to voice their views to the examiner.¹²⁴ Given the adverse consequences for creditors, it behoves the examiner – at least from a pragmatic perspective when allowance is made for the financial power of some of these parties- to treat the creditors with care.¹²⁵ The term “inefficiency” is understood in this context as having reference to traditional insolvency law thinking rather than to what is found in team production theory. At a practical level, therefore, the examiner is obliged to walk a very thin line.

Examinership is most evidently not effective, according to its critics, in that it is not often used.¹²⁶ In addition, the number of examinerships in recent years has decreased.¹²⁷ This is in

¹²⁴ There are arrangements in place to protect the interests of shareholders and creditors at each stage of the examination process. For instance, under s.3 of the 1990 Amendment Act, a creditor of the company or shareholder possessing over 10% of shares in the company with voting rights is entitled to petition for an examinership. Section 3B of the 1990 Amendment Act, as amended by s.10 of the 1999 Act, provides that each creditor who expresses a wish to be heard by the court must be given an opportunity to be heard before a decision is made about appointing an examiner. Section 3C of the 1990 Amendment Act, as amended by s.11 of the 1999 Act, provides that any interested party can obtain a copy of the independent accountant’s report. A creditor could be held to be such an interested party. Parts of the report can, however, be deleted in the particular case.

¹²⁵ There is an expectation on the examiner’s part that any proposed scheme of arrangement will be such as to meet with the approval of at least one class of creditors.

¹²⁶ In addition, for larger companies, pre-pack receivership can appear on some counts as a better option than examinership. These cases tend to be characterised by the following: a financier or other third party who is present with a right to appoint a receiver; the introduction of new funds in addition to what the financier may provide; and the leaving of some or all of the remaining debts in the rump business, with associated losses for unsecured creditors. The prepack receivership can be completed quickly and is cost-efficient. Unlike examinership, however, there is no judicial oversight and consequently no independent consideration as to whether the proposals are in the best interests of the wider body of creditors. There is no transparency. Typically, third parties, employees and other relevant stakeholders know little or nothing until the transaction is complete. The purchasing party can cherry-pick those elements of the business that they wish to take forward, and leave the remainder to be cast aside through liquidation. The former owners may be displaced. .K Prendergast, *Prepack Receiverships: The New Game in Town* last downloaded on 9th October, 2015 at <http://www.cpaireland.ie/docs/default-source/JobSeekers/pre-pack-receiverships--the-new-game-in-town.pdf?sfvrsn=2>

some part due to the costs involved.¹²⁸ Legal processes involving court appearances are necessarily expensive. Some of these costs could be reduced. For instance, the substantial fees payable to the examiner might sometimes be reduced. Where an examinership results in a scheme of arrangement being sanctioned by the court, the examiner's remuneration and expenses will usually be met by the new investor, under the terms of the scheme. There is anecdotal evidence to suggest that examiners often accept reduced fees and expenses as an act of goodwill and on account of the fact that they will receive quick payment for work completed.¹²⁹ Matters become more difficult when the examinership is not successful. The examiner's fees and expenses rank higher in priority to those of creditors.¹³⁰ It is thus necessary for the courts to ensure that the fees and expenses are in every way reasonable, rather than to rubber stamp any claim made under a s29 application.¹³¹

¹²⁷ The number of examinership appointments for the years 2009, 2010, 2011, 2012, 2013, 2014 was 39, 43, 25, 37, 24 and 35 respectively. Data last downloaded on 16th December, 2015 at <https://www.cro.ie/Termination-Restoration/Examinership>

¹²⁸ According to Deputy Stephen Donnelly TD who has a background in management consultancy, an examinership prior to examinership lite typically costs about €70k. The costs could in certain cases be up to €300k. Data last downloaded on 9th October, 2015 at <http://stephendonnely.ie/an-opportunity-missed-to-improve-examinership-save-jobs/> By contrast, it is claimed by a chartered accountancy firm that specialises in examinerships that the costs for examinership lite cases approximate to the following. The petition costs would be €7k together with VAT, which is reclaimable. The independent accountant's costs would be about €5k. The examinership costs for an SME retail business would be in the region of €15k per month. The data related to examinership lite costs were downloaded on October 9th, 2015 at http://www.examinership.ie/images/The_Costs_of_Examinership.pdf The data in this footnote are subject to verification.

¹²⁹ This statement was made to the author by a senior member of the accountancy profession in Ireland.

¹³⁰ The examiner's fees and expenses claim are made under s 29 of the C(A) A Act, 1990. On matters of priority see s29(3). S29(1) provides that the court may make orders for the payment of remuneration, costs and 'reasonable expenses properly incurred by the examiner from time to time. These matters are usually dealt with at the completion of the examinership. There is some evidence that the courts will not sanction expenses which they consider unreasonable. In this regard see the comments of Kelly J in *Re Missford Ltd* [2010] 3 IR 756 at 761.

¹³¹ The Irish courts have moved in this direction. I Lynch-Fanning and G N Murray *Corporate Insolvency and Rescue* 2nd edn Bloomsbury Professional, 2012 610 make the following observation: "The court can sanction part of the amounts claimed, for example, if it is shown that the examinership should have been concluded sooner (see *Re Edenpark Construction Ltd* [1994] 3 IR 126 and *Re Clare Textiles Ltd* [1993] 2 IR 213). In *re Missford ltd a residence members club* [2010] 3 IR 756 the court determined that where an interim examiner, or an examiner, considers that it may be necessary or appropriate for him or his staff to engage in work beyond the confines of the direction given by the court under the Companies (Amendment) Act 1990 he should seek an order under section 9 of the same Act, unless he and his staff are prepared to work pro bono. In an extreme case, the court can disallow the examiner's claims for his remuneration, costs and expenses entirely, for example, if the examiner has acted improperly and in breach of his duty to the court (see *Re. Wogan's (Drogheda) Ltd* (9th February 1993) HC). In *Re Sharmane Ltd* [2009] 4 IR 285 at para 36, Geoghegan J held that there were no statutory criteria to determine reasonable remuneration. On the other hand, it was held that it

2.4.6: STREAMLINED EXAMINERSHIP FOR SMALL- AND MEDIUM –SIZED ENTERPRISES

One of the more important developments in the history of examinership – that relating to an examinership process known as “examinership lite”- has been in place since late December, 2013.¹³² This process has the potential to reduce the cost of examinership for small businesses by thirty per cent. The same procedures as those applicable to examinership cases in the High Court will obtain. These examinership cases involving smaller companies will now go before the Circuit Court. Companies who satisfy two or more of the following conditions may opt for this approach:

- the company currently employs less than 50 people,
- its balance sheet does not exceed €4.4m and
- its turnover is no greater than €8.8m.¹³³

The following may help to put matters in context: in the period prior to the introduction of the legislation for examinership lite, only one per cent approximately of SMEs in distress are using the courts to enter into examinership, because of the high costs involved.¹³⁴ This is now changing somewhat and the examinership process via the Circuit Court would seem to be the main contributory factor. For instance, 1,243 jobs were saved in small- and medium-sized enterprises in 2014.¹³⁵ This is an increase of 49% on the 832 figure for the same categories of company in 2013.¹³⁶ There is data from the US and the UK for the period 2010-2014 that is not entirely comparable, but it does prompt reflection. It is as follows: about 20% of US

was unreasonable to calculate remuneration by means of some simple yardstick such as hours worked. Qualitative matters – such as the complexity of the work- must also be considered.”

¹³² This is now found in Section 509(10), Companies Act, 2014.

¹³³ Section 350, Companies Act 2014.

¹³⁴ Data provided by Deputy S Donnelly TD last downloaded on 9th October, 2015 at

<http://www.slideshare.net/StephenDonnellyTD/examinership-current-and-proposed-changes> The Dáil Debates of February 4th and 5th, 2014 on the Companies (Amendment) Bill, 2014, a private member’s bill introduced by Deputy Donnelly cast more light on the costs involved in examinership in the High Court.

¹³⁵ Hughes Blake SME Examinership Index 2015 last downloaded on 10th October, 2015 at

<http://www.hughesblake.ie/hughes-blake-sme-examinership-index-reveals-331-jobs-saved-in-q2/>

¹³⁶ Hughes Blake SME Examinership Index last downloaded on 10th October, 2015 at

<http://www.hughesblake.ie/hughes-blake-sme-examinership-index-reveals-331-jobs-saved-in-q2/>

companies facing difficulty applied for Chapter 11; in the UK, 15% of companies facing insolvency opted for one or other of the restructuring schemes.¹³⁷

2.4.7: SOME OBSERVATIONS REGARDING THE PLANNING STAGE IN EXAMINERSHIP

There have been three significant developments in the approach to planning in examinership in recent years. The first relates to the impact of the Eircom examinership.¹³⁸ This examinership was the biggest in the State and was characterised by both professional excellence on the part of the examiner and speed in the process itself. The greatest strength of the plan was that it did not contain any conditionality and it could be given effect by the court in very short order. Another notable feature of the scheme was that the secured creditors had come together before the examiner was appointed and agreed proposals that had facilitated the restructuring plan. (All of this potentially made it possible for the new management in Eircom to have enough cash-in-hand to invest meaningfully and cover debt repayments). It is thus evident that the Eircom examinership could usefully become an exemplar for restructuring candidates in the future, so far as the professionalism and focus of the key parties in that case is concerned. (It is possible to argue, however, that the Eircom management could have chosen a pre-pack administration process in the UK as an alternative route and there is some evidence that they had considered this.)¹³⁹ In the event, they chose examinership to avoid potential tax issues that might be involved by going through a British court. This does not take away from the success of the examinership overall.

The second development is that the management of many Irish companies became more proactive in the period following the 2008 recession: they are now inclined to invite in

¹³⁷ Data last accessed from <http://download.pwc.com/ie/pubs/pwc-2014-ireland-sme-examinership-brochure-january.pdf> at page 4 on 10th October 2015.

¹³⁸ *In re Eircom Ltd* [2012] IEHC at 158. See the A and L Goodbody report “Irish Examinership post Eircom: A Look at Ireland’s Feasiblest and Largest Restructuring through Examinership and the Implications of the Process” at <http://www.algoodbody.com/media/InsolvencyRestructuringInternational.pdf> last accessed on October 1st, 2014.

¹³⁹ The Irish Times, March 16th 2012. Article last accessed on December 16th, 2015 <http://www.irishtimes.com/newspaper/finance/2012/0316/1224313394594.html>

experts to find restructuring solutions when significant commercial problems loom.¹⁴⁰ This makes sense given the potential liability for fraudulent or reckless trading and a restriction order in the event that the company continues to trade while insolvent and ultimately goes into insolvent liquidation. In part, this has been prompted by the very demanding criteria now applied by the courts to candidates for examinership¹⁴¹

The third development relates to the examinership process specifically for SME companies – that is, examinership lite- which is detailed in the Companies Act 2014. The expectation is that the planning and other stages of the examinership lite process can be completed in any given case within three months. This development offers something more to a management of a small- to medium-sized failing company -in addition to the other options such as pre-pack liquidations- although the process does have its critics.¹⁴² The difficulty is that secured creditors are still in a position to force the closure of examinership lite candidates. A solution to this problem is discussed in Chapter 5.

The Personal Insolvency Act, 2012 is a welcome development for company directors in that they make it possible for the bankruptcy discharge period to be reduced from twelve to three years in certain instances. The redesigned scheme of arrangement mechanism in the Companies Act 2014 (as detailed below) is also welcome. Again there is a great need for the

¹⁴⁰ Professional services and accounting firms such as PriceWaterhouseCoopers Dublin and Mazars Dublin have thriving company restructuring practices. For an overview of methods such as debt equity swaps and balance sheet restructuring' see B O'Riordan and D McDonald, *Ireland – Corporate Debt Restructuring Solutions in a Distressed Marketplace* (2013) PCW Dublin. In addition, the Ireland Strategic Investment Fund (ISIF) has a prominent role in nurturing growing companies as indicated by Mr Noonan, the Minister for Finance. Information last downloaded on 10th October, 2015 at <http://www.finance.gov.ie/news-centre/speeches/current-minister/ireland-open-investment-and-isif-open-business-speech-minister>

¹⁴¹ See in this regard: *Re Tivway Limited (in examination) and in the matter of John J. Fleming Construction Company (in examination) and in the matter of J.J. Fleming Holdings (in examination) and in the matter of the Companies Acts 1963 to 2009* [2010] IESC 11, [S.C. No. 440 of 2009] and *Re Vantive Holdings* [2009] IEHC 409.

¹⁴² This is considered later, in Chapters 5 and 7 in particular.

diffusion of knowledge regarding these developments so that unnecessary liquidations of companies will not occur.¹⁴³

2.4.8 THE REDESIGNED SCHEME OF ARRANGEMENT MECHANISM IN THE COMPANIES ACT 2014

The redesigned scheme of arrangement mechanism became operative on 1st June 2015.¹⁴⁴ It is the one substantive change in company rescue legislation following the enactment of the Companies Act 2014. It is not really a rival to examinership, because -for the most part- it caters for a class of companies who wish to cease trading in a way that suits their needs and that does not invite publicity prior to the event. It is discussed at length elsewhere. A scheme of arrangement – here viewed as a stand alone mechanism- is a statutory procedure pursuant to Part 9, Chapter 1, ss 449 – 454 of the Companies Act 2014 whereby a company is able to reach a compromise or arrangement with its creditors and members or any class of them.¹⁴⁵ This replaces s201 of the Companies Act 1963.¹⁴⁶ The main purpose of section 201 of the Companies Act 1963 was to allow a compromise of the company's liabilities to creditors or a rearrangement of the company's capital structure. The Company Law Review Group identified two shortcomings in the existing scheme of arrangement:

¹⁴³ See Dáil Éireann Debate *Vol. 771 No. 3* Unrevised at p 9 for details of the Personal Insolvency Bill, 2012. A substantive summary of scheme of arrangement mechanisms in modern times is found in *Garuda Sea Assets Ltd v Perusahaan Perseroan (Persero) PT Perusahaan Penerbangan Garuda Indonesia* [2001] EWCA Civ ar para 2. The judgment notes the power of the implemented scheme of arrangement to bind a dissenting minority, but nevertheless recognises its utility.

¹⁴⁴ This replaced the scheme of arrangement system under s 201 Of the Companies Act 1963. Laffoy J in *Re Millstream Receiving Ltd* [2009] IEHC 571 considered the various steps towards the approval of schemes of arrangement under the Companies Act 1963.

¹⁴⁵ G O'Dea, J Long and A Smyth, *Schemes of Arrangement: Law and Practice* (Thornton 2012). This authoritative text which covers the relevant UK law provides a means of determining whether or not a scheme of arrangement or a company voluntary arrangement is appropriate in any given case in the UK.

¹⁴⁶ The main purpose of section 201 of the Companies Act 1963 was to allow a compromise of the company's liabilities to creditors or a rearrangement of the company's capital structure. The Company Law Review Group identified two shortcomings in the existing scheme of arrangement:

1. The parties had to initiate two separate legal proceedings to convene the scheme meetings and to approve the scheme; and
2. The matter had to be brought before the court three times (convening the meeting, seeking directions in relation to advertising the petition and getting approval of the scheme).

CLRG , First report, December 2001 107. This prompted the change by the Government to the streamlined scheme of arrangement process under the Companies Act 2014.

1. The parties had to initiate two separate legal proceedings to convene the and getting approval of the scheme.scheme meetings and to approve the scheme; and
2. The matter had to brought before the court three times (convening the meeting, seeking directions in relation to advertising the petition and getting approval for a scheme of arrangement¹⁴⁷

This prompted the change by the Government to the streamlined scheme of arrangement process under sections 449-455 of the Companies Act 2014.

Court approval is no longer necessary to convene scheme of arrangement meetings of creditors or members,¹⁴⁸ if the meetings are convened by the directors.¹⁴⁹The scheme can be proposed by the directors or the liquidator of the company. If the directors are not the ones calling the meetings, court involvement remains. Before the scheme of arrangement is put together, an application can be made to the High Court for a moratorium.¹⁵⁰ This prevents creditors from taking action against the company. In the event of no such legal proceedings being imminent, it will not be necessary for the company to take such an action. The draft scheme can be put together by the company's accountants. The scheme of arrangement is likely to include a detailed memorandum outlining the company's history and the reasons for its current financial difficulties. Transparency in statements and honesty on the part of the directors is obligatory. There is no need for High Court approval to be sought before entering the process. This can be particularly relevant where the directors have, for example, deliberately understated liabilities on tax returns. The High Court might reject an examinership candidate in such a case. Unlike what obtains for examinership candidates, the company need not be viable. Schemes of arrangement may be used to wind up a company's

¹⁴⁷ CLRG , First report, December 2001 107.This prompted the change by the Government to the streamlined scheme of arrangement process under the Companies Act 2014.

¹⁴⁸ Section 452 of the Companies act 2014 specifies what information must be sent to members and creditors before the meeting. Section 453 provides for a vote together with a notice in at least two daily newspapers and court sanction before the scheme of arrangement becomes binding on creditors or members. The provisions which facilitate reconstruction are now contained in section 455 of the Act.

¹⁴⁹ Companies Act 2014, s 450.

¹⁵⁰ Companies Act 2014, s 451.

affairs and pay a greater dividend to creditors. In such “wind-up” schemes” monies can be set aside for voluntary strike off.¹⁵¹ There are no strict deadlines to adhere to in schemes of arrangement.

While these and some other features would seem to make this option attractive to company directors who might otherwise choose examinership, it does have serious drawbacks. For instance, trade creditors in a given case may still retain title to goods. In addition, there is no provision for compulsory repudiation of title. There are other serious weaknesses. All of this is considered in chapter 5.

CONCLUSIONS

The purpose of this chapter was to consider plan drafting in formal reorganisation in each of the following jurisdictions: the United States, the UK and the Irish Republic. It was noted that during the exclusivity period, the debtor company has the sole right to draft the plan of reorganisation and seek to have it accepted. This was not the case in the comparable legislation in the other two jurisdictions with the exception of *cvas*. It was also found that there was a disparity between the spirit Chapter 11 on the one hand and what happens at plan drafting stage in big cases on the other. It was found that DIP lenders often have an inordinate influence on the Chapter 11 plans of large corporations, although this was sometimes disputed. It seemed that in such cases that the purpose of the Chapter 11 bankruptcy legislation had been defeated. Turning to the UK, it was found that the primary objective of the Enterprise Act, 2002 was to facilitate the rescue of viable companies, but that arrangements at planning stage very much favoured the creditor interest. For an administrator, the formula at planning stage seemed to be as follows: if there were alternative courses of action, one of which benefited creditors only, and another which, with little delay, conferred benefits on employees and shareholders without significant detriment to the

¹⁵¹ Companies Act 2014, s 731.

creditors then it was a legitimate function of insolvency law to have regard to those wider interests. There was one recommendation that had emerged from the debate about the efficacy of company administration in the UK that had possible application in Ireland. It was suggested that in order to provide an incentive for the directors to take the administrative route, it could help if the power to dismiss directors currently available to an appointed administrator were subject to court approval. The independent expert report and the scheme of arrangement mechanisms associated with the planning stage of examinership were found to be rigorous, although they inclined towards accommodating the creditor interests at all times and were not compatible with team production theory.

Chapter 3 offers a consideration of both the negotiating and implementation stages of the corporate restructuring processes in the three countries selected.

Chapter 3

THE NEGOTIATION AND APPROVAL STAGES

INTRODUCTION

This chapter connects with the last in that it reconsiders some more processes central to the existing company rescue law in Ireland. That is, the negotiation and confirmation processes in examinership. It also briefly considers the relevant processes in the redesigned scheme of amendment in the Companies Act 2014. The purpose of this investigation is to determine – in accordance with the research question- whether or not they are efficient processes which are fit for purpose. The negotiation and confirmation processes in the other two jurisdictions selected – that is, the United States, the UK are also investigated. The efficient and inefficient elements of these processes are considered from a team production perspective and some suggestions are offered for improvements in the Irish arrangements.

The chapter is structured as follows. Section 3.1 considers the United States context; section 3.2 that of the UK and section 3.3 considers the negotiation and approval stages within examinership. This is followed by a summing-up.

3.1: THE US CONTEXT

The Chapter 11 plan model which was described in the last chapter is at its simplest a contract between the debtor and the creditors. The debtor-in-possession has, in almost all cases, the right to determine the draft plan. It must then be negotiated between the parties and confirmed by the court. The parties that play a significant role at this stage (besides the Debtor-in-Possession) are the following: the secured creditors, the creditors' committees appointed to represent the interests of general unsecured or other creditors, the United States Trustee (who appoints the creditors' committees and monitors the reorganization process for

compliance with the administrative requirements of the Bankruptcy Code)¹ and the bankruptcy judge (who determines legal issues, establishes procedures, and either supports or blocks a proposed course of action by one or other party). The rules of procedure, of engagement and of court confirmation limit the autonomy of all creditors in pursuing their individual interests, but do promote equal treatment of the creditors. A key function at this stage (as in all other forms of bankruptcy) is in large part to maximise the assets.² The debtor-in-possession is the party who initiates procedures and proposes the method and timing of repayment. The debtor is obliged to respect fundamental doctrinal points of bankruptcy law such as the repayment of classes of creditors according to statutory priority.³ There is a formidable array of rules which confront the Debtor-in-Possession in Chapter 11 proceedings and which circumscribe what is and is not possible in arriving at a solution. For instance, on the evidence of the plan and in subsequent negotiations, the DIP must show that it is acting in good faith. Were the debtor to propose the retention of ownership of the corporation over the objections of a majority of the creditors, this would not be acceptable to the court unless the creditors were paid the full amount owing.⁴ Alternatively, the debtor would be obliged in the circumstances to inject a large amount of money into the corporation. In addition, the debtor cannot engage in a behind-the-scenes deal with major creditors that would be to the detriment of most creditors.⁵ These rules serve to indicate that the reorganisation plan – as originally envisaged by the designers of Chapter 11- can only succeed if it has the backing of the creditors who formally vote for it.

¹ 11 U.S.C. § 1102.

² J Westbrook, “The Control of Wealth in Bankruptcy” (2004) 82 Texas Law Review 798 at 821.

³ L LoPucki, “A Team Production Theory of Bankruptcy Reorganisation” (2003) University of California School of Law Research Paper No3-12 at 16: “The team production contract entered into at the founding of the public company permits resort to bankruptcy reorganization. By doing so, it deliberately incorporates the provisions of existing bankruptcy law.”

⁴ This approach constitutes the ‘absolute priority rule.’ The absolute priority rule stipulates the order of payment of creditors before shareholders - in the event of liquidation. Chapter 11, Section 1129(b)(2) is the relevant section. Chapter 11, Section 1129(b)(2) provides that a plan is “fair and equitable” with respect to a dissenting impaired class of unsecured claims if the creditors in the class receive or retain property of a value equal to the allowed amount of their claims or, failing that, no creditor of lesser priority,

⁵ § 1112 of the code covers this point.

The major task at this stage is for the creditors to vote for or against the plan of reorganisation. In order to make a decision that is both reasonable and defensible, they are provided with information which is thorough both in its range and its depth. This takes the form of the disclosure statement which as noted earlier accompanies the plan of reorganisation.⁶ The plan will have split the creditors into classes and indicated what each class will be eventually entitled to. The fundamental points are these. The secured creditors will be paid in full to the value of the collateral, at least. The payment will probably come in the form of interest instalments and be followed by a large sum at the end of the payment schedule.⁷ Unsecured creditors have a right to the receipt of an amount that is not less than what would be available in a Chapter 7 settlement (the liquidation Chapter in the American bankruptcy code). That is to say, it will be a smaller sum than the amount owing.

The arrangements involve firstly the disclosure statement being approved by the bankruptcy court before being made available to the creditors. Within a period of eight weeks the results of the voting of each class are usually available to the bankruptcy court. Where the majority in each class vote in favour, the plan will be confirmed by the court. In cases where a class votes against the plan, the DIP can request – in accordance with §1129(b)- that the court put aside that particular vote and still opt for confirmation.⁸ The relevant section of §1129(b) is as follows:

- (b)
- (1) Notwithstanding section 510(a) of this title, if all of the applicable requirements of subsection (a) of this section other than paragraph (8) are met with respect to a plan, the court, on request of the proponent of the plan, shall confirm the plan notwithstanding the requirements of such paragraph if the plan does not discriminate unfairly, and is fair and equitable, with respect to each class of claims or interests that is impaired under, and has not accepted, the plan.

⁶ This is discussed in chapter 2.

⁷ Section 1129(b)(2)(A).

⁸ The procedure with regard to its effects on the dissentient creditors (as found in section 1129(b)(2)(A) of Chapter 11) is known as ‘cram down.’ The cram down rules are in Section 1129(b). This section provides that if a class has voted no and therefore all of the requirements of Section 1129(a) are not met, the plan may be confirmed anyway, if the requirements of section 1129(b) are met.

Negotiation matters relating to small distressed businesses in a BAPCPA context are very different. On account of the modest amount of assets in question, the US trustee has a prominent oversight role vis-à-vis the debtor. The trustee has to determine the debtor's viability and to do so before the first meeting of the creditors. Cases that are not viable are weeded out by the trustee at this stage. Many small businesses find it difficult to provide the necessary accounting and other information to satisfy the court.⁹

3.1.1: ON CREDITOR COMMITTEES AND TRUSTEES

One of the important features of Chapter 11 is that the court does not take on all the tasks: to a significant extent, the work falls to the creditor committees. The most prominent of these in most cases is the unsecured creditors committee. The US Congress structured matters in such a way that the unsecured creditors committee would both negotiate with and (together with the US Trustee) oversee the activities of the debtor.¹⁰ The committee consults with the debtor concerning the administration of the Chapter 11 case; it investigates the acts, conduct, assets and liabilities, and financial condition of the debtor and the operation of the debtor's business and participates with the debtor in the formulation of a plan of reorganization.¹¹ U.S.C. §1103 of the Bankruptcy Code authorizes the unsecured creditors' committee to employ one or more attorneys, accountants or other agents to assist the committee in the performance of its duties. The fees of the professionals employed by the committee are allowable as administrative expenses of the Chapter 11 case. Committee members are not responsible for such payment. The US Trustee holds a significant, if not an equally important role to that of the committees.

⁹ McCormack G, "Rescuing Small Businesses: Designing an 'Efficient' Legal Regime" (2009) *Journal of Business Law* 308.

¹⁰ See H.R. Rep. No. 595, 95th Cong., 1st Sess. 401 (1977) and Trust Business Reorganizations Under Chapter 11 of the New Bankruptcy Code 34 *Bus. Law* 1309 (1979).

¹¹ U.S.C. § 1103 A committee is usually formed of creditors within the same class. There are various types of committees, such as a senior creditors committee, a bondholders' committee and an unsecured creditors' committee. A particular committee is formed if there is sufficient interest among unsecured creditors in having one.

The US Trustee, however, is not a trustee of the business as noted earlier; the task of running the business remains with the debtor-in-possession. His role is to ensure that the debtor company is being run in a manner that conforms to the letter and the spirit of the bankruptcy code. He has an additional duty of insuring that the debtor-in-possession is working to the maximum extent possible to meet the corporate reorganisation goal. The debtor-in-possession is obliged to make periodic financial reports on the corporation available to the US Trustee and to allow him to make visits to the business operation. At no time, however, is the US Trustee the advocate or agent of any creditor interest.¹² It is the duty of the US Trustee under the terms of U.S.C. § 1102(a)(1) of the United States Bankruptcy Code to appoint a committee of unsecured creditors as soon as is possible after a Chapter 11 case begins.¹³ While the unsecured creditors committee has a position of considerable prominence, it is always possible for the US Trustee to appoint other committees such as a creditors' committee.¹⁴ As regards obligations of committee members, each has a formal fiduciary duty to work zealously as a representative of the class of creditors that the committee is designated to represent.¹⁵ That fiduciary duty is not, however, so burdensome as to compel the member to have regard to any one particular creditor.¹⁶ The courts demand absolute commitment to committee's objectives on the part of members and full impartiality in related dealings.¹⁷ The

¹² 11 U.S. Code § 704 - Duties of Trustee is the relevant section.

¹³ 11 U.S. Code § 1102(a)(1) reads as follows:

Except as provided in paragraph (3), as soon as practicable after the order for relief under chapter 11 of this title, the United States trustee shall appoint a committee of creditors holding unsecured claims and may appoint additional committees of creditors or of equity security holders as the United States trustee deems appropriate.

¹⁴ 11 U.S.C. § 1102(a)(1) (1988). Subsections (1) and (2) of 11 U.S.C.

¹⁵ For a representative sample of how this has been examined by the courts see *Westmoreland Human Opportunities, Inc. v. Walsh*, 246 F.3d 233, 256 3d Cir. 2001. In this case it was held that committee members had fiduciary duties towards those whom they represented. *In re Life Serv. Sys., Inc.*, 279 B.R. 504, 513 Bankr. W.D. Pa. 2002 it was held that "Members of a creditors' committee owe a fiduciary duty to the committee's constituents—i.e., the class of general unsecured creditors in general."

¹⁶ *Shaw & Levine v. Gulf & Western Indus. (In re Bohack Corp.)*, 607 F.2d 258, 262 n.4 (2d Cir. 1979).

¹⁷ The duties undertaken by the committee members to the particular creditors outlined above do not extend to the debtor. It was held in *In Re Life Serv. Sys.*, 279 B.R. 513 *In Re Fas Mart Convenience Stores, Inc.* 265 B.R. 427, 432 Bankr. E.D. Va. 2001. See also K F Gwinne, "Intra-Committee Conflicts, Multiple Creditors' Conflicts, Altering Committee Membership and Other Alternatives for ensuring Adequate Representation under Section 1102 of the Bankruptcy Code" (2006) 14 ABI Law Review 109.

determination of who should gain membership of the creditors' committee is not necessarily an easy one. The relevant legislation would seem to make it likely that the membership would consist of the seven creditors who are owed the most, but that is not necessarily the case. It is important that the committee should have a representative dimension and that may mean appointing a creditor owed a relatively modest amount to the committee to speak for that subgroup in particular.¹⁸ It is sometimes found also that the Trustee will appoint the members of an existing committee that was established in the expectation of but prior to the commencement of the Chapter 11 case.¹⁹ Membership of a committee has been found by many courts to be open to associations and others and not just individual creditors.²⁰

In practice creditor or other committees in this context are not always cohesive; in fact, they may contain parties who have competing interests. The difficulty in this is made manifest when the committee does not work effectively as the representative of a particular group of creditors. The committee member may have obligations to more than one party or interest group: in such circumstances the member may not serve the interests of those whom she/he purports to serve or to meet her/his fiduciary obligations as a committee member. If such problems arise, the bankruptcy court may decide to appoint another committee in accordance with section 1109 of Chapter 11.²¹ Other possibilities for the court would be to change the composition of the committee to enable the representation of those who had been previously

¹⁸ 11 U.S.C. § 1102(b)(1) (1988) allows for the straightforward approach. The case law, in addition, would suggest that the higher courts will be accommodating, if the Trustee or a bankruptcy court chooses to act in this manner. For instance, in *Bank Creditors Group v. Hamill (In re White Motor Credit Corp.)*, 27 Bankr. 554, 557 (N.D. Ohio 1982), the district court accepted the bankruptcy court's decision that four small shareholders and two large shareholders should serve on the equity security holder's committee in accordance with subsection 1102(b)(2).

¹⁹ This is in accordance with 11 U.S.C. § 1102(b)(1) (1988).

²⁰ See *In re Altair Airlines, Inc.*, 727 F.2d 88 (3d Cir. 1984) for a good example of this.

²¹ As 1102(c) of Chapter 11 has been repealed, the statutory basis for reconstituting a committee remains unclear. Section 1109 allows a party in interest to raise any issue in a case and be heard on that issue. This section may serve as the basis for parties to bring such challenges. There is a difficulty here, however, because of the repeal of s 1102(c) of Chapter 11. This removes the statutory basis for either a US court or a US Trustee to reconstitute a committee. Despite this, at least one court has stated that cases involving the removal of creditors from committees have established a "tenet that survives the repeal of subsection 1102(c)," namely, that "[a] committee member holding a conflict of interest cannot continue to serve." *First Republic Bank*, 95 Bankr. at 61. D Blain and D Harrison O'Gawa, "Creditors' Committees under Chapter 11 of the United States Bankruptcy Code: Creation, Composition, Powers and Duties" 73 *Marquette Law Review* 581 at 587.

neglected or to have a subcommittee appointed to achieve the same objective.²² In these and other instances, the US Trustee acts as the agent of the court.

The reorganisation plan arranges the creditors into different classes. Those whose claims are similar are put in the same class. Particular secured creditors are assigned in almost all cases to a distinct class by themselves; this is because in each case their claims are not comparable to any other secured creditor. In contrast, unsecured creditors are usually lumped together in one class. This is administratively convenient, because their rights one-to-another are roughly comparable.²³ The arrangement very often takes the following form: the secured creditors (each one in a class of his own), then the unsecured creditor class and a further class consisting of shareholders. In a case where creditors vote for a plan, it means that all the classes mentioned above voted for the plan. Should a class vote against the plan, it may, as discussed earlier,²⁴ be “crammed down.”²⁵ A class is said to accept the plan when at least two-thirds in amount and more than one-half in votes in than class affirm the plan.²⁶ In the case of shareholder classes, the plan is approved if at least two-thirds of the share interests vote for it.²⁷

²² 11 U.S.C. § 1102(c) (1982) and H.R. REP. NO. 99-764, at 28 (1986), in the 1986 US U.S.C.C.A.N. 5227, 5240–41 See also Harvey R. Miller, *The Changing Face of Chapter 11: A Reemergence of the Bankruptcy Judge as Producer, Director, and Sometimes Star of the Reorganization Passion Play*, 69 Am. Bankr L.J. 431, 453 (1995) This paper examines whether or not creditors committees are efficient and effective in what they do.

²³ This follows the rule in § 1122(a).

²⁴ Cram-down was discussed on page 118 at footnote 132.

²⁵ In accordance with Section 1129(b)(1).

²⁶ 11 U.S.C. §1126(c). §1126(c) is worded as follows:

A class of claims has accepted a plan if such plan has been accepted by creditors, other than any entity designated under subsection (e) of this section, that hold at least two-thirds in amount and more than one-half in number of the allowed claims of such class held by creditors, other than any entity designated under subsection (e) of this section, that have accepted or rejected such plan.

²⁷ 11 U.S.C. §1126(d).

3.1.2: THE EFFICIENCY OF VOTER CLASSIFICATION FROM A TEAM PRODUCTION PERSPECTIVE

Voter classification which enshrines the principle of equality of claims treatment is on its face an efficient one and, in addition, is a requirement of Chapter 11.²⁸ This principle has its origins in corporate law and pre-dates the Chapter 11 model.²⁹ In this approach, classification is efficient in that it groups together those who have very similar interests as defined by corporate law on a basis of equality.³⁰ According to this way of thinking, this limits the possibility of unfair discrimination vis-à-vis similar claims.³¹ Classification, per se, is positive in so far as it directs bargaining that would otherwise occur between individuals towards a more manageable and logical approach: that of classes.³² There is, however, a fundamental difficulty with this approach, if viewed from a team production theory perspective. Classification of creditor (whether secured or unsecured) and shareholder interests where equal treatment is enshrined is perfectly reasonable, so long as one proviso is allowed. It cannot be taken to apply in a scenario in which only the rights of creditors and shareholders are considered to the exclusion of all others. Other parties have rights also –even priorities in matters of bankruptcy. These include employees,³³ revenue authorities³⁴ and those who have made deposits for purchases.³⁵ In addition, the broad sweep of legislative reform in the United

²⁸ 11 U.S.C. §1126(c).

²⁹ See D G. Baird and RK. Rasmussen, “Control Rights, Priority Rights and the Conceptual Foundations of Corporate Reorganization”(2001) 87 *Va. L. Rev.* 921 at 930 for a history of US bankruptcy reorganisation in its early years. A significant part of the paper offers a description of the methodologies by which claim-holders were classified. Representatives of these classes both bargained for and drafted the reorganisation plan.

³⁰ 11 U.S.C. § 1122(a) allows for a substantial similarity in claims, but is not expressed imperatively. In this connection see Scott F. Norberg, “Classification of Claims Under Chapter 11 of the Bankruptcy Code: The Fallacy of Interest Based Classification”(1995) 69 *American Bankruptcy Law Journal* 119 at 145. See also Bruce A. Markell, “Clueless on Classification: Toward Removing Artificial Limits on Chapter 11 Claim Classification”(1995) 11 *Bankruptcy Dev. Journal* 1 at 34 for an analysis of the lacunae in 11 U.S.C. § 1122(a). In Markell’s view, the section is silent on what claims should go together to form a class.

³¹ This approach is set out in D G. Baird, *Elements of Bankruptcy* Foundation Press, 5th edition, New York 2010. See also T H Jackson, “Bankruptcy, Non-Bankruptcy Entitlement, and the Creditors' Bargain”(1982) 91 *Yale L. J.* 857 at 860.

³² See W Christopher Frost, “Running the Asylum: Governance Problems in Bankruptcy Reorganisation ” (1992) 34 *Arizona Law Review* 89 at 116 for a full review of this matter.

³³ 11 U.S.C. §507(a)(3) and (4).

³⁴ 11 U.S.C. §507(a)(8).

³⁵ 11 U.S.C. §507(a)(6).

States has been such as to encompass the increased entitlements of unsecured creditors and shareholders to the detriment of secured creditors.³⁶ Secured creditors no longer are entitled to liquidate defaulting debtors.³⁷ They are in some instances not entitled to claim interest during a bankruptcy case.³⁸ On the other hand, the Bankruptcy Code makes provision very largely only for creditors and shareholders, an approach which is perfectly consistent with Creditors Bargain Theory, but not with TPT.³⁹ The Code does, however, modify this general approach: it acknowledges that there are parties other than creditors and shareholders who must in some contexts be considered in a restructuring.⁴⁰ Were it the case that creditors and shareholders interests alone could be considered in a Chapter 11 case – as is postulated by Creditors’ Bargain Theory- it would seem appropriate for creditors and shareholders to lead the negotiations. That, however, is not the case. That role falls to the debtor-in-possession who is precluded at law from representing the interests of creditors and shareholders.⁴¹ The only duty the DIP has to them is to provide them with information. When the parties

³⁶ This does not take away from what happens in practice in big cases vis-à-vis the DIP financier and its capacity to determine the content of Chapter 11 plans and outcomes.

³⁷Section 1141(c) of the Bankruptcy Code provides that, under certain circumstances, “property dealt with by (a chapter 11) plan is free and clear of all claims and interests of creditors.” Although the language of the provision is unambiguous, several courts have added a judicial gloss by requiring the creditor to “participate in the reorganization” as a prerequisite to the application of section 1141(c). *Acceptance Loan Co., Inc. v. S. White Transp., Inc. (In re S. White Transp., Inc.)*, 2013 BL 207801 (5th Cir. Aug. 5, 2013). D Prieto and M Douglas, “Secured Creditors may choose to take no action without hazarding Lien Stripping” (2013) Jones day last downloaded on 12th October 2015 at <http://www.jonesday.com/secured-creditor-may-choose-to-take-no-action-during-chapter-11-case-without-hazarding-lien-stripping-09-30-2013/>

³⁸ *United Sav. Assn. of Texas v. Timbers of Inwood Forest Assocs. (In re Timbers of Inwood Forest Assocs.)* 484 U.S. 365 (1988). The noted partisan for the Creditors Bargain Theory, Professor Jackson, objected to this trend by submitting amicus briefs in both the Supreme Court, *id.* at 366 and the Ninth Circuit case *Crouser Nat’l Bank v. American Mariner Indus., Inc. (In re American Mariner Indus., Inc.)*, 734 F.2d 426, 426 (9th Cir. 1984). This last is referenced by LoPucki in footnote 17 to L Lopucki “A Team Production Theory of Bankruptcy Reorganization” Research Paper No. 3-12 at 6 <http://ssrn.com/abstract=397801> last downloaded on 12/10/2015.

³⁹ For example 11 U.S.C. § 1129(b)(2). This relates to cramdown provisions which are discussed later. 11 U.S.C. § 1129(b)(2) specifies financial payouts where applicable as being available to creditors and shareholders.

⁴⁰ For example 11 U.S.C § 1104((a)(2). 11 USC § 1104((a)(2) reads:

- (a) At any time after the commencement of the case but before confirmation of a plan, on request of a party in interest or the United States trustee, and after notice and a hearing, the court shall order the appointment of a trustee
- (b) if such appointment is in the interests of creditors, any equity security holders, and other interests of the estate, without regard to the number of holders of securities of the debtor or the amount of assets or liabilities of the debtor.

⁴¹ “Estate Counsel represents the Estate-not its principals, not any of its creditors, but the Estate” in C.R. Bowles, Jr. and Na B. Rapoport, “Has the DIP’s Attorney Become the Ultimate Creditors’ Lawyer in Bankruptcy Reorganization Case?” (1997) 5 *Am Bank Ins L Rev.* 47 at 49.

negotiate, they negotiate as adversaries.⁴² It necessarily follows that what might appear to be an efficient approach on the part of the debtor-in-possession might not at all appear so to the shareholders and creditors.⁴³ In the essential task – at least essential from the perspective of the partisans of team production theory- of reconciling team entitlements with bankruptcy entitlements, the DIP negotiators should target a negotiation objective by which the creditors and shareholders classes agree to a statutorily minimum recompense.⁴⁴

On the matter of inefficiencies in voter classification from a team production perspective, at least two points can be made. The capacity of the debtor-in-possession to determine who should or should not be entered as a member of a particular class -given the ambiguity of 11 U.S.C. §1122(a) - can in certain instances, leave the debtor open to the charge of voter manipulation. There is a motivation on the debtor's side to manipulate class composition by offering terms favourable to major creditors, but less so to minor ones, so as to get a plan passed by that class.⁴⁵ The DIP may, for instance, be unclear whether or not it is reasonable to classify tort creditors, loan creditors or trade creditors as being similar in important ways; hence the temptation for the debtor to manipulate the classification.⁴⁶ Courts do not block the debtors' decisions on these matters, provided that the classification choice by the debtor does

⁴² Lynn M.LoPucki & William C.Whitford, "Corporate Governance in the Bankruptcy Reorganization of Large, Publicly Held Companies" (1993) *141 U. Pa. L. Rev.* 669 note that from a study they had undertaken that in 11 of 25 cases (44%), the managers of the debtor company in Chapter 11 viewed themselves as not being committed to the creditor and shareholder side – beyond their statutory duty to act equitably as negotiators for the dip. The main concern of seven of the managers was to preserve the company. Four viewed their chief objective as being the maximisation of the estate. In two cases where the companies were insolvent, the management took the side of the equity holders. This, as evidence, does not support the Creditors' Bargain Theory side; it can be said to support in some measure the team production viewpoint.

⁴³ No claim is made by the originators of team production theory that it purpose given the present development of technology and contract arrangements.

⁴⁴ For a sustained critical review of Team Production Theory see A J Meese, "The Team Production Theory of Corporate Law: A Critical Assessment" (2002) 43 *William and Mary Law Review* 1629.

⁴⁵ In this connection see J. Ronald Trost, Joel G. Samuels, and K T Lantry, "Survey of the New Value Exception to the Absolute Priority Rule and the Preliminary Problem of Classification" (1998) *SD21 ALI – American Bar Association* 401 at 416 and P E.Meltzer, "Disenfranchising the Dissenting Creditor through Artificial Classification or Artificial Impairment" (1992) 66 *American Bankers Law Review* 281 at 302.

⁴⁶ D G. Baird, *Elements of Bankruptcy Foundation Press* 5th edition, New York 2010.

not amount to unfair discrimination.⁴⁷ The great difficulty here from the perspective of the team production theory protagonist is that court actions undertaken by aggrieved parties necessarily deplete the estate's financial resources and are thus an inefficiency.

The second inefficiency relates to what might be regarded as a redundant aspect of Chapter 11. This relates to the supermajority rule. The supermajority rule requires that two-thirds of a class vote in favour of a plan, if that plan is to be carried. That level of consensus would appear to promote overall efficiency- particularly from the perspective of the Creditors' Bargain Theory- in so far as it makes it impossible a minority being expropriated by a majority.⁴⁸ It needs to be added, however that this supermajority stipulation can constitute a huge obstacle on the road towards consensus.⁴⁹ A better solution would be to negotiate a via media between the rocks of minority entitlements and the obstructions due to holdouts. This could be overseen by the courts. The present arrangement is inefficient.

3.1.3: THE BALLOTS AND THE CONFIRMATION PROCEDURE IN STANDARD CHAPTER 11 CASES

Having complied with the exhaustive requirements of the disclosure statement, the debtor-in-possession presents the document to the court. In cases where a creditor objects point blank to a plan, the creditor will most often claim that the details presented in the disclosure statement are insufficient.⁵⁰ The object of the dissenting creditor will not be to force an expensive trial,

⁴⁷ See *Frito-Lay, Inc. v. LTV Corp. (In re Chateaugay Corp.)* 10 F.3d 944, 957 2d Cir.1993 It was found in this case that separate classification and disparate treatment was reasonable in the circumstances. A second case is *Jersey City Medical Ctr.* 817 F.2d 1061 In that case, the court thought it reasonable to view the claims of medical doctors, medical malpractice victims, employee benefit plan participants, and trade creditors as being distinguishable classes one from another. As a contrast see *in re Lettick Typographic* 103 B.R. 32, 38-9 Bankr. D.Conn. 1989. Here the court did not confirm the plan or the classification. The court found that the approach used by the debtor amounted to improper manipulation and constituted an attempt to neutralise objections. It was also found that the debtor had falsely established an impaired class: in this case the debtor did not pay for a short time in accordance with an amended plan the debtor had put together.

⁴⁸ On the whole matter of supermajority voting see D A. Skeel, "The Nature and Effect of Corporate Voting in Chapter 11 Reorganization Cases" (1992) 78 *Virginia Law Review* 461 at 489. Skeel observes that reorganisation law cuts across pre-bankruptcy rights. The supermajority rule may have been introduced to assuage the grievances of minority dissenters in particular. See also S F Norberg *Debtor Incentives, Agency Costs, and Voting Theory in Chapter 11* 1998 46 *University of Kansas Law Review* 507.

⁴⁹ R B Thompson and P H Edelman, "Corporate Voting" (2009) 62 *Vanderbilt Law Review* 129 at 132.

⁵⁰ Section 1125(b) and (c) of the Bankruptcy Code requires that, other than in a small business case under section 1125(f), a written "disclosure statement" must be approved by the court, after notice and hearing, and

but rather to slow the progress of the DIP and thus gain some leverage in negotiation. The DIP may modify the disclosure statement at an early stage, so as to appease the particular creditor. If the plan is approved, he is then at liberty to send a copy of it to each of the creditors for a vote.

The ballot is conducted within each of the creditor classes. The vote is carried if a majority of those creditors who are not insiders vote in favour of the plan. It is also necessary that those who vote in favour command two-thirds of the monies owing to the class.⁵¹ One other difficulty that a plan proponent (usually a DIP) has to overcome is that relating to the absolute priority rule.⁵² By that rule, a debtor must first pay off all secured creditors in toto. The implications of the rule cut deeply, because no class is entitled to any monies until the secured creditors claims are fully satisfied. This puts enormous pressure upon a debtor in that it must meet the absolute claims of the secured creditors and seek to ensure that the unsecured credits class will vote for the plan. A debtor can succeed by offering a sufficient amount to the unsecured creditors to entice them into accepting the plan.⁵³ A debtor is not permitted to retain any assets prior to gaining the approval of the relevant classes of creditors for the plan

sent to holders of claims and interests along with a copy of the plan of reorganization and/or a summary of the plan. Numerous US courts have heard objections to the disclosure statement based upon contentions that the accompanying plan of reorganization is non-confirmable - in other words, if a plan is not confirmable on its face as a matter of law, then the court will withhold approval of the disclosure statement. e.g., *In re Beyond.com Corp.*, 289 B.R. 138 (N.D. Cal. 2003). In this case, the court disapproved of the contention of a disclosure statement being appropriate when the "underlying plan was patently unconfirmable.

⁵¹ Section 1126(c). The distinction between creditors who choose to ballot and those who do not is of some significance. In practice, most creditors with small claims do not vote. Impaired creditors should affirmatively opt out of consensual third party releases unless they want to be bound by such releases. A decision from 2013 in the United States Bankruptcy Court for the District of Delaware would indicate this. *Indianapolis Downs, LLC., et al.* Case No. 11-11046 (BLS). Details downloaded on 12th October, 2015 at <http://business-finance-restructuring.weil.com/releases-exculpations/dont-throw-away-that-ballot-you-may-be-releasing-third-parties-if-you-do/>

⁵² This rule stipulates the order of payment in the event of a liquidation. Under this rule, creditors are paid before shareholders. The absolute priority rule is used in Chapter 11 cases to determine what portion of payment will be received by which participants.

⁵³ A good example of how this process of appeasement may be undertaken can be found in the case *In re Perez*, 30 F.3d 1209 (9th Cir. 1993). The case indicates that unsecured creditors with a substantial stake may be offered sufficient returns to entice them to vote in favour of the plan. If that fails, the unsecured class may be crammed down. Cram down allows the bankruptcy courts to modify loan terms subject to certain conditions in an attempt to have all parties come out better than they would have without such modifications. The conditions to which they are subject are mainly that the new terms are fair and equitable to all parties involved. While awkward, it is usually feasible for the debtor to do this, all other things being equal.

and its business operations can be the subject of further scrutiny conducted by creditors under Bankruptcy Rule 2004.⁵⁴ Within a period of eight weeks the results of the voting are usually available. In the overwhelming majority of Chapter 11 cases where each class of creditors has supported the plan, the reorganisation plan is confirmed by the court.⁵⁵ This can be explained by the following: most unsecured creditors would in all probability receive at least as much in a successful corporate reorganisation as they would if the corporation were to be liquidated. In addition, contesting issues in court related to “cram down” for instance is likely to prove very costly for most parties and by depleting resources all around would work against their interests. Alongside that, there are some rewards available to the creditors, if they are cooperative. Under the terms of the approved plan, the value of the corporation as a going concern – and not just the market value of its resources- become available to the creditors in order of priority should a successful reorganisation be achieved.⁵⁶ In some cases, a class of unsecured creditors will have voted ‘no.’ The debtor remains at liberty to “cram down” that particular class of creditors and the court may confirm that arrangement. There are in turn good reasons for a court to decide matters in that way. A hearing relating to cram down can be enormously expensive, because it involves the review of much evidence and the retention of very costly experts.⁵⁷ The debtor company is not at liberty, however, to ‘cram down’ all creditors: the arrangement must secure the support of at least one class of creditors other than

⁵⁴ Last accessed at http://www.law.cornell.edu/rules/frbp/rule_2004 on 7th October, 2014. The rule includes the following:

(a) EXAMINATION ON MOTION. On motion of any party in interest, the court may order the examination of any entity.

(b) SCOPE OF EXAMINATION. The examination of an entity under this rule or of the debtor under §343 of the Code may relate only to the acts, conduct, or property or to the liabilities and financial condition of the debtor, or to any matter which may affect the administration of the debtor's estate, or to the debtor's right to a discharge.

⁵⁵ 11 U.S.C. § 1129 (a), details the requirements which must be met before the confirmation of the plan.

⁵⁶ This is in accord with economic rationality. In successful Chapter 11 cases, the DIP's attorneys have convinced the court that the insolvent corporation's revenues are higher than its variable costs. In such cases, the corporation's going concern value will be greater than its liquidation value. Its revenues to be higher than its variable costs. Successful Chapter 11 cases indicate the presence of asset specificity; that is to say, some of the corporation's assets have a greater value when owned by that particular corporation than when owned by another. C Adams, “An Economic Justification for Corporate reorganisations” (1991) 20 Hofstra Law Review 117 at 130.

⁵⁷ Contested cases of this kind are allowed for in Bankruptcy Rule 9014. Other bankruptcy rules such as Rule 7001 also apply.

those who are insiders whose rights are being reduced.⁵⁸ A party that is not an insider may in some cases be a secured creditor - it is not invariable that it will be the single class of unsecured creditors. In all of this it is incumbent upon the debtor company directors to prove to the bankruptcy court's satisfaction that the company is capable of meeting its targets set out in the plan and on the balance of probabilities will do so.⁵⁹ Besides this, the debtor-in-possession is obliged to be seen to be acting in good faith by meeting the reasonable expectations of the creditors to the greatest extent possible.

Where the parties have voted in favour of the plan, the lion's share of the work for confirmation has been completed. It remains for the court at the confirmation hearing to determine positively that the reorganisation plan has goals that are achievable and that the creditors will do better under the plan than they would do in the event of a liquidation.⁶⁰ The court will also require information on the future management.⁶¹ Should it happen that a secured creditor votes no to the plan, it falls to the plan proponent to prove that the creditor will be paid all of the amount outstanding together with interest at market rates, that the plan

⁵⁸ U.S.C. § 1129(a)(10). Section 1129(b)(2)(B) of the Bankruptcy Code in its turn provides that classes junior in priority to a non-accepting class of unsecured claims (such as shareholders) cannot receive or retain any property "on account of" their claims or interest unless the non-accepting impaired unsecured creditor class will receive distributions having a value equal to the allowed amount of their claims. Many courts, however, recognize an exception for certain "insiders." If certain insiders such as some shareholder contribute sufficient "new value" to the debtor and receives equity in the reorganized company, this is permissible. In such cases, the shareholder theoretically is not receiving property "on account of" its old equity, but in exchange for the new value that it contribution. *Bank of America National Trust and Savings Association v. 203 North LaSalle Street Partnership* 6 U.S. 434 (1999).

⁵⁹ U.S.C. § 1129(a)(11). A good example of this approach is *In re Acequia, Inc.*, 787 F.2d. 1352, (9th Cir. 1986) whose judgment included the following: "Finally, we find that the Plan satisfies the "feasibility" requirement of 11 U.S.C. § 1129(a)(11). The Debtor presented ample evidence to demonstrate that the Plan has a reasonable probability of success. The Debtor provided both "conservative" and "best case" projections. The Debtor's experts testified that the Debtor's assets are attractive and in demand. That the Plan provides for the eventual liquidation of assets does not preclude confirmation. 11 U.S.C. § 1123(a)(5)(D) (1982). We do not agree with (objecting creditor's) assertion that the Plan is a "visionary scheme.... and we find no abuse of discretion in the bankruptcy court's determination that the Plan is feasible."

⁶⁰ The "best interest test" is applicable in this context. This relates to U.S.C. § 1129(a)(7) of Chapter 11. This requires the debtor to pay at least as much to creditors as it would in the context of a Chapter 7 liquidation. In some cases the expectation is that the debtor will pay creditors in full. This does not happen very often because of the weakened financial condition of the debtor. The test is useful in helping to balance the legitimate interests of dissenting creditors on one side against the significant utility of moving forward a reorganisation plan that lacks absolute consensus on the other. See J Hicks, "Foxes guarding the Henhouse: The Modern Best Interests of Creditors Test in Chapter 11 Reorganisations" (2005) *Nevada Law Journal* 820.

⁶¹ Section 1129(a).

is feasible and that all reasonable expectations will be met.⁶² In the event that the bankruptcy court decides to turn down the plan, the plan proponent (most often the debtor) at best has an invidious choice. He or she may put forward another plan which will include another disclosure statement or abstain from doing so. It is more probable, however, that the case will become a Chapter 7 one.

3.1.4 THE EFFICIENCY OF THE BALLOTING RULES, THE ENTITLEMENTS OF STAKEHOLDERS AND THE CONFIRMATION PROCESS FROM A TEAM PRODUCTION THEORY PERSPECTIVE

As a preface to any assessment of these particularly technical aspects of the Chapter 11 process, the following points are offered. The relevant law is consistent with the principles of team production theory in that power emanates from the board. The board usually directs the process. The board exercises its authority subject to the ‘business judgment rule’ The rule makes it possible for the board to direct the affairs of the business unhindered to a very large extent.⁶³

The critically important point in all of this – at least from a team production perspective-is that given the predominance of the board, the rights of creditors and shareholders are limited to what bankruptcy law stipulates.⁶⁴ The team production arrangement – which LoPucki and others would argue best describes what obtains in the world of corporate contracts- automatically assumes a right on the part of the debtor company to resort to a bankruptcy

⁶² Section 1129(b)(2)(A).

⁶³ See *NLRB v. Bildisco & Bildisco* 465 U.S. 513, 5231984. It was found acceptable in this case to employ the business judgment rule as regards a review of motions to reject executory contracts. See also R T. Nimmer and R B. Feinberg, “Chapter 11 Business Governance: Fiduciary Duties, Business Judgment, Trustees and Exclusivity” 1989 6 *Bank Dev J.* 1 The main argument here is that where there is no statute blocking its use in any given instance, the business judgment rule will be found acceptable in the courts as regards board decisions of a strategic or tactical nature. The court may object to its use where its employment may cause severe hardship to one or other group and where its employment may lead to a solution that disregards other major factors which would lead to a different result.

⁶⁴ When a corporation is close to insolvency, the corporation has a duty to serve the team contracted parties through the exercise of good faith in its business dealings and not just the interests of the shareholders. See *Credit Lyonnais Bank Nederland, N.V. v. Pathe Communications Co., No Civ.A. 12130*, 1991 Del. Ch. Lexis 215 Del. Ch. Dec. 30,1991.

settlement, should the need arise.⁶⁵ It is reasonable to view bankruptcy law, therefore, not as something anomalous and oppressive, but as an intrinsic part of the corporate contracting world.⁶⁶ It remains possible for a creditor to insulate himself from the effects of bankruptcy by means of asset securitisation.⁶⁷ Such creditors are simply not subject to bankruptcy. Team Production Theory acknowledges and accepts such arrangements.⁶⁸ At least as importantly, following on in this way of thinking, the team production arrangement puts the non-enforceable contracts of team participants other than creditors and shareholders ahead of creditors and shareholders. The explanation for this can be found in both bankruptcy law and more particularly in the Bankruptcy Code. That is in the “best interests” test⁶⁹ and the “cramdown test”, the two critical tests of the plan before it can be approved by the court.⁷⁰ The “best interest” test promises creditors and shareholders an equivalent amount to what

⁶⁵ This clearly runs contrary to an underlying assumptions of Creditors’ Bargain Theory.

⁶⁶ See L A Bebchuk and A T. Guzman, “An Economic Analysis of Transnational Bankruptcies” (1999) 42 *Journal of Law and Economics* 775 at 801. Bebchuk and Guzman argue that it is not possible for any party to opt out of bankruptcy law. Both J S Rogers, “The Impairment of Secured Creditors’ Rights in Reorganization: A Study of the Relationship between the Fifth Amendment and the Bankruptcy Clause” (1983) 96 *Harvard Law Review* 973 and A Schwartz, “A Contract Theory Approach to Business Bankruptcy” (1998) 107 *Yale Law Journal* 1807 at 1833 take the same view. See also J Friedman, “What Courts do to the Secured Creditors in Chapter 11 Cram Down” (1993) 14 *Cordozo Law Review* 1496.

⁶⁷ Advocates of asset securitization generally deny that the transaction is a loan disguised as a sale, but they readily acknowledge the similarity. Steven L. Schwarcz, “Commercial Trusts as Business Organizations: Unraveling the Mystery” (2003) *Business Law* 559 takes the view that asset securitisation is a distinct entity from a loan camouflaged as a sale. The two entities are not, however, dissimilar. See also C A. Hill, “Whole Business Securitization in Emerging Markets” (200) 12 *Duke Journal of Comparative and International Law* 521. Hill considers that asset securitisation is a hybrid whose origins are in the worlds of asset securitisation and corporate credit.

⁶⁸ Asset-securitization relate o a class of contracts by which the debtor sells assets and then contracts to continue using them. Through a complex arrangement, - as stated by LoPucki- multiple parties replicate for borrower and lender the effect of a secured loan in the form of an absolute transfer of ownership. Virtually any of a debtor’s assets can be sold, securitized, and leased back. If the borrower later files bankruptcy, the securitized assets are unavailable to the bankruptcy court because their owner is not bound by contract to permit the debtor to continue using them. If the effect is to prevent reorganization, no reorganization occurs. The whole point and purpose of these contracts is to insulate the lender from bankruptcy/insolvency proceedings. L LoPucki, “A Team Production Theory of Bankruptcy Reorganisation” (2003) University of California Los Angeles School of Law Research Paper 3-12 at 17.

⁶⁹ 11 U.S.C. §1129(a)(7).

⁷⁰ 11 U.S.C. §1129(b)(2). For a consideration of the “best interest” test see “Confirmation of Chapter 11 Bankruptcy: A Practical Guide to the Best Interest of Creditors Test” 2005 41-SPG *Tex. J. Bus. L* 7 at 9.

they would receive in a hypothetical liquidation of the debtor company under the terms of Chapter 7.⁷¹

These arrangements are efficient and consistent with the team production theory because in practice they do not in most instances take away from the power of the debtor company board as DIP during the Chapter 11 process. For instance, most creditors do not seek asset securitisation. In addition, Chapter 11 enables the DIP to secure the interests on a priority basis of team members other than shareholders and creditors.⁷² The courts support this approach.⁷³ Moreover, the best interest and cramdown tests for creditors set a minimum amount that must be available to creditors, nothing more.

3.1.5: Indianapolis Downs LLC VOTING

In re Indianapolis Downs, LLC is illustrative of the complexities involved in balloting and voter solicitation.⁷⁴ The solicitation of votes is a lengthy process that would seem often to be largely unavoidable. In addition it is expensive and difficult. The turnout is not always predictable. This is because §1125(b) of the Bankruptcy Code requires that once a Chapter 11 case has been initiated, ballots on the plan cannot commence until the DIP has made available a court-approved disclosure statement to the creditors.⁷⁵ The ABI Commissioners, for their part, in their Report were much exercised by negotiation and class acceptance issues,

There are some mechanisms available in Chapter 11 which streamline the process and increase the likelihood of a predicted outcome. Two of these mechanisms are pre-pack and

⁷¹ 11 U.S.C. §1129(a)(7)”.

⁷² LoPucki expresses it as follows: “team production entitlements, like other expenses, have a claim on the earnings stream that is prior to that of shareholders.” L LoPucki, “A Team Production Theory of Bankruptcy Reorganisation” (2004) 57*Vand L Rev* 741 763.

⁷³ The Delaware Chancery Court ,for instance, in *Quadrant v Vertin* [2015] C A. No 6990 -VCL, noted that when a company is close to insolvency, the board of the debtor company has duties to the community that underpinned the corporation as such. The debtor company board must therefore make its business decisions in a way that maximizes the company’s long-term wealth-creating capacity.

⁷⁴ No 11-11046 486, 2013 WL 395137 B.R. 286 (Bankr. D. Del. 2013).

⁷⁵ 486 B.R. 286 (Bankr. D. Del. 2013). It is perhaps unwise to over simplify matters in this area. 11 U.S.C. § 1126(b) validates pre-petition plan solicitation if certain tests is satisfied particularly those relating to the provision of adequate information. “Adequate information”is defined in 11 U.S.C. § 1125(a).

pre-negotiated plans. The difficulty with these mechanisms is that they can take months to put together. Some companies do not have that luxury. The mechanisms streamline the Chapter 11 process in the following way. The debtor company and some of its principal creditors can agree a post-petition restructuring support agreement by which the parties determine the substantive terms of a plan after the bankruptcy case is filed. They also agree to support the plan and no other.

The corporate debts were as follows: \$98 million in first lien debt; \$375 million in second lien debt and \$78 million in third lien debt. There had been difficulties in paying interest on the second lien debt. Negotiations on this had followed, but they were fruitless. This all happened prior to the petition date. A party consisting of the debtor, holders of second lien debt and Fortress Investment Group then employed a parallel path approach to Chapter 11.

This parallel path agreement consisted fundamentally of the following elements:

The debtor company would put the assets for sale in the market with a view to covering payouts to major creditors

If the approach involving offering the assets for sale in the market were to fail, then the debtor company would be recapitalised under the parallel path plan

These elements were set out in a formal restructuring support agreement (“RSA”).

The RSA was almost immediately submitted to the court along with a plan and the disclosure statement. This disclosure statement provided a very detailed account of the RSA. This statement was then approved by the court. Centaur LLC offered \$500 million for the larger part of the assets. Indianapolis Downs LLC sought confirmation of the plan on the basis of this possible sale.

A second group, the Oliver Parties, objected to the confirmation. This group consisted of senior management and holders of debt and equity. They opposed confirmation because they viewed the RSA as constituting wrongful solicitation. The argument of the Oliver party was not that the group that moved for confirmation had acted in bad faith, but rather that the RSA

votes had been solicited prior to the disclosure statement having been approved. In their view, this was in violation of §1125(b) of the Bankruptcy Code.⁷⁶

What was needed, among other things, in this case was a means of facilitating more timely diligence, investigation and resolution of disputed matters. This could be achieved by the presence of an *estate neutral* that is an individual who could be appointed depending on the particular needs of the debtor or its stakeholders to assist with certain aspects of the Chapter 11 case.⁷⁷

The decision in the Indianapolis Downs LLC case went in favour of the party promoting the RSA. The view was taken that the right to vote was a fundamental component of a Chapter 11 plan. It was found also that the courts would be slow to restrict the flexibility of negotiating parties in the context of disclosure and solicitation provisions as all of this is at the heart of Chapter 11.⁷⁸

The Indianapolis Downs LLC case is an excellent example of the simple but profound truth that markets and financial products and of business itself often evolve far more quickly than any financially driven regulation to govern them. It may well be, as the ABI Commissioners noted in their Report that four decades is the maximum amount of time that any financially driven regulation can remain substantively relevant.⁷⁹ For the purposes of this thesis, Chapter 11 and the BABCPA and other provisions respectively remain relevant to company rescue

⁷⁶ §1125(b) relates to post-petition disclosure and solicitation. §1125(b) is as follows:

(b) An acceptance or rejection of a plan may not be solicited after the commencement of a case under this title from the holder of a claim or interest with respect to such a claim or interest, unless at the time of or before such solicitation, there is transmitted to such holder the plan or a summary of the plan, and a written disclosure statement approved, after notice and a hearing, by the court as containing adequate information. The court may approve a disclosure statement without a valuation of the debtor or an approval of the debtor's assets.

⁷⁷ The provision of estates neutral to particular cases was a specific recommendation of the ABI Commissioners. American Bankruptcy Institute, *Commission to Study the Reform of Chapter 11* (2014) Washington DC, at 6. The tasks of the *estate neutral* in a particular case could at the outset be specified.

⁷⁸ Per Justice Shannon at pages 22 -27 *In re Indianapolis Downs* B.R. 286 (Bankr. D. Del. 2013).

⁷⁹ American Bankruptcy Institute, *Commission to Study the Reform of Chapter 11* (2014) Washington DC, Introduction.

law in Ireland, but they do so subject to the proviso that the recommendations of and the insights provided by the ABI Commissioners in the *Commission to Study the Reform of Chapter 11* report are also carefully considered by any future reformers of the company rescue legislation in this country.

Considering bankruptcy law in the US as it stands, the Indianapolis Downs LLC precedent is likely to facilitate plan negotiations. In the ordinary course of negotiations – often conducted over a period of two to three months- things can easily go awry. This is because in a long drawn out negotiation process may have little incentive to move towards consensus in an ever changing market context.

3.1.6: THE EFFICIENCY OF “CRAM DOWN” AND OF PRE-PACKAGED NEGOTIATION FROM A TEAM PRODUCTION THEORY PERSPECTIVE

On first examination, the cram down provisions seem reassuring from a creditor and shareholder perspective and would appear to be in line with the expectations of team production theory supporters. Things, however, are much less straightforward. For instance 11 U.S.C. §1129(b)(2)(C) is as follows:

“with respect to a class of interests—

- (i) the plan provides that each holder of an interest of such class receive or retain on account of such interest property of a value, as of the effective date of the plan, equal to the greatest of the allowed amount of any fixed liquidation preference to which such holder is entitled, any fixed redemption price to which such holder is entitled, or the value of such interest; or
- (ii) the holder of any interest that is junior to the interests of such class will not receive or retain under the plan on account of such junior interest any property.”

The substantive point here is that shareholders are entitled only to the value of their shares at the given time. In accordance with elementary principles of finance, that means the net present value of earnings into the future less the amount owing to creditors. Expenses –

according to TPT-must be deducted also – including team production entitlements.⁸⁰ These last team production entitlements are paid irrespective of the bankruptcy status of the corporation. Clearly these entitlements have a higher priority ranking. LoPucki would reasonably contend that this approach is efficient, because it mirrors the contractual arrangement made by the team members.⁸¹ The debtor’s obligations to unsecured creditors are these:

The condition that a plan be fair and equitable with respect to a class includes the following requirements: . . . With respect to a class of unsecured claims . . . the plan provides that each holder . . . receive property of a value . . . equal to the allowed amount of such claim; or the holder of any claim or interest that is junior to the claims of such class will not receive or retain . . . any property.⁸²

The absolute priority rule applies here. All that is required is that the distribution arrangement meet a somewhat modest requirement such that the unsecured creditors should get more than shareholders. Where there is no distribution for creditors, the requirement is easily satisfied.⁸³

The secured creditors are the best positioned legally.

The relevant stipulation is this:

⁸⁰ L LoPucki, “A Team Production Theory of Bankruptcy Reorganisation” (2004) 57 *Vanderbilt Law Review* 741 at 759. LoPucki’s contention is placed in the context of the cramdown for distributions to shareholders. “[T]he condition that a plan be fair and equitable with respect to a class includes the following requirements: ... With respect to a class of interests ... the plan provides that each holder of an interest of such class receive or retain . . . the value of such interest ... ” 11 U.S.C. § 1129(b)(2)(C). LoPucki contends that this provision – that is, 11 U.S.C. § 1129(b)(2)(C)- only entitles shareholders to the value of their shares. In or out of reorganization, the value of shares is the present value of all future earnings remaining after allowance for the entitlements of creditors. The critical point is this: earnings are what is left of revenues after expenses have been paid. Team production entitlements are paid as expenses, whether or not the firm is in bankruptcy. Thus, LoPucki concludes, the value guaranteed shareholders by the cramdown test is only the value remaining after team production entitlements have been paid.

⁸¹ L LoPucki, “A Team Production Theory of Bankruptcy Reorganisation” (2004) 57 *Vand L Rev* 741.

⁸² 11 U.S.C. § 1129(b)(2)(B).

⁸³ The absolute priority rule relates to the rankings in order of rights to payment of unsecured creditors and shareholders in the event that the debtor company’s assets are being distributed, for instance in the context of a restructuring. The rights involved are found in ordinary commercial law. The distribution arrangements would be similar to those obtaining in the event of a liquidation. The task of valuation of assets is expensive and a drain on the estate. The absolute priority rule is efficient in that it respects the pre-bankruptcy entitlements bargained for by the interested parties and distributes the debtor’s value among the unsecured creditors and shareholders in the reorganization procedure in accordance with the same order of priority as that under non-bankruptcy law and in a liquidation procedure For an analysis of the absolute priority rule see D G Baird and T H. Jackson, “Bargaining after the Fall and the Contours of the Absolute Priority Rule” (1988) 55 *University of Chicago Law Review* 738. Jackson considers that given the complexity of matters to be considered in any calculation, the rule is in practice often circumvented.

the condition that a plan be fair and equitable with respect to a class includes the following requirements: . . . With respect to a class of secured claims . . . that each holder . . . receive . deferred cash payments . . . of a value . . . of at least the value of the holder's interest in the estate's interest in (the collateral).⁸⁴

This provision would seem to offer secured creditors the full measure of the amount owing. When, however, a valuation of the assets is undertaken, the valuation arrived at will relate to corporate earnings less the amount distributed to the non-creditor or shareholder team members: a lesser amount than what first might be assumed.⁸⁵ The larger context for this way of reasoning is as follows. Consider a commercial operator which provides a community service.⁸⁶ If the operator is liquidated, its value is at 'A', the lowest of all possible figures. It will be supposed that the operator undertakes some services which operate at a loss and which somewhat blunt its earnings capacity, but are undertaken as a quid pro quo because they serve a region whose governmental agencies have enhanced the infrastructure specifically for the operator and have offered it other valuable services. It will thus be taken to be the case that there is an ethical obligation upon the operator to reciprocate and to continue some non-profitable services specifically for that region. The earning power of the operator is at 'B', higher than the liquidation value at 'A', but less than 'C' which would be the commercial operator's earnings, if it had not the financial drain of providing non-profitable services in the local region. Let us suppose further that the amount owing to the secured creditor is 'D', a figure greater than 'A', 'B' or 'C'. Regarding how much 'how much is to be paid to the secured creditor under the absolute priority rule, the answer is 'B', not the

⁸⁴ 11 U.S.C. §1129(b)(2)(A).

⁸⁵ The literature on the complications related to and the hidden implications of valuation are ample. There is no statutory valuation formula as such. The relevant provision - 11 U.S.C. §506(a)- reads as follows: "Such value shall be determined in light of the purpose of the valuation and of the proposed disposition or use of such property, and in conjunction with any hearing on such disposition or use or on a plan affecting such creditors' interest.". See C J. Fortgang and T Moers, "Mayer Valuation in Bankruptcy" (1985) 32 *UCLA Law Review* 1061 at 1123. For an insight into how these matters were dealt with by the US courts in times past see *Case v. Los Angeles Lumber Products Co.*, 308 U.S. 106 (1939). T H Jackson makes much of this case in T H. Jackson, *The Logic and Limits of Bankruptcy Law* (2001) Bear Books, Washington, 213. He claims that the interpretation given to the absolute value rule by the judge in this instance conforms perfectly with the standard non-bankruptcy entitlements for creditors and shareholders. Judicial thinking and statute law has developed so much in the last decades as to make Jackson's interpretation rather questionable.

⁸⁶ L Lopucki, "A Team Production Theory of Bankruptcy Reorganization"(2004) Research Paper No. 3-12 23 <http://ssrn.com/abstract=397801>, downloaded on March 6th, 2013. Acknowledgement is hereby provided.

liquidation figure, but still a relatively low amount in the circumstances.⁸⁷ In terms of the logic of this position, given that the directors have the right to decide matters for the corporation, it follows that they have the right to pursue corporate objectives that above all benefit the immediate region.⁸⁸ This leaves the operative's assets with a value of 'B' which is the amount owing to the secured creditor. This is perfectly consistent with bankruptcy law.

As regards inefficiency, the issue relates to the cost of valuations, which was referred to earlier.⁸⁹ This is because there is no statutory valuation formula. A robust and legally defensible valuation method is necessarily costly.

The cram down provisions are efficient from a team production theory perspective, because they do not impair the directors' ability to meet their legally non-binding obligations to their team members. This maximises the value of the company without weakening the secured creditors contractual rights. In practice, comparable matters are not quite so straightforward in the context of examinership.⁹⁰

The best interest rule offers creditors and shareholders a return which will be at least as much as they would receive in a liquidation of the debtor company in accordance with Chapter 7.⁹¹

⁸⁷ This is because the Bankruptcy Code stipulates – at 11 U.S.C. §1129(b)(2)(A)(i)(II): the test applicable in cases where a secured creditor objects to a payout under a DIP plan- - that the secured creditor can receive the “value of the holder’s interest in the estate’s interest in [the] property.” The important point here is that the secured creditor is entitled to the value of the commercial operation, but that value is not ‘C’ (which would only obtain in certain circumstances), but rather ‘B’. The Bankruptcy Code – at 11 U.S.C. § 506(a) - reinforces this view that the value of asset is calculated “in light of the purpose of the valuation and of the proposed disposition or use of the collateral.” In this instance, the proposed disposition or use is a business that comprises profitable and by choice unprofitable components. The value in the circumstances is put at ‘B’.

⁸⁸ Technically, 11 U.S.C. § 1108 approves the trustee’ to run the business. The board is the stand-in for the trustee.

⁸⁹ See footnote 432.

⁹⁰“Cram down “when considered in the context of examinership does not work in so straightforward a manner. In *In the matter of McInerney Homes* [2010]IEHC 340 at para 7.2, Clarke J took the view that the courts have the jurisdiction to approve a scheme which has the effect of reducing the amount due to the secured creditors provided that the scheme complied with the other provisions of the examinership legislation, one being that it is not unfairly prejudicial to any creditor. In the *McInerney* case, the syndicate of banks argued that they would be in a better position should a workout receivership model be employed in the case rather than an examinership. For that reason, the scheme was found to be unfairly prejudicial to the creditors. Although the decision clarified the point that it is technically possible for secured debt to be written down in an examinership, it remains the case that this would be likely to occur without the general support of the secured creditors.

⁹¹ 11 U.S.C. §1129(a)(7).

This arrangement would seem to preclude distributions to other team members, but that need not necessarily be the case. It is conceivable, for instance, that if the corporation were sold at its re-organisation value there would be a surplus for the other team members.⁹²In any event, creditors and shareholders do not have an automatic right to the proceeds of the corporate liquidation. They have a right only to the sum of a Chapter 7 assumed liquidation less the selling costs.⁹³ Trustees in practice rarely opt for Chapter 7, because of its lack of suitable provisions.⁹⁴ In addition, the best interest rule will be complied with – certainly in the case of a large corporation- if assets are disposed of in individual lots –an approach which would be best suited to a much smaller business, but not a very good solution. Such returns are necessarily at a significantly lower level than what could be available in a reorganisation.⁹⁵ At that level, very little will remain for team members. More positively, it can be said that if the corporation does not cease operating, it is probable that there will be sufficient assets for pay-outs to creditors and shareholders as well as returns to team members.

As the best interest rule is related to a valuation under a hypothetical liquidation, it would seem on its face to be inefficient vis-à-vis tpm. It ranks creditors and shareholders high in priority. If, however, the company continues in operation, the liquidation value amounts to which creditors and shareholders are entitled can be paid while enough will remain over to cover the legitimate expectations of other team members.

⁹² This might arise where a business is sold as an operative entity. Given the significance of liquidations in recent years (they can arise more commonly than reorganisations in these distressed corporation contexts), the valuation practices in liquidation cases is not a topic of minor importance. See D G Baird and R K Rasmussen, “The End of Bankruptcy” (2002) 55 *Stan Law Rev* with regard to liquidation valuations.

⁹³ 11 U.S.C. §1129(a)(7)

⁹⁴ The empirical evidence would suggest this. See L LoPucki in this connection. Of 695 cases filed by large, public companies under U.S. bankruptcy law between the last quarter of 1979 and the end of the first quarter of 2003 only one opted for Chapter 7. L M.LoPucki, Bankruptcy Research Database, available at <http://lopucki.law.ucla.edu>. Last down loaded on 7th March, 2013. Of 695 cases filed by large, public companies under U.S. bankruptcy law between the last quarter of 1979 and the end of the first quarter of 2003 only one opted for Chapter 7. L M. LoPucki, Bankruptcy Research Database, available at <http://lopucki.law.ucla.edu>.

⁹⁵ Lynn M. LoPucki and W C Whitford, “Bargaining Over Equity’s Share in the Bankruptcy Reorganization of Large, Publicly Held Companies”(1990) 139 *U Pa. L. Rev.* 125 172 present data on liquidation values sourced from disclosure statements. The researchers found that the evidence indicated that the values ranged from almost nothing to seventy-seven cents on the dollar. On the other hand, see R J. Mann, “Strategy and Force in the Liquidation of Secured Debt”(1997) 96 *Mich. L. Rev* 159 177. The evidence presented by Mann would suggest that secured creditors gain significantly by a debtor company’s piecemeal liquidation of assets.

3.1.7: PRE-PACKAGED AND PRE-NEGOTIATED PLANS AT NEGOTIATION AND CONFIRMATION

A pre-packaged restructuring significantly reduces the time involved from what is usual in the traditional Chapter 11 arrangement.⁹⁶ As already noted, this arrangement makes it possible to minimise the consequences of the restructuring on the trading ability of the corporation. A variant of the prearranged bankruptcy is pre-packaged bankruptcy, in which, before filing for Chapter 11, the debtor negotiates, documents, and discloses to creditors a plan of reorganization, and those creditors then vote in favour of the plan. As much of the work has been completed ahead of the filing, a pre-packaged Chapter 11 case can be completed in a far shorter period of time than a pre-arranged or traditional Chapter 11 application. If this option is chosen, administrative costs are cut and much of the uncertainty of the Chapter 11 process is eliminated.⁹⁷ The specifics relating to the pre-pack voting – the more prominent of the two forms discussed in this section- are these: Section 1126(b) of the Bankruptcy Code facilitates an arrangement whereby votes solicited prior to the Chapter 11 petition may be counted, provided that the solicitation complies with the relevant non-bankruptcy law which covers adequacy of disclosure. Where no such law is operative, the disclosure must be such as to constitute adequate information as defined by Section 1125 of the Bankruptcy Code. Section 1126(b) indicates that a holder of a claim will be held to have accepted or rejected a plan if the communication from the plan proposer was in accordance

⁹⁶ A number of provisions of the Bankruptcy Code (such as Sections 1121(a) and 1102(b)(1) alongside the Federal Rules of Bankruptcy Procedure are used together to enable pre-packaged plans to go forward. In addition, particular courts such as the United States Bankruptcy Court for the Southern District of New York, have their own rules that are specific to the filing and administration of prepackaged cases. See Amended Procedural Guidelines for Prepackaged Chapter 11 Cases in the United States Bankruptcy Court for the Southern District of New York, dated November 24, 2009. See also BK. Tester, LG. Beckerman, D S. Bleck and J Sigel, “Need for Speed: Pre-packed and Pre-negotiated Bankruptcy Plans” a paper presented at the 17th Annual Northeast Bankruptcy Conference, American Bankruptcy Institute.

⁹⁷ See § 1125(g) §341(e) and particularly § 1126(b) of the Bankruptcy Code These sections, as noted earlier in the chapter, make it possible for the court to count votes on a plan that was solicited before the case was filed, provided that this acceptance does not impinge on any other law, and in so far as the creditors who voted were provided with sufficient information of a quality at least as good as what would be available to them when voting in a Chapter 11 case. § 1126(b) is arguably the single most important provision in this context.

with the relevant law or if adequate information (as defined in section 1125(a) was communicated to the party.⁹⁸

This permits the debtor corporation to seek out creditor support for its proposed plan prior to the granting of court approval for the corporation's disclosure statement. At the court hearing, the following matters are examined: the adequacy of the solicitation of the creditors whose interests are being impaired – that is, the quality of the information supplied to these creditors by the debtor corporation- and whether or not enough votes were cast in favour to carry the motion.⁹⁹ A period of twenty-eight days notice is required prior to the hearing of the debtor corporation's plan; in addition twenty-eight days are required for official examination of the disclosure statement.¹⁰⁰ The hearing for both the restructuring plan and the disclosure statement can occur at the same time and thereby much delay can be avoided. Bankruptcy rules such as Rule 3018(b) – relating to the submission of relevant materials to all or almost all creditors and the adequacy of time to be made available to them to decide on matters- are important in this context.¹⁰¹

At its best, a prepack arrangement is an attractive option because it offers both a prompt reorganisation and a quick exit from bankruptcy.

⁹⁸ U.S.C.A. § 1126.

⁹⁹ 11 U.S.C. § 1126(b)(2)

¹⁰⁰ Bankruptcy Rule 2002(b)

¹⁰¹ Bankruptcy Rule 3018(b) reads as follows: (b) Acceptances and Rejections obtained before Petition An equity security holder or creditor whose claim is based on a security of record who accepted or rejected the plan before the commencement of the case shall not be deemed to have accepted or rejected the plan pursuant to §1126(b) of the Code unless the equity security holder or creditor was the holder of record of the security on the date specified in the solicitation of such acceptance or rejection for the purposes of such solicitation. A holder of a claim or interest who has accepted or rejected a plan before the commencement of the case under the Code shall not be deemed to have accepted or rejected the plan if the court finds after notice and hearing that the plan was not transmitted to substantially all creditors and equity security holders of the same class, that an *unreasonably short time* (this writer's italics) was prescribed for such creditors and equity security holders to accept or reject the plan, or that the solicitation was not in compliance with §1126(b) of the Code.

3.1.9: THE EFFICIENCY OF PRE-PACKAGED NEGOTIATION FROM A TEAM PRODUCTION PERSPECTIVE

The most positive aspects of a pre-packaged arrangement is its short duration. As a result of this, as noted, the costs involved are greatly reduced. In addition, the limited exposure to the Chapter 11 process has less harmful business consequences.¹⁰² The pre-pack model also makes for certainty on the part of the debtor-in-possession team. The company does not have to start into Chapter 11 proceedings unless it has already secured the affirmation of two-thirds of the creditors who have suffered financial impairment. Moreover, the pre-packaged model can in any instance go forward without one-hundred-per-cent support from the impaired creditors. This makes possible a financial resettlement that could not be envisaged without the agreement of all the impaired creditors. There are other positive aspects. Section 1126(b) of the Bankruptcy Code provides that subject to any limitations that may be set down by the court, the debtor-in-possession has all the rights and powers of a trustee in the great majority of cases. The reduced duration of the process makes it less likely that the DIP will lose partial or full control of the process so as to defeat the expectations of the broad range of team members. Without the pre-pack arrangement, the dip is subject to a great deal of scrutiny by many interest groups and is therefore vulnerable.¹⁰³

There are, however, some risks. If and when a debtor company solicits acceptances of a prepack arrangement with its creditors, it signals to the world that it intends to opt for a

¹⁰² The key point in Chapter 11 is that the bankruptcy code allows for the comprehensive restructuring of all obligations of the debtor company. That means that all of the many constituencies of the debtor company have access to the negotiating table. This contrasts with a workout arrangement, for instance, where only the company's lenders and other major creditors participate. The vast majority of the company's obligations are left unimpaired. In both a workout and a bankruptcy reorganisation, however, the debtor company will be obliged to disclose substantial quantities of information concerning its business, financial condition and efforts to restructure. Moreover, the dissemination of this information may generate significant publicity. Alongside that, the disclosure requirements of the debtor company in a Chapter 11 case are greater than those in a workout and the resulting negative publicity may be even more severe. Pre-packaged plans are put together in order to reduce the length of time a company needs to be in bankruptcy to a minimum. By so doing, the debtor company hopes to reduce bankruptcy costs and disruptions significantly. This goal can be best served if additional matters that could prolong and possibly disrupt the Chapter 11 case are addressed. This can only be opted for in situations which will not have a detrimental effect on the debtor company. A Resnick and H Sommer, *Collier Guide to Chapter 11: Key Topics and Selected Industries* 16th edn (Lexis Nexis 2012) at sections 5.04 and 5.05.

¹⁰³ See footnote 106.

Chapter 11 arrangement. This may increase the likelihood that some of them may attempt to circumvent efforts to negotiate the pre-pack plan by filing a bankruptcy case against the debtor company. In addition, there is the possibility that trade creditors may in the circumstances tighten terms or cease to provide an open account trade credit altogether.

3.1.10: ON THE TRANSFER MARKET

In the context of transfer market phenomena, the court ruling in *Southland* has proved important.¹⁰⁴ In that case it was held that only those who were claim holders had a right to vote on a plan. No one else could do so, unless they were the authorised agent of the claim holder.¹⁰⁵ As the result of the *Southland* judgment, Congress amended Bankruptcy Rule 3017 to include a new section (e) in order to regulate matters more efficiently. Bankruptcy Rule 3017(e) relates to procedures for the transmission of beneficial ownership of securities with regard to relevant documentation and information. The court's role is to determine the adequacy of such procedures.¹⁰⁶

The Bankruptcy Abuse Prevention and Consumer Protection Act (BAPCPA) of 2005 introduced amendments which focused on specific aspects of pre-packages at the negotiation stage. For instance, Section 1125(g) allows the debtor corporation's agents to seek out votes in support of a plan in a Chapter 11 post-petition context. This goes against the old practice which was that a debtor corporation could not seek out these votes in the Chapter 11 petition context before the court granted or did not grant approval of the disclosure statement.¹⁰⁷ Before this provision became operative, a debtor in such circumstances who was seeking out

¹⁰⁵ In *re Southland Corp.*, 124 B.R. 211 227 Bankr. N.D. Tex. 1991.

¹⁰⁶ Bankruptcy Rule 3017(a) relates to the matter of holding a hearing on at least 28 days' notice to the debtor, creditors, equity security holders and other parties in interest as provided in Bankruptcy Rule 2002.

¹⁰⁷ This statutory exception to the rule was highlighted in *re Trans Max Technologies, Inc.*, 349 B.R. 80, 86 n.7 (Bankr. D. Nev. 2006).

creditor support would have had to cease doing so and start again if the solicitation was derailed by a forced bankruptcy filing. Section 1125(g) blocks opponents from closing down a pre-packaged plan through the filing of an involuntary petition. A second amendment which facilitates pre-packaging solutions is Section 341(e). This specifies the timing and formal details of meetings and formal details of creditors and equity security holders which are necessitated by the bankruptcy.

(e) Notwithstanding subsections (a) and (b), the court, on the request of a party in interest and after notice and a hearing, for cause may order that the United States trustee not convene a meeting of creditors or equity security holders if the debtor has filed a plan as to which the debtor solicited acceptances prior to the commencement of the case.

The objective here is to minimize the time spent in confirmation of pre-packaged plans, where the debtor has already sought the support of the creditors.

3.1.11: CHAPTER 11 NEGOTIATION – A PRELIMINARY SUMMING- UP

The task of team production theory in company reorganisation is to reconcile team member entitlements with bankruptcy law. During the Chapter 11 process, the debtor-in-possession retains their position and functions and the obligations to all team members remain. The obligations of the Debtor-in-Possession to the creditors and shareholders are not absolute: these parties are entitled to the amount they would receive under a Chapter 7 outturn or to the present value of their shares, nothing more.¹⁰⁸ Negotiations revolve around the question of retained ownership. That is, matters need to be resolved about when additional loss should be placed on the creditors and when additional loss should be placed on the debtor in order to defend the interests of the creditors. Chapter 11 was designed so as to allow debtors and creditors the maximum amount of flexibility in reorganising the business entity – often in the headline cases a very large corporation. The process, however, does allow for rules which can force dissenting creditors into a cramdown. Broadly speaking, the negotiation stage is

¹⁰⁸ That is the present value of all future earnings less the entitlements of creditors.

compatible with team production theory objectives, provided that the DIP does not lose control of the negotiation process. Pre-pack negotiations can strengthen the position of DIP's and reduce costs, but these arrangements are not always possible and they do not always work out positively.¹⁰⁹

SECTION 3.2: THE UK CONTEXT

As in the planning stage, the negotiation and confirmation stages are very different in the UK model, in comparison to that in the US. Administration is not comparable in important respects to Chapter 11. Administration does not function independently; rather it is a gateway to solutions such as a company voluntary administration, a scheme of arrangement or even a liquidation. This necessarily means that the mode of procedure of the administrator and communication between the administrator and creditor interests are very different to those considered in the US context. To begin with, the Enterprise Act 2002 has made the administration process a much less court-centred one.

Briefly stated, the contents of the full statement of the Administrator's proposals will consist of data on the company and its officers and information about the appointment of the administrator. Information will also be provided that should enable creditors to gain a proper insight into the company's options prior to them exercising their vote (in cases where it is to be exercised). An appended statement of affairs will also be found with the proposal document.¹¹⁰ The administrator is at liberty to recommend what should be made available to the creditors. The proposal documentation is exceptionally important, because – once voted upon by the unsecured creditors – it circumscribes what is open to the administrator to do

¹⁰⁹ Pre-pack negotiations in an Irish context are valuable, because they serve to reduce costs. They do not, however, serve to enhance the bargaining position of the debtor company directors in an envisaged examinership scenario. The asymmetry of power between the directors of the debtor company on the one side and the major creditors (including the financial institutions) on the other is fully accepted by all parties in insolvency negotiations in Ireland. This serves usually to limit the debtor's flexibility in all but the largest debtor company cases.

¹¹⁰ In certain instances, only limited disclosure will be made in the statement of affairs. This arrangement must, however, be first permitted by the court. This is in accordance with IR 1986 r 2.30.

thereafter.¹¹¹The means adopted by which the objectives of the particular administration will be achieved will be set out in the proposals as well as an indication of how the administration will be concluded.¹¹² One or other of the three main options possible in administration – that is, company rescue (often by means of a cva) or failing that a company winding-up or, as a last resort, the distribution of the proceeds of sale of existing assets to preferential or secured creditors- will have been decided upon. There is, in addition, another possibility open to the administrator. There is a company voluntary arrangement as well as a compromise under the terms of the Companies Act 1985 or Part 26 of the Companies Act 2006. It is possible to distinguish this from a cva approach by reference to the voting arrangements specific to each. In a scheme of arrangement – the more involved of the two- voting is conducted within each class of creditors.¹¹³ The vote must be confirmed by the court. It cannot subsequently be contested in court. It is not required that the creditors assent to the scheme of arrangement. By contrast, the goals of the company voluntary arrangement can be achieved quickly and inexpensively.

From the creditors' perspective, the legislation does seem to offer protection: creditors rights, in particular, are substantial and cannot easily be altered without the consent of the creditors.¹¹⁴ There are, however, some exceptions to this. For instance, in cases where there are insufficient assets available for unsecured creditors.¹¹⁵ In such cases, the administrator's commercial judgment is what counts. The judgment is a subjective one and cannot be successfully challenged.¹¹⁶

¹¹¹ An allowance may be made by the courts for subsequent actions by the administrator which are not in every detail in accordance with the unsecured creditor approved proposals, provide that the deviation is not substantive in nature. This allowance is found in IA 1986 Sch B1 para54(1)(c).

¹¹² IA 1986 r.233(2)(m).

¹¹³ Companies Act 2006, Part 26, ss 895-901.

¹¹⁴ For instance, the Insolvency Act 1986, Schedule 6 which relates to the preferential status of debts owned by secured creditors is a good example of this.

¹¹⁵ Schedule B1 Insolvency Act 1986 para 66.

¹¹⁶ Schedule B1 Insolvency Act 1986 para 84.

The following legal powers are available to creditors at the consultation and negotiation stages. The creditors can elect to establish a committee to represent their collective interests.¹¹⁷The creditor committee model facilitates an arrangement whereby the committee can assist the administrator in his work and in a way that has been agreed between the administrator and the committee.¹¹⁸ In addition to the assistance that is to be provided, the committee has a monitoring and – at least ostensibly- controlling role.¹¹⁹It does not, however, have a decision-making role. Where the creditors determine to establish a creditors committee they may do so by means of a simple majority.¹²⁰Creditors’ committees are composed of between three to five people who are unsecured creditors of the company in administration.¹²¹They are elected by general ballot of the secured creditors. The only secured creditors who can have a say in such committees are those who also have unsecured claims.¹²²” In addition, while the rules are ostensibly considerable in extent, at a practical level they are often of relatively minor importance because of the fact that while creditors’ committees may be established they are not effective.”¹²³ The consequence is that in practice, creditors’ committees are established in only 3 percent of all administration proceedings”¹²⁴ It

¹¹⁷ IA 1986 Sch B1 para 56(2).

¹¹⁸ IR 1986, r 2.52 (1).

¹¹⁹ With regard to the powers of the creditors’ committee as being more apparent than real see page 183 of this thesis.

¹²⁰ Creditor committee rules can sometimes be counter-intuitive in nature. For instance, an unsecured creditor may split his votes such as to vote partly for and partly against the establishment of a creditors’ committee. This was examined in *Re Polly Peck International plc (No.1)* [1991] BCC 503 (Ch).

¹²¹ During a moratorium it is not possible for a creditor to bring or pursue legal proceedings against the debtor company or its assets (Insolvency Act, Schedule B1 1A paragraphs 42-44. It is possible for a creditor to ask the administrator or the court for permission to bring proceedings against a company that is in administration. A creditor who has a monetary claim is, however, unlikely to be granted such permission. It is generally only claims that have a proprietary nature that are allowed to continue. The best that a creditor can do in the shorter term is to submit details of the claim to the administrator. An unsecured creditor may do well to join a creditors’ committee, if that is possible. Unlike major financial institutions, unsecured creditors do not so easily have access to accounting and legal expertise. Administrators have a duty to report to the company’s creditors on their progress. Formally, the creditors’ committee is there to assist the administrator in fulfilling his/her functions.(Insolvency Rules 1986, rules 2.50-2.56) as discussed later.

¹²² IR 1986, r 2.40 . The number of votes available for any one party is determined by the quantum of the claim in accordance with I R r 2,38

¹²³ Office of Fair Trading, The market for Corporate Insolvency Practitioners: June 2010from the OFT website. http://www.of.gov.uk/shared_of/reports/Insolvency/of1245 accessed 22 January 2013. The other statistics in the relevant paragraph beginning above come from the same source.

¹²⁴ R Bork, “Creditors’ Committees: An Anglo-German Comparative Study”(2012) 21 *Int InsolvRev* at 129.

is important to qualify this last statement. Payments to unsecured creditors do not occur in eighty percent of cases, so it is reasonable to conclude that unsecured creditors participate in committees where a substantial return to them is at least probable. Bork states that unsecured creditors do not attend a creditors' meeting in ninety-five percent of cases.¹²⁵ There is an additional difficulty. These creditors are not usually familiar with the technicalities of insolvency and restructuring law and cannot begin to follow closely the work of the administrator. People with expertise are, however, allowed to stand in on behalf of the unsecured creditors in committee deliberations.¹²⁶ The one conclusion that can be made here is that the committee of unsecured creditors model is not a robust means of checking and monitoring an administrator's activities in cases where expertise is for whatever reason not being availed of by the creditor side. The formal role of the creditors' committee is to support as well as control the administrator.¹²⁷ The administrator is obliged to call the preliminary meeting which must take place within six weeks of the committee's coming into being.¹²⁸ Further meetings must be agreed to by the administrator and these last should be held within twenty-one days of the administrator receiving a request for such.¹²⁹ The committee has the power to demand that the administrator be present at a creditors' meeting provided that seven days notice has been given to administrator.¹³⁰ It is possible also for the administrative order to be challenged, following on from one important precedent related to winding-up orders.¹³¹ In any event, a creditors' meeting will ordinarily convene within ten weeks of the date when the company goes into administration in order to consider the administrator's proposals.¹³²

¹²⁵ Bork, "Creditors' Committees: An Anglo-German Comparative Study"(2012) 21 *Int InsolvRev* at 129.

¹²⁶ Rule 2.55 IR

¹²⁷ IR 1986, r 2.52 (1)

¹²⁸ IR 1986, 2.52.

¹²⁹ IR 1986, 2.52.

¹³⁰ IR 1986 r 2.52(4)

¹³¹ *Cornhill Insurance v Cornhill Financial services Ltd* [1992] B.C.C.818. R Parry in Parry *Corporate Rescue* Sweet & Maxwell, London 2008 at 79 offers the following: "The IR 1986 r.7.47 enables the review, rescission or variation of a winding up order."

¹³² IA 1986 Sch. B1 para51(3).

The first meeting will serve to identify what proposals are acceptable to the creditors and what are judged to be in need of modification.¹³³ That is to say that the creditors assent to them without qualification or opt for a modification which is acceptable to the administrator.¹³⁴ A resolution is carried if an independent majority by value at the meeting indicate their support for it.¹³⁵ The administration will run along the lines of what has been approved at the first and subsequent meetings. In accordance with rule 2.52(2) of the Insolvency Rules 1986, the administrator organises the meeting, although the members can request a meeting.¹³⁶ Where there are not sufficient numbers of creditors to constitute a necessary majority, the meeting may be adjourned.¹³⁷ In cases where the meeting turns down the administrator's proposals or any revision of them, the matter is referred to the court. The court has the following options available: by order it may end the administrator's appointment; it may make an interim order; it may make an order following a petition for winding up or it has a broad discretionary power to make another order.¹³⁸ The court cannot simply dictate to the creditors what is or is not acceptable.¹³⁹ If it should happen that the proposals are altered fundamentally after having been voted for by the creditors (subject or not to modification), the matter needs to be returned to the creditors for another meeting.¹⁴⁰

An administrator does not have to consult creditors before deciding on a course of action. Having put together a proposal with detailed explanation of what objectives are considered feasible for the company, the next duty of the administrator is to put the proposal before the

¹³³ *Re Parmeko Holdings Ltd (in liquidation)* [2014] All ER (D) 39 (Jan) considered what administrators can do if creditors failed to vote on the administrator's proposals.

¹³⁴ IA 1986 Sch. B1 para.53(1).

¹³⁵ IR 1986 r.2.44(2).

¹³⁶ This meeting must be held within three weeks in accordance with IR 1986, r 2.52(3A)(a). Ordinarily, the administrator acts as chairman. The one exception to this is where the members by their own initiative plan a meeting and formally request that the administrator be present. This last is in accordance with IA 1986, sch B1, para 57(3).

¹³⁷ IA 1986 r.22.34(4).

¹³⁸ IA 1986 Sch.B1 para.55

¹³⁹ These matters are taken up in *DKLL Solicitors v HMRC* [2007] EWHC 2067 (Ch) and *Re Structures and Computers Ltd* [1988] B.C.C. 348 at 353.

¹⁴⁰ IR 1986 Sch B1 para.54. In exceptional circumstances- such as those with a time sensitivity- the court may agree to a significant modification.

creditors for a ballot.¹⁴¹ Thus, one of the most critical things about administration is that the creditors' committee power is strictly circumscribed. It cannot veto the decisions of the administrator and the administrator is not obliged to obtain its consent.¹⁴² The committee's view does, however, have some weight when the court is exercising discretion. This applies particularly in relation to distributions proposed by the administrator.¹⁴³ The options available to the court are considerable: for instance, the court can allow an administrator to continue on a path opposed by the committee.¹⁴⁴ The court can even determine that the company which up to that point was in administration should now be wound-up.¹⁴⁵ In the ordinary way, any significant revision of the administrator's proposals will need to be approved by the shareholders. There is, however, good authority for the proposition that the court can allow major modifications of a proposals in instances – which may be rare- where, in order to save a business, speed is of the essence.¹⁴⁶ This whole matter of business necessity trumping a more leisurely consultation and negotiation process is something that goes against the long-standing practice of obtaining creditor approval.¹⁴⁷ Administrator autonomy is something that is validated in the Enterprise Act 2002 and that the English courts have been obliged to accept. In a leading case on this topic, Lawrence Collins J took the view that administrators are permitted to sell a company's assets before the proposals are approved by creditors. The

¹⁴¹ [2005] EWHC 1005 (Ch), 2005 WL 1333206.

¹⁴² For case law see *Sisu Capital Fund Ltd v Tucker* [2005] EWHC 2170 (Ch), [2006] BCC 463. See also Schedule B1 para 53 (1) of the IA A1986.

¹⁴³ See IA 1986, sch B1, para 65 and *Re Rover MG Belux SA/NV* [2006] EWHC 1296 (Ch), [2007] BCC 446 in this regard.

¹⁴⁴ *Re C E King Ltd* [2000] 2 BCLC 297 (Ch) 306.

¹⁴⁵ Schedule B1 Insolvency Act 1986 para 56. These matters are discussed more fully below.

¹⁴⁶ The Administrator may present a winding-up petition to the court (Insolvency Act 1986 section 124 (1). The petition must contain an application for his/her appointment as Administrator to end (Insolvency Rules 1986 rule 4.7 (7)).

¹⁴⁷ *Re Smallman Construction Ltd* (1988) 4 BCC 784 [1989] BCLC 420.

¹⁴⁸ All of this is analysed by G McCormack in *Corporate Rescue Law- an Anglo-American Perspective* Edward Elgar, Cheltenham, 2008 at 64.

learned judge noted that this interpretation consistent with that of his colleague Neuberger J in *Re T & D Industries plc*¹⁴⁸ a case in which the same policy arguments applied.¹⁴⁹

It is important, however, to put all matters relating to the court's discretion – and the weight to be given to the creditor committee wishes- in context. The Neuberger J judgment mentioned immediately above relates to very exceptional circumstances: that is the creditor committee rejection of the administrator's proposals.¹⁵⁰ Other circumstances could produce different results. In the law relating to liquidations, the customary practice in the courts has been to give considerable weight to the creditor committee views, if the views are found to be reasonable.¹⁵¹ It follows that the courts are inclined to follow those views in the absence of compelling reasons to do otherwise. This has been the common practice.¹⁵²

Where the proposals are approved, it remains the task of the administrator to direct the company's affairs in accordance with the plan. The administrator may be obliged to arrange further creditor meetings in instances where the court directs or where creditors who own ten-per-cent of the debts in toto of the company so requests.¹⁵³

The debt restructuring deal –where it has been negotiated- will involve the restructuring of the company's debt by means of a modification of the terms of its existing borrowing or an exchange of its existing borrowing for new borrowing on different terms. In both instances

¹⁴⁸ *Re T & D Industries plc* [2000] 1 WLR 646.

¹⁴⁹ *Re Transbus International Ltd* [2004] 2 All E R 911. There is another point. The courts have supported the liquidator rather than the creditors committee where to do otherwise would be to go against the interests of the creditors as a whole. See *Andrew Rhodes Ltd v Rhodes* [2005] EWHC 1005 (Ch), 2005 WL 1333206. The reasoning in the last mentioned case has, it is submitted, applicability in administration cases.

¹⁵⁰ *Sisu Capital Fund Ltd v Tucker* [2005] EWHC 2170 (Ch), [2006] BCC 463.

¹⁵¹ This follows naturally from the status of the creditors' committee. The function of the committee is to assist the Administrator in discharging/her functions. The committee may also require the Administrator to attend before it at any reasonable time and to furnish it with information relating to the exercise of his/her functions. The purpose of the committee is to represent the interests of the creditors as a whole and not just the interests of individual creditors. (Insolvency Act, Schedule B1, paragraph 57 and Insolvency Rules 1986, rule 2.52).

¹⁵² *Re ABC Coupler and Engineering Co Ltd* [1961] 1 WLR. 243, 246 (Pennycuik J), approved by the Court of Appeal in *Re Bank of Credit and Commerce International SA (No.3)* [1993] BCLC 1490 (CA).

¹⁵³ *Re Brilliant Independent Media Specialists Ltd* [2014] All ER 111 (Oct) considers the matter of remuneration of administrators.

the face value of the existing and replacement debt will be the same.¹⁵⁴ The arrangements are so constituted that English courts have no subsequent leeway to modify creditors' claims. What usually happens is that one bank among other banks who are parties to the restructuring plan opts to take possession of the collateral and liquidation rights relating to the distressed company and as a result becomes the dominant player in the proceedings.

3.2.1: COMMENTS ON THE NEGOTIATION AND CONFIRMATION STAGES OF ADMINISTRATION

There are a number of aspects of the creditor committee arrangement in English law which impair its functioning. There are very significant impediments to creditor committees becoming effective. In England, they tend to be formed at a relatively short time before the administrator's proposals are to be voted on. In addition, creditors' committees have few formal powers. They have no coercive or directory powers which may be exercised in relation to the administrator.¹⁵⁵ This contrasts very much with what obtains in Germany in similar circumstances. There, creditors' committees play an important role both as parties in decision making and in the monitoring of the administration process.¹⁵⁶ The German system of creditor committee involvement has a number of features which produce satisfactory outcomes from the creditors' perspective. The committee involves itself from the beginning in the administration process. The range of relevant competencies of the committee members – who in some instances may be professional people deputed to represent individual creditors

¹⁵⁴ This approach is used for tax reasons. CFM92490 - Debt Cap: the available amount: debt restructuring mismatches. Information last downloaded from HM Revenue & Customs at <http://www.hmrc.gov.uk/manuals/cfmmanual/cfm92490.htm> on 18th October, 2015.

¹⁵⁵ I Fletcher, *The Law of Insolvency* (Sweet and Maxwell 1990) at 381. Bork notes that there are a number of obstacles to effective representation of (unsecured) creditors as a whole, especially those relating to the necessity for a decision of the creditors' meeting to establish a committee. Their late formation ensures they have no control over the key tasks in administration. In addition, it does not help that the number of members is restricted to five (as there may be more than five diverging interest groups) and that each committee member must be a creditor. R Bork "Creditors' Committees: An Anglo-German Comparative Study" (2012) 21 *Int Insol Rev* at 141.

¹⁵⁶ A Rhim, "Reorganisation Schemes under the UK Insolvency Act of 1986: Chapter 1 as a Springboard for Discussion" (1994) 16 *Loyola of Los Angeles International and Comparative Law Review* 985 at 1005. These matters are also taken up by R Bork "Creditors' Committees: An Anglo-German Comparative Study" (2012) 21 *Int Insol Rev* at 129.

-is considerable. Members of committees are paid for their contributions. They are also subject to personal liability. It is understood by all parties that the committee members are almost invariably highly motivated and pro-active. This approach to matters does not apply in the English case (as it does not also in the Irish case).

There is a need for change. The involvement of insolvency experts could be promoted. Reasonable fees would need to be offered, but they should not be too high so as to use up the debtor company's last assets. Remuneration to the committee members by the creditors as a whole would be fitting given that the committee members are fiduciaries. Alongside that, the decision-making powers of the creditors' committee should be increased, at least for the such matters as selling the business or the most valuable assets. Alternatively, the creditors' committee could be granted the power to approve the administrator's proposals. If this last mentioned were to happen, any contested matters could be referred to the creditors' meeting or the court. It is reasonable therefore to recommend that something along the lines of the German model would be applicable to UK administration (and also to examinership in Ireland).

So far as pre-packs are concerned, it was mentioned above that they leave open the possibility that they narrow the range of possible restructuring arrangements available to a company and usually involve only the major creditors. Thus, the pre-pack arrangement has tended to undermine the statutory protections that are otherwise available for creditors. In everyday practice, there is a strong possibility that one of the major creditors will be a bank. The representatives from the bank will generally wish to avoid the relative awkwardness of a creditors meeting and pressure the administrator to sell the company off as quickly as possible. Besides, the administrator may be anxious to be on good terms with the bank as a source of future work and may thus be inclined to comply with the bank's wishes. From an administrator's perspective there is an incentive to go along with what has been decided

already by the major creditors; by doing so he/she steers clear of protracted and often sterile negotiations. To take that course is, however, to betray the spirit of the legislation by failing to defend the rights of all parties and is totally unacceptable from a TPT perspective.

3.2.2: THE EFFICIENCY OF ADMINISTRATION AND RELATED SYSTEMS FROM A TPT PERSPECTIVE

While it is possible to argue that in the British case – certainly since the time of the Enterprise Act of 2002- an attempt has been made to steer a middle course between traditional approaches to insolvency (as found in Creditors’ Bargain Theory) and those found in Chapter 11, it remains very difficult to think of UK corporate restructuring legislation and the restructuring regime generally as being other than markedly pro-creditor.¹⁵⁷ It is perfectly reasonable, for instance, to view Administration post-2002 as really nothing more than ‘receivership-plus’ that is to say receivership with some additional duties.¹⁵⁸ Not a great deal has changed since the original Insolvency Act 1986. It is necessary simply to note therefore that corporate rescue legislation in the UK moves in a different trajectory to that found in the United States. When the principles and policy of the UK authorities are reviewed, it would seem that none of the interested parties have a full entitlement to the ownership of any given company or to equivalent claims or responsibilities. A legal analysis of the corporate form, moreover, does not suggest that any ownership claims will not fill the gaps left by incomplete contracts agreed to by other parties. In addition, there are no full owners of corporations. As Blair argues – as would all TPT partisans- ownership in corporations is not a well-defined concept.¹⁵⁹ Thus, there may be ground for believing that the UK authorities have charted a different course and have avoided policy difficulties encountered by their U S counterparts.¹⁶⁰

¹⁵⁷ Scholars such as H Rajak would speak of a compromise policy approach in the British case. See H Rajak, “The Enterprise Act and Insolvency Law Reform” (2003) 24 *Company Lawyer* 3.

¹⁵⁸ S Davies *Insolvency and the Enterprise Act 2002* (2003) Jordans, Bristol.

¹⁵⁹ ¹⁵⁹ See M M. Blair and L A. Stout, “A Team Production Theory of Corporate Law” (1999) 85 *Virginia Law Review* Vol. 85, No. 2 at 247.

¹⁶⁰ See J Armour, B R Cheffins and D A Skeel Jr Corporate Ownership Structure and the Evolution of Bankruptcy Law; Lessons from the United Kingdom 2002 55 *Vand L Rev* 1699.

There is one matter that remains unresolved, however: that relating to the efficiency and inefficiency from a TPT perspective of pre-pack administrations. This is because of a complicating factor. It is discussed below.

3.2.3: COMPANY VOLUNTARY ADMINISTRATION

In company voluntary arrangements, the ‘nominee’ –usually a licensed insolvency practitioner- arranges meetings of creditors and shareholders to vote on the proposed composition by which the outstanding financial claims against the company are reduced and altered in their legal nature.¹⁶¹ An insightful text on cvas vis-à-vis schemes of arrangement is: by G O’Dea, J Long and A Smyth, *Schemes of Arrangement: Law and Practice* (OUP 2012). They note that a cva includes the following features:

- (1) Unlike schemes of arrangement they do not ordinarily compromise secured creditors, but they do compromise unsecured ones
- (2) They do not allow for cross-class cram downs
- (3) They do not provide for a moratorium in the case of large companies.

The first feature has ensured that cvas are not commonly used in cases involving large reorganisations. The authors take the view that “the Cork Committee and the legislature (and the Insolvency Service and its predecessors in particular) failed to grasp the nettle in modernising corporate restructuring procedures.”¹⁶²

Pre-pack arrangements are much more popular with major creditors, because they will have far greater leverage in the process.¹⁶³ The creditors can call for modifications of the composition, but any modifications made must not be such as to alter the fundamental nature of the plan.¹⁶⁴ In addition, the creditors’ meeting is precluded from doing anything so as to block a secured creditor or a preferential debtor from securing their rights unless they concur

¹⁶¹ G O’Dea, J Long and A Smyth, *Schemes of Arrangement: Law and Practice* (OUP 2012).

¹⁶² G O’Dea, J Long and A Smyth, *Schemes of Arrangement: Law and Practice* (OUP 2012) at 105.

¹⁶³ Anecdotal evidence would suggest they are up to four times more popular. See K Majevardia “CVAs v Administration.” *Birmingham Post* 24th February, 2011 Birmingham, England.

¹⁶⁴ Insolvency Act 1986 s(4)2.

in the meeting by so doing.¹⁶⁵ Those creditors whose claims are unascertained have a right to vote at the meeting, if the chairman is prepared to estimate the debts outstanding to them at its minimum point.¹⁶⁶ On approval of the composition (should that happen), the nominee – whose title changes to ‘supervisor’- is obliged to notify all creditors and members to that effect and to provide an account of income and outgoings.¹⁶⁷ Where the meeting has approved the voluntary arrangement, it may be challenged in the courts within a period of twenty-eight days following the meeting.¹⁶⁸

3.2.4: PRE-PACKS AND THE GRAHAM REVIEW

The Graham Review was an independent review into pre-packaged sales in administrations and their wider economic impact published in 2014¹⁶⁹ The companies involved are often sold on to the directors of the entity that had been the subject of the pre-pack. Pre-packs processes are relatively few in number in the UK, but they are widely perceived as lacking transparency.¹⁷⁰ The Graham Review rejected the idea of placing pre-packs under legislative scrutiny in favour of a series of voluntary measures. It saw a role for pre-packs, but it concluded that a major improvement in how they are administered was necessary.

The Graham recommendations were as follows:

- (1) On a voluntary basis, connected parties such as the directors of the company subject to the pre-pack should approach a “prepack pool” of independent experts.¹⁷¹

¹⁶⁵ Insolvency Act 1986 S4(3) and (4).

¹⁶⁶ *Doorbar v Alltime Securities Ltd* [1995] BCC 1149 (CA).

¹⁶⁷ Insolvency Act 1986 Rule 1.29(1) and (2).

¹⁶⁸ Insolvency Act 1986, s 6(3).

¹⁶⁹ T Graham, *Graham Review into Pre-Pack Administration* (Insolvency Service UK 2014). The Review was commissioned by Mr Vince Cable, the then Secretary of State for Business, Innovation and Skills. It arose initially out of a speech given by Mr Cable concerning transparency and trust in business.

¹⁷⁰ The Graham Review notes that of the approximately 250,000 companies which become insolvent each year, 20,000 are steered towards insolvency procedures by their management. 600-700 of these last are pre-packs. T Graham, *Graham Review into Pre-Pack Administration* (2014) Insolvency Service 4.

¹⁷¹ Recommendation 1, T Graham, *Graham Review into Pre-Pack Administration* Insolvency Service UK 2014 at page 10.

It is intended that this approach would be low cost. It is also intended that members of the pool of independent experts would spend no longer than half a day reviewing the proposals. The fee for the service would be paid initially by the debtor company and would be expected to cover the administrative costs of maintaining the pool. There are, however, practical difficulties here. For instance, how would it be possible to form a pool of this sort on short notice? Would people of the right calibre be available for such work? It is possible that the directors of the company subject to the pre-pack process would overwhelm the pool members with data and information so as to protect their position legally. If that were to happen, it would quickly make the process unworkable.

- (2) On a voluntary basis, the connected party should complete a ‘viability review’ on the new company.¹⁷²

This exercise must include a statement of how the company will survive for at least twelve months. In practice, it may be difficult to offer this level of assurance. A short narrative is also required which is to detail what the new company will do differently from what was done by the old company. The purpose here is to help avoid business failure.

- (3) The Joint Insolvency Committee should consider the redrafted SIP 16 as redrafted by Graham and which was included in the Graham Review¹⁷³

The Graham Review proposed that should the recommendations above not be adopted by the market, the UK Government should consider legislating on these matters.¹⁷⁴

The Graham Review clearly has some relevance in the context of pre-pack receiverships in Ireland. There is no transparency regarding pre-pack receivership processes. In addition, there is no judicial oversight and, as a result, no independent consideration as to whether the proposals in the pre-pack are in the best interests of the broad range of creditors. Graham recommends improved marketing of pre-packs to a wider range of potential purchasers and a

¹⁷² Recommendation 2, T Graham, *Graham Review into Pre-Pack Administration* Insolvency Service UK 2014 at page 10.

¹⁷³ SIP 16 has pre-packaged sales as its subject matter. The redrafted SIP 16 is found in Annex A of the Graham Review at page 69. T Graham, *Graham Review into Pre-Pack Administration* (2014) Insolvency Service

¹⁷⁴ Recommendation 3, T Graham, *Graham Review into Pre-Pack Administration* Insolvency Service UK 2014 at page 10. Criticisms of Graham are detailed in R Crump, “Key Pre-Pack Measures are unworkable” at www.accountancyage.com/aa/.../key-pre-pack-measures-are-unworkable last downloaded on September 29th, 201

fuller explanation for interested parties of the valuation methodology being employed in the pre-pack to address such difficulties. In addition, Graham recommends that the voluntary introduction of an independent opinion on the substance of the pre-pack would prove useful (Recommendation 1) as would a clear argument on why the approach being adopted in the given case by the insolvency professional is a cogent one (Recommendation 5). This would be particularly useful in pre-pack cases involving connected parties. It would also be helpful to complete a viability review on the new company (Recommendation 2). Reflecting upon the Irish context for a moment, it would seem necessary in the pre-pack receivership cases that the independent expert (the accountant) to address at least substantive matters related to recommendations 1, 2 and 5 respectively in a publicly available document as a matter of good practice. The feasibility of putting together a pool of independent experts see, is unlikely also in the Irish context, even if the recommendation is a worthy one.

There are a number of complicating factors which must be considered in this jurisdiction for those planning a pre-pack receivership. For instance, in a pre-pack involving connected parties, where there is, for instance, a substantial property transaction between a company and one of its directors, this will need formal sanction from the company's membership. (Formerly under section 29 of the Companies Act 1990, now under section 238 of the Companies Act 2014). This may not arise where the directors are the sole or the majority shareholders of the company, In addition, receivers are prohibited from selling significant company assets to officers or connected persons of the company without giving the creditors 14 days notice. (Section 316(A)3 of the Companies Act 1963, now section 439 of the Companies Act 2014. This section is an amended somewhat and relates to receivers liability on contracts generally). The purpose of these provisions is to protect the company's members and creditors. It is critically important for parties engaged in a pre-pack to be conscious of the risks of undertaking a transaction that could be viewed as having been engaged in for the

purposes of defrauding creditors. Minister Bruton, the Minister for Jobs, Enterprise and Innovation announced in the Dáil on 13th April, 2013 that he had requested of his departmental officials to investigate pre-pack practices in the Irish republic with a view to remedying those practices. Nothing more has been heard of this. The pre-pack receivership model is significant in the Irish context, because if it turns out that examineship lite is not widely availed of by SMEs, pre-pack receivership may be viewed by many as a very practical restructuring option. The difficulty with pre-packs processes is that they provide no formal right of review by creditors. In addition they lack transparency.

3.2.5: THE EFFICIENCY OF PRE-PACKS FROM A TPT PERSPECTIVE

Pre-packaged administration can be understood as a case in which a buyer or investor comes forward and successfully negotiates the commercial and legal terms with the existing board so as to enable the buyer to complete the transaction immediately or closely following the appointment of the administrator and to do so without interrupting the trading activity of the target company. Ostensibly, there are reasons to think that it may be efficient – with regard to employee retention and reduced legal cost – but those reasons may not be sufficient to meet the stringent TPT criteria. For instance, it has been found that the performance of pre-packs with regard to employment preservation is better than in conventional business sales (i.e. a going-concern sale of a company negotiated and arranged after the commencement of the insolvency procedure). In one study, an average of 92% of the employees were transferred to the new company compared with an average of 65% in a business sale.¹⁷⁵ In addition, it was found by the same author in a different study that the average returns to secured creditors in pre-pack administrations was 35%. This compares with a 33% figure in conventional business sales. Unsecured creditors also did better. They received an average return of 5% in

¹⁷⁵S Frisby, *A Preliminary Analysis of Pre-Packaged Administrations*, 2007. Last accessed at <https://www.r3.org.uk/publications/default.asp?dir=press&pag=prepackanalysis&i=420> on 8th December, 2015.

a pre-pack which compares with 4% in a conventional business sale.¹⁷⁶In addition, where it proves feasible to do so, a pre-pack arrangement can have other positive results, because a sale can be completed quickly thus preventing the loss of company value. In contrast to this, what often happens otherwise is that directors hesitate to engage in the selling process, however risky that tactic may prove, because the process may be prolonged and the company may as a consequence be subject to a decrease in value.

Unfortunately, there are also major inefficiencies. For instance, there are good reasons to believe that UK pre-packs are put together for the benefit of the creditors rather than for the company. Winding-up or liquidation would seldom offer a better result so far as creditors are concerned, so they have a motivation to be supportive of them. In cases where administrative receivership is not employed, pre-packs offer much to secured creditors as a way of reinforcing their position. It is found that most cases of pre-packs involve secured creditors or directors: this is not surprising given that few others will find the pre-pack candidate commercially attractive. There is, in addition, a high level of second failures of businesses that were sold to previous owners as pre-packs.¹⁷⁷ It is very evident that this model is not compatible with TPT thinking, because of the absence of concern for the wider group of team members.

SECTION 3.3: THE IRISH CASE: EXAMINERSHIP AT THE CONSULTATION AND CONFIRMATION STAGES

This part of the chapter relates to the consultation stage (a more accurate term than negotiation in the context of examinership) together with the confirmation stage. It is somewhat misleading to talk about negotiation between the examiner and the creditors in the Irish case, although it is certainly the case that creditors do possess many rights (and this is

¹⁷⁶ S Frisby “A The pre-pack promise: signs of fulfilment?” Recovery magazine, Spring 2010. Last accessed at www.r3.org.uk/recovery on 8th December, 2015

¹⁷⁷ S Frisby, *A Preliminary Analysis of Pre-Packaged Administrations*, 2007. Last accessed at <https://www.r3.org.uk/publications/default.asp?dir=press&pag=prepackanalysis&i=420> on 8th December, 2015.

most evident at the confirmation stage discussed below). Section 538 of the Companies Act 2014 specifies that an examiner may call upon creditors to assist by means of a committee when formulating proposals for a compromise or scheme of arrangement. He/she may convene such meetings and may chair them.¹⁷⁸ The persons who comprise the committee shall not be more than 5 in number and will include the holders of the three largest unsecured claims who are willing to serve.¹⁷⁹ The examiner is obliged to make his proposals known to the committee. The committee may in turn make their view known to the examiner.¹⁸⁰ What is required to be included in the proposals is set forth in Section 539 of the Companies Act, 2014. The proposals must define the various classes of creditors and members and it must be indicated clearly that each class will be treated in an equal manner unless the members of a particular committee agree with the debtor to something less. A clear indication of how the compromise or scheme will be activated must also be set out. A range of matters may be included such as possible changes in the composition of the board, the direction of the company or of the company constitution- to include the more substantive ones. A clear indication is also provided as to the assets and liabilities of the company and how each class of creditor will fare should the proposal be put into effect. The proposals may also encompass other matters.¹⁸¹ The proposals are voted on by each class of creditor and member.¹⁸² The rules for members' and creditors' votes are different one from another. Under the original legislation of 1990, if the majority of members voted in favour of the

¹⁷⁸ Companies Act 2014, s538(4)

¹⁷⁹ Companies Act 2014, s 538: "An examiner may, and if so directed by the court shall, appoint a committee of creditors to assist the examiner in the performance of his or her functions."

¹⁸⁰ Order 75A Rule 18 of the Rules of the Superior Courts details the rules of procedure for the relevant committee meetings of creditors and members.

¹⁸¹ Company Act 2014 s.536(1) See I Lynch-Fannon and G N Murphy (2012) 2nd edn, *Corporate Insolvency and Rescue* Bloomsbury 541 . As regards the requirement by the court that the proposals should encompass "other matters", the *Eylewood* case is instructive *Eylewood* [2010] IEHC 57. Here, the examiner put forward proposals that involved the displacement of the existing company board and some of the management. This was a requirement of the party offering new investment to the company. The existing directors contested this, in accordance with the Companies (Amendment) Act 1999 (No2), s(9), now section 513(7) of the Companies Act 2014.

¹⁸² In accordance with section 23 of the Companies (Amendment) Act 1990 as amended by Section 23 of the Companies (Amendment) Act (No 2), 1999.

proposals, they were accepted.¹⁸³ This was later changed, so that if the members vote against the proposals this does not in itself preclude the court from approving the examiner's proposal.¹⁸⁴ In the case of creditors, the proposals are judged to have been approved, if a majority of creditors by number and by value so vote.¹⁸⁵ Section 540(6) of the Companies Act 2014 provides the Revenue Commissioners with the means whereby they can agree to a compromise put to them by the debtor: prior to this, the inability of the Revenue to compromise had caused many schemes of arrangement to go under.

After meeting with the members and creditors, the next step for the examiner is to put together a report.¹⁸⁶ In accordance with section 536 of the Companies Act 2014, the examiner's report will include or make references to the following¹⁸⁷

- (a) The proposals placed before the required meetings,
- (b) Any modification of those proposals adopted at any of those meetings,
- (c) The outcome of each of the required meetings,
- (d) The recommendation of the committee of creditors, if any,
- (e) A statement of the assets and liabilities (including contingent and prospective liabilities) of the company as at the date of his report,
- (f) A list of the creditors of the company, the amount owing to each such creditor, the nature and value of any security held by any such creditor and the priority accorded under sections 621 and 622 to any such creditor and any other statutory provision or rule of law,
- (g) A list of the officers of the company
- (h) The examiner's recommendations
- (i) Such other matters as the examiner deems appropriate or the court directs
- (j) status of any such creditor under section 285 of the Principal Act or any other statutory provision or rule of law
- (k) A list of officers of the company
- (l) His/her recommendations
- (m) Such other matters as the examiner deems appropriate or the court directs

In an appendix to the report, the proposed scheme of arrangement is set forth.¹⁸⁸ The proposals are then subject to approval by the court.¹⁸⁹ Section 541(4) reads as follows:

¹⁸³ Section 23(3) of the Companies (Amendment) Act, 1990.

¹⁸⁴ Section 541(4) of the Companies Act, 2014.

¹⁸⁵ Section 540(4) of the Companies Act, 2014.

¹⁸⁶ The examiner is obliged to conform to the requirements set out in section 534 of the Companies Act 2014.

¹⁸⁷ RSC 186, Ord 75(A), r 17(2).

The court shall not confirm any proposals—

(a) unless at least one class of members and one class of creditors whose interests or claims would be impaired by implementation of the proposals have accepted the proposals

(b) unless the court is satisfied that—

(i) the proposals are fair and equitable in relation to any class of members or creditors that has not accepted the proposals and whose interests or claims would be impaired by implementation, and

(ii) the proposals are not unfairly prejudicial to the interests of any interested party.

and in any case shall not confirm any proposals if the sole or primary purpose of them is the avoidance of payment for tax due.

This needs to be considered in the context of the right of any creditor or member whose interests would be impaired to be heard by the court.¹⁹⁰ Everything at the hearing revolves around the scheme of arrangement and whether or not it should be approved. Creditors or other parties who are dissatisfied with the scheme have a right to communicate their concerns to the examiner.¹⁹¹ This arrangement makes it much easier for the examiner to alter his scheme, in cases where he/she is minded to do so, before it is submitted to the court.¹⁹² The examiner is obliged to bring any relevant matters of substance raised by dissatisfied parties to the attention of the court for its directions. The court may instruct the examiner before the hearing takes place to request further details in writing from a dissatisfied party.¹⁹³

¹⁸⁸ Rules of the Superior Courts 1986, Ord 75A, r 17(2).

¹⁸⁹ As required by section 541(3) of the Companies Act 2014.

¹⁹⁰ Companies Act 2014, section 543(1). For instance in *Re Eylewood Ltd* [2010] IEHC 57 Finlay-Geoghegan J permitted two contingent creditors who had given personal guarantees in respect of the companies to be represented. Those same creditors were also directors of the company and they were allowed to be represented in court as directors. The examiner had recommended in his proposals that the directors be removed from their positions.

¹⁹¹ Section 541(2) of the Companies Act 2014. See also *Re Tony Grey & Sons Ltd* [2009] IEHC 557 at para 7.

¹⁹² *Re Laragan Developments Ltd* [2009] IEHC 390 at paras 4.2- 4.3.

¹⁹³ *Re Laragan Developments Ltd* [2009] IEHC 390 at para 1.4.

The court will not approve a scheme, if it becomes evident that the real objective of the debtor is to avoid taxation.¹⁹⁴ Section 541(2) of the Companies Act 2014 allows a party whose interests would be impaired or who imputes something improper to the arrangement to put forward their objections at a hearing. Where a party has agreed to the proposals at a vote of members or creditors, he/she cannot change his/her mind at the confirmation stage, except in cases relating to ground (b) above.

The court is at liberty to modify the examiner's proposals, but it will do so only within limits. There are good precedents for this view. For instance, in *Re Goodman International*¹⁹⁵ Hamilton P found that while he could approve the instant modifications, if it were a case that 'the modifications suggested were to fundamentally alter the proposals which have been considered by the members and creditors of [the company] then a court would be slow to modify the scheme in a fundamental manner without having the modifications considered by the members and creditors.'

The case law in this area is also critically important. In *Re Antigen Holdings Ltd* McCracken J stated that the proposals must be an enabling mechanism for intrinsically viable companies to re-establish themselves commercially.¹⁹⁶

3.3.2: THE McINERNEY CASE

The *McInerney* case¹⁹⁷ provides an insight into how the courts will view the reduction of secured creditors rights in examinership. An examiner had proposed a scheme of arrangement under which a banking consortium would receive a little over 20% of the monies advanced in full and final settlement of a €113 million loan provided to the debtor company. The scheme was opposed by the banking syndicate on the basis that it could recover more of its debt

¹⁹⁴ Companies Act 2014 s541(4).

¹⁹⁵ *Re Goodman International* (28th January 1991) High Court at 14. In a second pertinent case, that of *Re Antigen Holdings Ltd* [2001] 4 IR at 600, McCracken J stated that the court would not accept modifications of such a character as to fundamentally alter a scheme.

¹⁹⁶ *Re Antigen Holdings Ltd* [2001] 4 IR at 600.

¹⁹⁷ *Re McInerney Homes Ltd* [2001] IEHC63.

through a long-term receivership workout plan. The High Court did not confirm the scheme. Clarke J held that the scheme was unfairly prejudicial to the banking syndicate. He accepted that the syndicate could receive a more favourable outcome by a controlled long-term receivership. It was also held that the court could approve a scheme of arrangement provided that the write down of secured creditors was not unfairly prejudicial to them. The case was returned to the High Court following the transfer of some of the syndicate loans to NAMA (the National Debt Management Agency).¹⁹⁸ It was argued for McInerney that the syndicate would not be then in a position to carry out its long-term receivership plan. The Court determined that in the changed circumstances some members of the syndicate were no longer prejudiced by the scheme, although the remaining one was. The Court again refused to confirm the scheme. The McInerney Group then appealed the case to the Supreme Court. The appeal was dismissed. The Supreme Court confirmed that the onus of proving that the scheme is not unfairly prejudicial to any involved party rests with the examiner and confirmed the High Court finding that in this case the onus had not been discharged.

3.3.3: THE SIAC CASE

The SIAC case concerned the rights of aggrieved creditors in an examinership, particularly those relating to unfair prejudice.¹⁹⁹ The High Court and the Supreme Court in 2014 confirmed a scheme of arrangement for SIAC Construction Limited (SCL) and some related companies despite the objections of a number of creditors. The Polish Roads Authority was among these. It submitted that the scheme was unfairly prejudicial to its position because:

- (1) claims for unwanted damages were being excluded; and
- (2) the scheme precluded it from recovering its subrogated claims

The Supreme Court found that in assessing unfair prejudice under a scheme of arrangement a wide range of potentially relevant factors must be taken into account. Such factors include the

¹⁹⁸ *Re McInerney Homes Ltd* [2001] IEHC340.

¹⁹⁹ *SIAC Construction Limited and Others in Examination* [2014] IESC 225

prejudice potentially caused to other creditors and employees, if the scheme is not approved. The main implication of the judgment is that interested parties who wish to object to a scheme should be aware that the Court, in assessing whether a scheme is unfairly prejudicial, will take into account the totality of the objector's circumstances. It is not sufficient for an objector merely to distinguish itself from other creditors. Rather it should go further and show that the effects of the scheme as a whole are prejudicial.

3.3.2: THE EFFICIENCY OF EXAMINERSHIP AT THE NEGOTIATION AND CONFIRMATION STAGES FROM A TPT PERSPECTIVE

As already noted, examinership in the High Court at both the negotiation and confirmation stages are very costly exercises.²⁰⁰ Therefore, those who petition for examinership today must have a confidence that is both robust and well-grounded. The rights afforded to creditors and members at the confirmation stage is impressive, but the costs involved for the participants in addressing the many technical points at this stage are necessarily significant.²⁰¹ The complexity of examinership at the consultation and confirmation stages – as Lynch-Fannon and Murray indicate- revolve around ‘substantial or procedural legal difficulties on the one hand and problems that are commercial in nature on the other.’²⁰² The two authors astutely quote from D G Baird in this context:

To the extent a reorganisation promotes bargaining over rights that do not exist elsewhere, it may promote bargaining about the wrong thing. Nothing is gained from havingbargaining about anything other than substantive rights, yet much of the bargaining in a reorganisation is over procedural rights that exist nowhere else. Such bargaining is a cost of the organisation not a justification for it.²⁰³

This would seem to be an apt description of how things have worked out in the Irish case.

Before, however, these matters are considered, it may be helpful to go back to first principles

²⁰⁰ See footnote 222 above. The actual costs involved in conducting examinerships in the Circuit Court have yet to be ascertained.

²⁰¹ In this regard see *Re United Meat Packers Ltd* (13th March 1992) Supreme Court *ex tempore* . Reported in the Irish Times, Dublin on 14th March, 1992.

²⁰² I Lynch-Fannon and G N Murray 2nd edn *Corporate Insolvency and Rescue* Bloomsbury West Sussex 2012 at 553.

²⁰³ D G Baird “The Uneasy Case for Corporate Reorganisations” (1986) 15 *Journal of Legal Studies* 127 at 145

with regard to examinership in Ireland. On the one hand, the focus of the legislation is to preserve employment through allowing in any given case an enterprise to continue where there is necessary and sufficient evidence to persuade the court that it is prudent to do so.²⁰⁴ On the other hand, O'Donnell J has said in *McInerney Homes* that the examinership process has other objectives also: the legislation is aimed not only at rescuing “ fundamentally sound businesses...[but must achieve that purpose] in a manner that is not unfair to any party.”²⁰⁵ It is difficult to be definitive on the matter. The other fundamental objectives of examinership would appear to be the protection of the shareholders and the broad range of creditors; while the protection of the workforce is central also. This is stated clearly in *Atlantic Magnetics*.²⁰⁶

In that case McCarthy J stated that:

It is clear that parliament intended that the fate of the company and those who depend on it should not lie solely in the hands of one or more creditors who can by appointing a receiver pursuant to a debenture effectively terminate its operation and secure as best they may the discharge of the monies due to them to the inevitable disadvantage of those less protected. The Act is to provide a breathing space albeit at the expense of some creditor or creditors.²⁰⁷

The above cases taken together are ambiguous and do not provide clear direction. It may be reasonable to suggest that the examinership legislation is of a hybrid nature and perhaps necessarily so. Lynch-Fannon notes that the courts have had to resolve bitter disputes regarding the meaning of the statutory provisions and that this has added to the length and cost of examinerships.²⁰⁸ This is a recipe – it is submitted- for both dissent and disputation at the negotiation and confirmation stages. More positively, it leaves much room for judicial discretion, a discretion that the Irish courts have not been slow to exercise in the last thirty

²⁰⁴ See *Re Traffic Group Ltd* [2007] IEHC 445.

²⁰⁵ *Re McInerney Homes Ltd* [2011] IESC 31.

²⁰⁶ *Re Atlantic Magnetics Ltd* [1993] 2 IR 561.

²⁰⁷ *Re Atlantic Magnetics Ltd* [1993] 2 IR 561 at 578.

²⁰⁸I Lynch-Fannon, and G N Murphy, 2nd edn, *Corporate Insolvency and Rescue* (Bloomsbury 2012) at 557 makes the point that many of the judicial pronouncements in examinership cases indicate that the legislation is open to differing interpretations. They also indicate that the opposing sides in those cases have not been slow to capitalise on this. The only conclusion that can be drawn from this is that the legislation has been poorly drafted and perhaps at least in part, poorly thought out.

years. In any event, none of the above serves to suggest that the legislation on examinership and judicial practice here comes any nearer to approximating to the TPT model than anything obtaining in the United States.

From a TPT efficiency perspective, the following matters may be considered. Examinership is, broadly speaking management-friendly. The examiner cannot, in the ordinary way, take over the role of management of the company in examinership.²⁰⁹ In addition, in the great majority of cases where management has initiated the examinership, relations between the management and the examiner are positive. What often happens in practice is that the management and examiner are lined up on one side of the negotiating table and secured and preferential creditors on the other.²¹⁰ Certain aspects of the legislation promote the expediting of cases. For instance, the examiner has the right both to convene and to preside at meetings of members and shareholders.²¹¹ Similarly, the examiner may also appoint a committee of creditors.²¹² The creditors do not have a right in Irish legislation to form such committees. Another important feature deriving from Irish case law relates to the judiciary's rather difficult test with regard to prejudice of member and creditor interests. In the *Pye (Ireland)* case it was decided by both the High Court and the Supreme Court that the addition of certain creditors or members in a class had to have as a consequence the 'actual (rather than potential) prejudice' before that action could be nullified.²¹³ The Supreme Court accepted the arguments of the aggrieved creditors in that instance. In view of the significant complexity of the arguments that can be adduced by advocates for aggrieved creditors in similar cases in other jurisdictions, this could be held by some to be a wise approach on the part of the Irish

²⁰⁹ *Re Eden Park Construction Ltd* [1994] 3 IR 126. This applies where there is no court order requesting that the management cede their ordinary powers to the examiner. The examiner does, in addition, have the power to repudiate contracts of the board under the Companies (Amendment) Act 1990, section 20, now section 537 of the Companies Act 2014 subject to the approval of the court.

²¹⁰ There are some exceptions to this pattern such as the *Irish Press Group* (1995) *Irish Times*, 27th June and *Eylewood Ltd* [2010] IEHC 57.

²¹¹ Companies (Amendment) Act 1990, section 23 and Companies (Amendment) Act 1990, section 18(2).

²¹² Companies (Amendment) Act 1990, section 21. The court may also appoint a committee of creditors.

²¹³ *Re Pye (Ireland) Ltd (No1)* (12th November, 1984), HC, Costello J.

judiciary.²¹⁴ This would seem to be the case when it is remembered that such creditors and members have a right to be heard at the confirmation stage of examinership. On matters relating to ‘cram-down’ the legislation is quite explicit: the court will not confirm the examiners proposals unless:

- (i) they have been accepted by at least one class of creditors whose interests would be impaired by their implementation,
- (ii) they are fair and equitable in relation to any class of members or creditors who have not accepted them and whose interests would be impaired and
- (iii) they are not unfairly prejudicial to any interested party.²¹⁵

A TPT partisan would not object to this arrangement, subject to the proviso given earlier in the Chapter 11 context.²¹⁶ In practice, however, this can easily shift over to inefficiency from a TPT perspective. What is most likely to happen in practice is that the obligation remains with the examiner at the confirmation stage to justify his decisions in these matters from the perspective of what is ‘fair and equitable.’²¹⁷ It would be helpful to have an objective test available in the Companies Act 2014 on what could be understood as “fair and equitable.” It is noteworthy also that terms such as “unfair prejudice” are not defined in the legislation. Given the wide discretion of the court in judging such matters and the significant commitment by the judiciary to property rights in almost all instances, it can be difficult

²¹⁴ The test applied by Bowen LJ in *Sovereign Life Assurance Co v Dodd* [1892] 2 QB 573 at 582 to the effect that a class consists of “those persons whose rights are not so dissimilar as to make it impossible for them to consult together with a view to their common interests.” On the other hand, Chadwick indicated that:

“when applying Bowen LJ’s test to the question ‘are the rights of those who are to be affected by the scheme proposed such that the scheme can be seen as a single arrangement; or ought it to be regarded, on a true analysis, as a number of linked arrangements?’ it is necessary to ensure not only those rights really are so dissimilar that they cannot consult together with a view to a common interest should be treated as parties to distinct arrangements - so that they should have their own separate meetings – but also that those whose rights are sufficiently similar to the rights of others that they can properly consult together should be required to do so; lest by ordering separate meetings the court gives a veto to the minority group.”

The Court of Appeal sanctioned the scheme. These questions are analysed in B Hannigan, *Company Law* 3rd edn (OUP, 2012) at 717.

²¹⁵ Companies (Amendment) Act 1990, section 24 as amended by the Companies (Amendment) (No2) Act 1999, section 24.

²¹⁶ The Team Production Theory approach on cramdown matters is that the value guaranteed shareholders by the cramdown test is merely the value remaining after team production entitlements have been paid. L LoPucki, “A Team Production Theory of Bankruptcy Reorganisation” (2004) 57 *Vanderbilt Law Review* 742 at 750.

²¹⁷ Companies (Amendment) Act 1990(h). See *Re McInerney Homes Ltd* [2011] IESC 31.

sometimes to predict the outcome of a given case.²¹⁸ In fact, the many other tests at confirmation stage and the formidable right to be heard by aggrieved parties may be such such as to wither the confidence of all but the most sanguine and wealthy High Court examinership candidates.²¹⁹ In addition, the claims costs of the examiner are prohibitively expensive.²²⁰

Regarding suggestions for reform, the first observation is that given the significant accumulation of case law that has become available since the enactment of the Companies (Amendment) Act, 1990 and the manner in which it has exposed the weaknesses of existing statutory formulations, there is a good argument for a thorough review of the existing legislation. The CLRG report clearly demonstrated the inadequacy of the existing examinership legislation for small- and medium-sized companies. The CLRG suggested that a largely non-judicial examinership process would be much more suitable for such companies.²²¹ “Examinership lite” is just a pale shadow of what is really required. Equally importantly, the existing statutes allow for too great a measure of judicial discretion because of the absence of defined terms or objective tests in deciding matters. For instance, as Lynch-Fannon observes, there is a need to define what an objectively reasonable creditor might

²¹⁸ At the confirmation stage the 1990 Companies (Amendment) Act, section 24 as amended provides that any creditor or member whose claim or interest would be impaired if the proposals were implemented may appear before the court. In *Re Antigen Holdings Ltd.* (High Court, unreported, McCracken J., 8 November, 2001) the court allowed representations from an investor and from the trade unions representing employees. McCracken J. expressed the view that while the 1990 Amendment Act stated that certain persons had a right to be heard, this did not in any way preclude the court from hearing other people. In addition, in *Re 3V Multimedia Group* (High Court, unreported, Costello J., 20 August, 1992), the court allowed a proposed investor to appear before the court.

²¹⁹ The tests referred to include that of unfair prejudice – involving comparisons of aggrieved parties with the outturn for other classes of creditors and members and comparison with available alternatives test among many others is detailed in I Lynch-Fannon and G N Murray 2nd edn *Corporate Insolvency and Rescue* Bloomsbury West Sussex 2012, Chapter 13.

²²⁰ The Irish courts have attempted to reign in such costs by limiting the costs the examiner can certify under section 10 of the Companies (Amendment) Act, 1990. In *Re Missford Ltd* [2010] 3 IR 756 Kelly J found it necessary to determine that the remuneration of the former interim examiner should be reduced by 15%. Kelly J did this because the interim examiner had undertaken duties which were in excess of those conferred by the court.

²²¹ CLRG, *Company Law Review Group Annual Report 2013* Department of Jobs, Enterprise and Innovation, Dublin 2013.

demand.²²² As things stand, the burden falls upon the examiner to persuade the court that s/he has not prejudiced the interests of such creditors. In addition, there is a burden placed upon the judiciary to come to a decision on this question without having accepted procedures available to them. It is somewhat ironical that High Court examinership candidates – who presumably are suffering from revenue generating and other difficulties – are called upon in their hour of need to pay for a legal process that is on any reckoning extraordinarily expensive. The solution, at least in part, may lie with “examinership lite”, but that has yet to prove itself.

3.3.3: CONCLUSION

In chapter 2, it was established that the restructuring model from which the Irish examinership system took its inspiration was that of Chapter 11. The parties that play a significant role in the US model (besides the debtor) are the secured creditors, the creditors’ committees appointed to represent the interests of general unsecured or other creditors, the United States Trustee (who appoints the creditors’ committees and monitors the reorganization process for compliance with the administrative requirements of the Bankruptcy Code)²²³ and the bankruptcy judge (who determines legal issues, establishes procedures, and either supports or blocks a proposed course of action by one or other party). The duties of debtors-in-possession, of administrators and examiners (and also liquidators) are onerous ones and the decisions that they make have long-range implications. Matters which are most critical often include decisions about whether to sell the whole or important parts of the business; decisions about whether or not to take proceedings in the courts; and decisions about whether or not it is worth pursuing certain claims. Moreover, administrators

²²² I Lynch-Fannon and G N Murray 2nd edn *Corporate Insolvency and Rescue* Bloomsbury West Sussex 2012, at 566.

²²³ 11 U.S.C. § 1102

and examiners as well as debtors-in-possession in Chapter 11 cases in the United States act with a good deal of autonomy. They are not obliged to refer every decisions they take either to the courts or to creditors. It is not uncommon, therefore, for the activities of administrators and examiners (as well as liquidators) - whatever about debtors-in-possession- to be viewed with a certain amount of suspicion on the part of creditors.

As in chapter 2, the material in this chapter points to a similar conclusion to that already found so far as Chapter 11 applied to larger companies is concerned. The primary objective of the creditors' committee is to provide a window unto the debtor-in-possession' or unto the administrator's or examiner's activities as appropriate. The committee is a kind of monitoring device. In exceptional circumstances it can engage in litigation, if it has objections to any given action on the part of the administrator or examiner. It can prove difficult sometimes to determine what is in the best interests of the unsecured creditors and consensus is not easily achievable.²²⁴ Other significant topics covered in this chapter included the best interest rule, cram down and the absolute priority rule (topics central to the negotiation and confirmation stages). Reconsidering the research question as outlined on page 16 of this thesis, that is the question of whether company rescue law in Ireland as found in Part 10 of the Companies Act 2014 provides efficient mechanisms which are fit for purpose, the evidence would suggest that that is not usually the case. Examinership processes are expensive and complex. They are often lengthy. Much of the bargaining in it is concerned with procedural rather than substantive rights. This has served to drive away most small companies which are in financial distress and which could benefit from a formal restructuring arrangement. It was also noted that the CLRG report for 2013 clearly demonstrated the inadequacy of the existing

²²⁴ The cases are sometimes interminable. The most well-known case in this connection is that of Eastern Airlines. A criticism that was often levelled at the traditional Chapter 11 arrangement was that debtors-in-possession spun out negotiations to their own advantage and thus weakened unsecured creditors. See C MacLachlan, *Blame Flies in Demise of Airline* 1991NAT'L L.J May at 1 in this connection. In the Eastern case , the unsecured creditors' shareholders ultimately received only 2.8 cents on the dollar of amounts owing to them.

examinership legislation for small- and medium-sized companies. The CLRG suggested that a largely non-judicial examinership process would be much more suitable for such companies.²²⁵ It was suggested that a good argument could be made for the proposition that “examinership lite” is just a pale shadow of what is really required.

Pre-pack examinerships may work for a limited number of larger companies cases as may pre-pack receivership, particularly if they were to become subject to the principles outlined in the Kempson Report. Another take-away – this time from the sections on Chapter 11 and BAPCPA- is that examinership could be enhanced, if it were to be facilitated by more timely diligence, investigation and resolution of disputed matters. This could be achieved in the US context by the presence of an *estate neutral* or in the Irish case by an independent professional arbitrator-that is, an individual who could be appointed depending on the particular needs of the debtor or its stakeholders to assist with certain aspects of the case. The appointment where necessary of such independent professionals was recommended by the ABI Commissioners.²²⁶

The next chapter, chapter 4, considers moratoria and related financing.

²²⁵ CLRG, *Company Law Review Group Annual Report 2013* DJEE, Dublin 2013.

²²⁶ American Bankruptcy Institute, *Commission to Study the Reform of Chapter 11* (2014) ABI Alexandria at Part 4.

CHAPTER 4

THE BUILDING BLOCKS OF CORPORATE REORGANISATION: MORATORIA AND RELATED FINANCING

INTRODUCTION

The team production theory of corporate reorganisation, like its major rival, creditors' bargain theory, is contractual in nature. One of its chief objectives is to determine what arrangements are economically efficient; it is presupposed that such arrangements would be chosen by contracting team members.¹ Chapter 11 is an economically efficient arrangement from the perspective of TPT advocates in a way that others are not or are so to a lesser degree. This argument has been developed earlier and will be continued in this chapter.² A key objective of TPT as applied to corporate reorganisation is to enable the company to continue as a business entity when it becomes bankrupt. Using the TPT yardstick of efficiency, the company should continue in business in cases where the total benefits to team members exceed those that would be available in the event of liquidation. The automatic stay in Chapter 11 or the moratorium in Administration and Examinership is an important enabler of company reorganisation and survival. It offers time during which the board of the debtor company in the US context or an agent of the court or the company (that is, the administrator) in the UK context can reach an accommodation with its creditors both with regard to the debts outstanding and the terms of their repayment and to the company restructuring.³ Both

¹ This argument is developed in Lynn LoPucki, "A Team Production Theory of Bankruptcy Reorganization"(2004) 57Vanderbilt Law Rev 741.

² See Chapter 1, page 48.

³ The rationale for the automatic stay has been expressed as follows:

The automatic stay is one of the fundamental debtor protections provided by the bankruptcy laws. It gives the debtor a breathing spell from his creditors. It stops all collection efforts, all harassment and all foreclosure actions. It permits the debtor to attempt a repayment or reorganisation plan, or simply to be relieved of the financial pressures that drove him into bankruptcy.

the mechanisms employed and the objectives aimed at by the designers of the moratoria systems are quite different. Chapter 11 is debtor-friendly, at least at the level of legislative intent, in a way that could not easily be said of Administration, for instance. This is fully reflected in the surrounding features of the two systems, such as who leads the moratorium at company level and what their priorities are. The moratorium model in examinership in Ireland fully reflects its hybrid nature as a formal reorganisation system. On the one hand, examinership approximates most closely to Chapter 11 in its details than does any other comparable corporate rescue system in Europe with the possible exception of Italy.⁴ In the intent of its drafters and in the judgements of the Irish courts, the examinership process displays a clear bias towards employment retention,⁵ although this is always balanced by a cautionary regard for company creditors. On the other hand, the moratorium arrangement employed in examinership displaces the management from decision-making in a manner found also in Administration. It is a pragmatic arrangement in accordance with section 520(4) of the Companies Act 2014 it has continued to conform to the intent of its practically-minded designers. It may simply be a mistake to look for too much consistency of principle in the details of the examinership legislation, because it deals with objectives that are not easily reconcilable. Team production theory, for its part, with its heavy emphasis on director primacy throws much light on central features of Chapter 11 such as the automatic stay, but less light on both Administration and Examinership.

The purpose of this chapter is to complete the analysis of the previous two chapters on plan drafting and on the negotiation and approval stages of formal company rescue by addressing the great enablers -that is the moratorium and the mechanisms by means of which new finance is made available to financially troubled companies. Section 4.1 offers a description

This is taken from HR Rep No 595, 95th Cong, 1st Session 340 (1977). It is detailed in G McCormack *Corporate Rescue Law- an Anglo-American Perspective* (2008) Edward Elgar, Cheltenham 156.

⁴ The Italian Bankruptcy Law of 2012, Article 161, paragraph 6.

⁵ See page 5 of thesis.

of the automatic stay in Chapter 11 (under the US Bankruptcy Code) together with a consideration of its efficient and inefficient aspects. This section also provides a full review of pre-petition finance related to Chapter 11. Section 4.2 relates to the moratorium and to financing of Administrations and *cvas*. The chapter continues in section 4.3 with comparable analyses of the examinership moratorium model and financing. Section 4.4 concludes the chapter.

SECTION 4.1: THE AUTOMATIC STAY AND PREPETITION FINANCING IN CHAPTER 11

As already noted, in Chapter 11 an automatic stay becomes operative immediately after the filing of the petition.⁶ As a result, secured and unsecured creditors are precluded from taking actions against the debtor or together engaging in a joint claim against the debtor.⁷ Secured creditors are obliged to put aside the earlier agreement with the debtor and extend an amount equivalent to the amount owing.⁸ The automatic stay together with the debtor-in-possession arrangement are intrinsic to Chapter 11. They are consonant with TPT (in the US context) in so far as together they highlight the independence of the directors from other parties. At the theoretical level, if not necessarily at the practical level, the directors do not hold office subject to the will of shareholders and creditors because of the reprieve of automatic stay.⁹ The shareholders— at least in theory- cannot take control of the board except in the most dire of circumstances. Some related requirements and other matters should also be considered. For

⁶ 11 U.S.C. 362.

⁷ Brian A. Blum, *Bankruptcy and Debtor/Creditor: Examples and Explanations*, (Aspen Publishers, 4th Ed. 2006) 236.

⁸ 11 U.S.C. 362. See also Thomas O Kelly III. “Compensation for Time Value as Part of Adequate Protection during the Automatic Stay in Bankruptcy” (1983) 50 University of Chicago Law Review 305.

⁹ The following reasons are given by L LoPucki, “ A Team Production Theory of Bankruptcy Reorganisation” (2004) 57 Vanderbilt Law Review 742 at 758: TPT during the automatic stay period, leaves the board with absolute control while limiting the creditors and shareholders to what is strictly theirs by entitlement. This implies that the team production contract which is not legally enforceable has priority over the legally enforceable claims of creditors as well as the interests of creditors. The board represents those all those who are subject to the Team Production contract. LoPucki argues that the reasons for this can be traced back to the distribution rights of creditors and shareholders. To support this position, LoPucki refers to the Delaware Chancery Court’s recognition that the board of directors are there to serve the community of interests and not just the shareholder interest.

instance, in Chapter 11, there is a requirement for “adequate protection” on the part of the debtor-in-possession for property rights holders.¹⁰ The term ‘adequate protection’ is not defined in the US Bankruptcy Code.¹¹ In practical terms, the class of creditors most adversely impacted by the automatic stay is usually the secured creditor, because the claims of that class of creditor are secured by the debtor-in-possession’s property.

That property is in any event subject to decline in value; in the context of the automatic stay, however, that cost is then borne by the creditor. As a quid-pro-quo for automatic stay, the US Congress saw fit to design a system that would provide relief from the terms of the stay.¹² For instance, a secured creditor can have an automatic stay lifted where both the following indicia are found: that the creditor’s claim against the debtor-in-possession is greater than the collateral and the collateral is not necessary to advance the re-organisation.¹³ Should the creditor be successful in the action, a liquidation of the debtor-in-possession can be sought. The automatic stay may also be lifted for cause, such as a lack of adequate protection of the creditor’s interest on the part of the debtor-in-possession.

¹⁰ 11 U.S.C. § 361

¹¹ USC Prelim current through pub. L.112-131 of the current US Congress offers the following guidance regarding the term “adequate protection”. Such “adequate protection “ could be provided by obliging trustees to make periodic payments to the entity; providing the trustee with an additional or replacement lien or granting other relief as an administrative expense other than any compensation allowable under §503(b)(1) of Chapter 11.

¹² 11 U.S.C. § 362(d) (Supp. II 1984). Section 362(d) provides:

On request of a party in interest and after notice and a hearing, the court shall grant relief from the stay provided under subsection (a) of this section, such as by terminating, annulling, modifying, or conditioning such stay

- (1) for cause, including the lack of adequate protection of an interest in property of such party in interest; or
- (2) with respect to a stay of an act against property under subsection (a) of this section, if-
 - (A) the debtor does not have an equity in such property; and
 - (B) such property is not necessary to an effective reorganization.

In a later finding – *Wright v Vinton Branch of Mountain Trust Bank of Roanoke* 300 US 440 (1937)- the US Bankruptcy Court, the new Frazier Lemke Act was found not to be unconstitutional. It stated that during stays on collection/foreclosure, mortgages are the property of the debtor not the creditor.

¹³ See footnote 11.

Section 361 of the Bankruptcy Code provides the following three examples of what may provide adequate protection of a party's interest in property: 1) a cash payment or periodic cash payments to the extent that the party's interest declines in value as a result of the debtor's actions; 2) an additional or replacement lien to the extent that the party's interest declines in value as a result of the debtor's actions; or 3) such other relief, as will result in the realization of the "indubitable equivalent" of an entity's interest in property. Sections 362 (automatic stay), section 363 (use, sale or lease of property) and section 364 (obtaining credit) of the Bankruptcy Code authorize a court to grant adequate protection of a party's interest in property. A party that succeeds in its plea is entitled to adequate protection of its bankruptcy interest, if the automatic stay prevents it from enforcing such interest. Section 363(e) of the Bankruptcy Code permits a party to seek adequate protection of its interest in property when a debtor seeks to use, sell or lease such property. Section 364(d)(1)(B) of the Bankruptcy Code requires a debtor to provide "adequate protection" to a creditor where the debtor obtains credit or other debt secured by a lien on estate property that is senior to the creditor's lien on such property. Thus, the debtor company is subject to major constraints in such matters.

There are many other forms of adequate protection. As a general rule, when "adequate protection" is granted in connection with the automatic stay, debtor companies are required to protect the collateral. Thus, "adequate protection" in an automatic stay context may take the form of simply requiring the debtor company to pay taxes, maintain insurance and keep current on senior indebtedness. Where "adequate protection" is granted in connection with the debtor's use, sale or lease of property, it may take the more active forms of periodic cash payments (such as the payment of a portion of rent on encumbered property) or additional or replacement liens (typically in connection with a debtor's use of cash collateral). When

granted in connection with the issuance of priming liens,¹⁴ the adequate protection granted to the primed creditor generally takes the form of additional and replacement liens and periodic cash payments (such as current interest).¹⁵

The rights of secured creditors may seem considerable until it is remembered that fixed creditors are limited to their bankruptcy entitlements.¹⁶ These rights do not negate any proposition in team production theory. While the secured creditors are the best positioned creditors to secure their interests, they are not all that powerful. For instance, in cramdown the most important bankruptcy rule is the following:

The condition that a plan be fair and equitable with respect to a class includes the following requirements....With respect to a class of secured claims....that each holder... receive...deferred cash payments... of a value...of at least the value of the holder's interest in the estate's interest in (the collateral).¹⁷

The valuation of that collateral is, however, determined in the context of reorganisation. That valuation is arrived at in relation to earnings and critically to earnings arrived at after payment of team entitlements.¹⁸ The critical point here is that none of this negates the validity of team production theory as an explanatory mechanism of Chapter 11 or the potential usefulness of the theory in other comparable contexts.

¹⁴ A priming lien is a lien on property senior to or with the same priority as existing liens on the same property. This can arise occasionally in debtor-in-possession financing. It is a last resort when the debtor is unable to obtain any other financing. And either the holders of existing liens consent or the debtors can demonstrate such secured creditors adequately protected from the diminution in value of their collateral as a result of the priming lien. This edited description is taken from Practical Law Thompson Reuters Legal Solutions last downloaded at <http://us.practicallaw.com/4-383-2771> on October 19th, 2014.

¹⁵ US Code 11 U.S.C. § 361; US Code 11 U.S.C. § 362 and US Code 11 U.S.C. § 363 last accessed at <http://www.law.cornell.edu/uscode/text/11/> on October 19th, 2014. For a consideration of adequate protection issues in Chapter 11, see P D Russin and R S Lubliner, "Selected Chapter 11 Adequate Protection Issues"(2008) Thirteen Annual B Southeast Bankruptcy Workshop last accessed at http://melandrussin.com/wp-content/uploads/2014/09/Business_Reorg_July_2008_Adequate_Protection_Selected_Issues.pdf on October 19th, 2014.

¹⁶ This argument is taken up by Lynn LoPucki, "A Team Production Theory of Bankruptcy Reorganization"(2004) 57Vand L Rev 761.

¹⁷ 11 U.S.C. § 1129(B)("A).

¹⁸ The relevant section is 11 U.S.C. §506(a). It reads:

Such value shall be determined in light of the purpose of the valuation and of the proposed disposition or use of such property, and in conjunction with any hearing on such disposition or use or on a plan affecting such creditors' interest.

With regard to “adequate protection” of under-secured creditors, the following may be said. The claims of such creditors are usually secured by depreciating property from the beginning of a reorganization until confirmation (where it applies).¹⁹ In the simpler cases, there will be no cash collateral or financing issues. Adequate protection in this context is taken to be an allowed secured claim which is equal to the value of the collateral at each key valuation date or an allowed secured claim equal to the value of the collateral at confirmation. An unsecured creditor is entitled to be protected during the period of the automatic stay.²⁰ This protection often takes the form of monthly cash payments equal to the estimated monthly depreciation, pursuant to 11 U.S.C. § 361(1). The under-secured creditor is not entitled to receive any additional compensation, directly or indirectly.²¹ The observations made just above in relation to secured creditors apply here also, but with greater force. The governing rule, that is 11 USC §1129(b)(2)(B), requires nothing more than that the reorganisation plan should arrange things such that unsecured creditors have absolute priority over shareholders. In the worst case, if shareholders receive nothing, anything more by way of provision to unsecured creditors complies with the rule.

If a party’s claim is greater than the value of its interest in property, the excess portion of the claim is unsecured and not entitled to protection. For many years, the US courts have been divided in their opinions²² as to what is and is not subject to protection during automatic stay.²³ It is clear from §361 that secured creditors are entitled to compensation in the event of

¹⁹ creditors see S Diamond, “Adequate Protection: The Undersecured Creditor” last accessed on 20th October at <http://sidneydiamond.com/adequate-protection-the-undersecured-creditor/>

²⁰ *United Sav. Ass’n of Texas v Timbers of Inwood Forest Assocs., Ltd.*, 484 US 365, 108 S. Ct. 626, 981; *In Re Reddington Sunarrow Ltd. P’ship* 119 B.R. 809 (Bankr DNM 1990).

²¹ *United Sav. Association of Texas v. Timbers Of Inwood Forest Assocs., Ltd.*, 484 U.S. 365, 108 S. Ct. 626, 98 L. Ed. 2d 740 (1988) and *In re Reddington/S Unarrow, Ltd. Partnership*, 119 B.R. 809 (Bankr. D.N.M. 1990).

²² *In Re Rimsat Ltd.*, 12F 3d 1039 (7th Cir. 2000); *In re Enyedi* 372 B.R. 327, 334 (N.D. Ill,1991); *In re Prairee Trunk Railroad* 125 B.R.. 217, 220-222 (N.D. Ill.2007); *In re Roete*, 936F.2d. 963, 965 (7th Cir. 1991) and *In re Price*, 42F. 3d 1086 (7th Cir.1994).) See also “Understanding the Automatic Stay of Bankruptcy for the General Practitioner” (2009) 22 *The Journal of the DuPage County Bar Association* (no page given) last downloaded at <http://www.dcbabrief.org/vol221109art2.html> on 9th December, 2015.

²³ 11 U.S.C. § 361

the decline in value through depreciation or otherwise of their interest.²⁴ The courts have not been of one mind, however, about whether or not § 361 provides for time value compensation where a foreclosure is not possible; this has sometimes impacted adversely on under-secured creditors.²⁵ This ambiguity in the legislation with regard to the rights and duties of creditors and debtors has made it possible for the Bankruptcy Code to be manipulated.²⁶

There are other statutory provisions related to automatic stay which can sometimes impair the debtor-in-possession in a reorganisation exercise. For instance, under §362(d) of the Bankruptcy Code it is possible for a ‘party in interest’, that is, a creditor, to have the stay lifted for specific reasons such as a lack of adequate protection. There is an ample body of case law²⁷ and legislation to the effect that the creditors’ contractual rights should not be disrespected. This way of thinking can have serious implications. It can sometimes happen that a particular property is critical to the reorganisation exercise and this can sometimes work against property-holders’ interests. Not unexpectedly, these adverse developments from the creditors’ perspective meets with strong opposition on the part of property-rights upholders. All of this is, however, reconcilable with team production theory as the advocates of that theory acknowledge the rights of creditors to disassociate themselves from a reorganisation exercise in the contractual re-Chapter 11 agreements.²⁸ The TPT advocates would tend to be of the view, however, that those creditors who opted for this approach would be in the minority.

²⁴ 11 U.S.C. § 361(1)(2)

²⁵ By contrast, over-secured creditors during the automatic stay are entitled to the contract rate of interest on the debt to the extent of the excess of security on the creditor’s part. This is in accordance with 11 U.S.C. § 506(b).

²⁶ M S Indelicato, “How to Survive a Failing Chapter 11: A Creditors Perspective” last downloaded at http://www.hahnhausen.com/uploads/39/doc/2002_06_msi_failingchapter110.pdf on 20th October, 2014.

²⁷ HR Rep No595, 95th Congress, 1st Session 339 (1977). In *Re Bermac* (1971) 445 F2d 367 the court noted the concerns of creditors who were conscious that their security could depreciate to a point beyond salvaging.

²⁸ Lynn LoPucki (note 1) 757. On the matter of convoluted contracts which are designed to protect the creditor from the effects of corporate insolvency see Steven L. Schwarcz, “The Alchemy of Asset Securitization” (1994) 1 *Stan. J.L. Bus. & Fin.* 133.

Moreover, on reviewing both the House and Congressional debates on the Chapter 11 Bill and the salient cases, it is difficult to avoid the conclusion that both the legislators and the courts sought pragmatic solutions based on compromise. This can help to explain inconsistencies in the legislation and the flexible approach adopted by the courts. For instance, in the far-reaching *Briggs Transportation* decision,²⁹ it was found that a court in determining adequate protection questions must reconstruct the creditor's bargain – that is, the conventional understanding of credit contract terms – so as to meet the parties' legitimate expectations.³⁰ One of the challenges of the decision is that it leaves open the question whether or not a reasoned approach approximating to a decision-tree system should apply or whether it should be an ad hoc approach. While the court reemphasised the importance of the creditors' bargain on the one hand, it also held to the more neutral position adopted by the US Congress in the Chapter 11 debates in 1978.³¹ That has the following implications. The judicial view in *Briggs Transportation* is that the congressional debates approved a neutral position as found both in *Re Bermec*³² and subsequent cases³³ and in subsections 361(1) and (2) of the Bankruptcy Code. The *Briggs* opinion seemed to work against creditors in that the United States Bankruptcy Court (D) Minnesota viewed subsections 361(1) and (2) as demonstrating that "creditors may at times be unable to obtain compensation for their interests in collateral above the lien or salvage value of that property."³⁴ When, alongside this, §361(3) is considered in light of the debates in the House of Representatives and the Congress, it can be concluded that § 361(3) is really a compromise solution. It does not put in

²⁹ *Briggs Transp.*, 780 F.2d 1345-46.

³⁰ *Briggs Transp.*, 780 F.2d 1345-46.

³¹ H R REP. No. 595, 95th Cong., 2d Sess. 339 reprinted in 1978 U.S. CONG. & ADMIN. NEWS 5963, 6295.

³² *Re Bermec*, 445 F.2d 367. The court quoted *Re Bermec*: "We are conscious of the deep concern of the manufacturing secured creditors lest their security depreciate beyond adequate salvage, but we must balance that with the congressional mandate to encourage attempts at corporate reorganization where there is a reasonable possibility of success." *Briggs Transp.*, 780 F.2d at p1345.

³³ *In re American Mariner Indus., Inc.*, 734 F.2d 426, 435 (9th Cir. 1984). T Anderson, "Adequate Protection of Opportunity Cost after *Re Briggs*" (1986) 19 Creighton Law Review 775 at 769.

³⁴ *Bermec*, 445 F.2d. id.

question what rights are to be protected, but rather the manner in which that goal is to be effected.³⁵

This prompts reconsideration of the meta-bargaining among the interested parties about the details of the Bankruptcy Code prior to its enactment. Vis-à-vis §361, the secured creditors would seem to have bargained from a position of strength. This, however, may not have been entirely the case. This was because the creditor interests were not cohesive and logically positioned to meet the political and ideological interests often external to the insolvency/bankruptcy context or at least they were not so positioned in the early stages of negotiation³⁶ The lack of control of the political environment, as perceived by the secured creditors promoted uncertainty on their part and a willingness to compromise, however reluctant the move towards compromise may have been for them. From their perspective, the gains they could have made by insisting on the fulfilment by the debtor company of their contractual obligations would probably have been lost in the procedural and administrative dimensions of Chapter 11 practice. If they were to insist on the absolute priority rule, they would inevitably have sparked conflict with creditors below their ranking. The transaction costs of resolving conflicts would in any given instance deplete the assets of a company in Chapter 11. For the secured creditors it made sense to compromise, in view of their disgruntlement with the existing bankruptcy system.

4.1.1: EFFICIENT ASPECTS OF THE AUTOMATIC STAY

When the automatic stay is considered, it is a relatively simple task to reconcile the team production contract with Chapter 11. This is because the automatic stay enables the team production contractual system to survive into the re-organisation phase almost unscathed. The

³⁵ US House of Representatives, Congressional Record – House May 20th, 1976 at 14928 and 14931. These questions are examined in T Anderson, “Adequate Protection of Opportunity Cost” (1985-1986) 19 *Creighton Law Review* 765. See also 124 Cong. Rec. H11089 (1978) and 1978 U.S. Code Cong. And Ad. News at p 6444.

³⁶ This is considered in Bruce G Carruthers and Terence C Halliday, *Rescuing Business: the Making of Corporate Bankruptcy Law in England and the United States* (1998) Clarendon Press, Oxford 166.

directors continue to enjoy wide latitude in business decisions, because of the operation of the business judgment rule.³⁷ The automatic stay is thus efficient in that it provides a basis for and helps to stabilise the Chapter 11 process. It conserves the value of the company and rationalises the administrative costs. It shields the debtor company from predation or possible break-up.³⁸ It promotes orderly arrangements without which creditors individually would be likely to engage in particular legal actions which would be detrimental to all parties. Automatic stay thus provides the basis for the collective procedure. Moreover, the team production contract entered into when the company came into being allows for recourse to bankruptcy reorganization. It follows directly that TPT partisans accept the terms of current bankruptcy law.³⁹ The automatic stay is also an enabler in a second sense, because by leaving the board in full control of the company while restricting creditors and shareholders to their bankruptcy entitlements, it prioritises team entitlements.⁴⁰ That is to say that the non-legally enforceable entitlements of team member have an enhanced status at law vis-a-vis those of creditors and shareholders. The automatic stay provides support for the contention that keeping a company in being is an independent policy of the US bankruptcy system – that is, independent of the most stringent criteria employed by partisans of the creditors’ bargain theory.⁴¹

4.1.2: INEFFICIENT ASPECTS OF THE AUTOMATIC STAY

From a creditor perspective, one of the reassuring things about the present arrangements is that before a plan can be confirmed it must provide details about how repayments which are

³⁷ *NLRB v. Bildisco & Bildisco*, 465 U.S. 513, 523 (1984).

³⁸ For a slightly different perspective on team production theory see P C Costant, “Team Production and the Progressive Corporate Law Agenda” (2002-2003) 35 U.C. Davis L. Rev. 667. For a countervailing and dismissive approach to tpt see G W. Dent Jr, “Academics in Wonderland: The Team Production and Director Primacy models of Corporate Governance” (2007-2008) 44 Hous. L. Rev. 1213.

³⁹ Lynn LoPucki (note 1) 757.

⁴⁰ Blum (note 4) 238.

⁴¹ Thomas Jackson *The Logic and Limits of Bankruptcy Law* Cambridge MA, Harvard University Press, 1986 25.

equal to the present value of the creditor's secured claim will be made.⁴² In the relevant cases, this position has been arrived at in part by making use of a creditors' bargain model.⁴³ Moreover, the legislative history of section 361 of the Bankruptcy Code employs language which highlights the importance of protecting the creditor's bargain, but to a degree less than Jacksonian creditors' bargain theory would demand. Nevertheless, the protection afforded by the US Congress is at least that available in cramdown. From a TPT perspective, however, matters are viewed differently. Given that the board remains in control and that the creditors and shareholders are limited to their bankruptcy entitlements (again using the US terminology), the TPT advocates contend, Chapter 11 in effect prioritises the entitlements of team members – entitlements, moreover, which are non-enforceable- over the formal claims of creditors and shareholders. Those competing propositions can be reconciled, but in questions relating to adequate protection for creditors ambiguity can still occur. What increases this ambiguity is the possibility of a judicial ad hoc approach following the *Re Briggs Transportation* precedent which was discussed above.⁴⁴ Nevertheless both § 361(3) and the *Briggs* interpretation of it is a working compromise. That is to say, the decision clearly points to the court's acceptance of the bargain theory of adequate protection "as requiring something more than the maintenance of the collateral's liquidation value during the period before the confirmation of a plan."⁴⁵ On the other hand, the decision indicates a

⁴² 11 U.S.C. § 1129(b) (1982 & Supp. II 1984). Section 1129(b) states conditions under which the court may confirm a proposed plan even if the plan is rejected by one or more classes of creditors. Section 1129(b)(2) (A)(i)(II) sets forth one condition:

That each holder of a claim of such class receive on account of such claim deferred cash payments totalling at least the allowed amount of such claim, of a value, as of the effective date of the plan, of at least the value of such holder's interest in the estate's interest in such property.

⁴³ In *Re Briggs Transportation* 780 F.2d 1339 (8th Cir. 1985) at p1349; *Grundy Nat'l Bank*, 754 F.2d at 1440-41 and in *In re Vanas*, 50 Bankr. 988 (Bankr.E.D. Mich. 1985). In *Re Briggs Transportation* at p1349, trial courts were "directed to reconstruct the creditor's bargain and to determine which interests are entitled to adequate protection during the pendency of the automatic stay."

⁴⁴ In *Re Briggs Transportation* 780 F.2d 1339 (8th Cir. 1985). See page 219 of thesis.

⁴⁵ T Anderson, "Adequate Protection of Opportunity Cost" (1985-1986) 19 Creighton Law Review 778.

rejection of the larger claims of the Jacksonian creditors' bargain theory⁴⁶ and the *American Mariner* case.⁴⁷

There are, however, some significant areas where the debtor-in-possession (the company) is vulnerable and which are not efficient from a TPT perspective. For instance, it may happen that the valuation of a creditor's claim can be higher than the liquidation value. On matters related to valuation, the question is resolved with reference to §1129(b)(A)(i)(2) of the Bankruptcy Code.⁴⁸ This is a compromise arrangement that can work against the interests of the debtor-in-possession.⁴⁹ §1129(b)(A)(i)(2) of the Bankruptcy Code requires that each class of secured claims retain the liens securing such claims and that each holder of a claim receive cash payments at least the allowed amount of such claim. In addition, an unsecured creditor will probably, under the terms of 1129(b)(2)(B)(i), receive limited payment on an unsecured claim in a case where opportunity cost protection is pleaded. What this also means in practice is that the secured creditor will obtain more from a corporate reorganisation plan than would be obtainable when the adequate protection question was determined.

⁴⁶ Thomas Jackson *The Logic and Limits of Bankruptcy Law* Cambridge MA, Harvard University Press, 1986 25 and D G Carlson, "Bankruptcy Theory and the Creditor's Bargain" (1992-1993) 61 *University of Cincinnati Law Review* 453. The central argument of Creditors' Bargain Theory is cases where bankruptcy arises, the creditors are entitled to anything that everything that remains. To this way of thinking, a corporation exists solely to serve the interests of the creditors. In addition, the mode of operation of the corporation should be such as to maximise the interests of the creditors. Involvement of other parties in this arrangement is held to move the business entity towards inefficiency.

⁴⁷ For a consideration of some of the issues surrounding *In re American Mariner Industries Inc. Crocker National Bank v American Mariner Industries Inc* 734 F.2d 426 see T C Swanson, "Time Value Compensation as Adequate Protection in 11 USC Section 361" (1987) 22 *Valparaiso University Law Review* 191 and J E Babcock, "Some Common Issues involved in Oil and Gas Bankruptcies: A Primer for the Non-Bankruptcy Practitioner" (1986) 46 *Louisiana Law Review* 763. See footnote 34 on page 220 of this thesis.

⁴⁸ §1129(b)(A)(i)(2) of the Bankruptcy Code. For the relevant House debates on the provision, see S. Rep. No. 989, 95th Cong., 2d Sess. 54.

⁴⁹ As fiduciary debtors-in-possession under §1129(b)(A) negotiate terms for payment of secured claims under the restructuring plan. One of the key areas of contention relates to how long a debtor can stretch repayments to a secured creditor and how the present value of the secured claim is determined. It is advantageous to debtor companies, if they can stretch these repayments out for first lien creditors to as much as 7.5 years, but this does not always happen. A major case in recent times on these and related matters is *Momentive Performance Materials and its affiliated debtors US Bank Nat'l Ass'n v Wilmington Savings Funds Society FSB (in re MPM Silicones, LLC)*, No 14-7471, slip op (S D N Y. May 4th, 2015). This case related to cramdown, interest rates, the availability of a make-whole premium, third party releases and the extent of subordination of senior subordinated noteholders.

Overall, there is a reconciliation of both parties interests: the creditors receive an amount equal to the present value of their secured claims and the debtor corporation board remain in control on the understanding that the creditors will obtain only their bankruptcy entitlements.

SECTION 4.2: PRE-PETITION FINANCE

Unlike the situation in the UK, the US Bankruptcy Code facilitates the provision of further financing for companies in Chapter 11.⁵⁰ This often involves changing to some degree the claim priorities of existing creditors vis-à-vis the new creditor (where such exists) so as to provide an incentive to the new creditor - that is, the provider of new finance (where that party is other than an existing credit institution). There are two major possibilities open to the debtor-in-possession. The first one is to obtain finance which is afforded a priority level equal to that of the administrative expense. This type is known as a “defensive loan” and is usually offered by an existing institutional lender.⁵¹ The second possibility for the debtor-in-possession is to seek court approval for the finance provider to have administrative expense priority. This effectively means that the finance provider will have a priority greater than that of an administrative expense. The two alternatives within this general option are as follows: the credit institution can be provided with a lien on encumbered assets or with a lien on encumbered assets inferior to that of existing creditors (“offensive lending”).⁵² Clearly, the conditions required by creditor institutions who are prepared to provide new finance are such as to put in question at least at the margins the security of those who had existing liens in a company going through Chapter 11. The test applied here is one which measures the

⁵⁰ David A. Skeel, Jr. “The Past, Present and Future of Debtor-in-Possession Financing” (2004) 25 *Cardozo Law Review* 1905 and G W. Kuney, “Hijacking Chapter 11” (2004) 21 *Emory Bankr Dev Journal* 19.

⁵¹ It may be motivated on the institutional lender’s part to have some control over the bankruptcy process.

⁵² Offensive lending can be from a new institutional lender or an existing institutional lender who acquired their pre-petition debt in the expectation that the debtor company would be filing for bankruptcy. The goal of the “offensive debtor” may be to acquire a controlling stake in the financially stricken company by converting the debt owing into new equity.

company's existing collateral. If the collateral can provide adequate protection of the existing creditors' interest, the court can approve the new funds arrangement.⁵³ What often happens in practice is that a financial institution that is a major existing creditor to the corporation will, in favourable circumstances, provide the new finance. This type of contract has many attractive features from the perspective of the creditor. This is discussed below.⁵⁴

4.2.1: THE EFFICIENT AND INEFFICIENT ASPECTS OF PRE-PETITION FINANCE

The key principle of corporate reorganisation is that a company may have a higher value if it is kept in being as opposed to being sold off piecemeal. This principle is acceptable to most contractarian theorists: it is compatible with the view that companies exist solely for the benefit of creditors and shareholders. This is not the view of team production theorists. They take a stronger line. They consider that in the team production context, creditors and shareholders agree to subordinate their claims in favour of an objective of keeping the corporation going.⁵⁵ This is not to say, however, that strict legal entitlements of creditors for instance would not be recognised by a debtor-in-possession in a Chapter 11 context. The team production contract entered into when the company begins operation allows for the possibility of the creditor opting for bankruptcy reorganization. As a consequence of that, the

⁵³ James J. White, "Death and Resurrection of Secured Credit" (2004) 12 Am. Bankr. Inst. L. Rev. 139. See *In re Snowshoe*, 789 F.2d 1085, 1090 (4th Cir. 1986) (This approved the lower court's decision to permit trustees to get additional finance. It was a condition of the contract that the new creditor would obtain a senior lien on the existing property of the company in accordance with §364(d). This was objected to by a senior creditor. Counsel for the senior creditor argued that the client's interest were not adequately protected.. See also *Anchor Savings Bank FSB v. Sky Valley, Inc.*, 99 B.R. 117, 119 (N.D. Ga. 1989) (This case involved approval by a district court of a decision by a bankruptcy court. The case related to super-priority finance. A major existing creditor had a first priority security interest on collateral worth \$8 million. This was to protect a loan of \$3 million. They objected to a proposed plan for additional finance. The substance of the objection was as follows. The debtor-in-possession was so hedged about with encumbrances that it no longer had any property rights in the company. In addition, the company's cash flows were negative and that it had little capacity to reorganise. The district court, however, determined that there was sufficient equity cover. The financing arrangement went ahead.

⁵⁴ At this stage a majority of the candidates for pre-petition finance are large corporations; many smaller companies fall by the wayside in the Chapter 11 process. These last either opt for a Chapter 7 solution or go into liquidation.

⁵⁵ Lynn LoPucki (note 1) 758.

provisions of the Bankruptcy Code are fully accepted by TPT advocates.⁵⁶ More specifically the objective of the debtor-in-possession is to obtain plan confirmation and a critical part of that relates to obtaining pre-petition finance. Given the challenges for most companies of obtaining that finance, the present pre-petition system would seem to be sophisticated and to a degree – from a TPT- perspective- efficient.⁵⁷ The difficulty with this or rather the inefficiency from a team production viewpoint is that it necessarily displaces the debtor-in-possession company board from the control position. The new finance provider dictates to the board what they can and cannot do in major business decisions. They report directly to the finance provider on a frequent basis. The board members are moreover incentivised to go along with the arrangements during the Chapter 11 process: their position is thus compromised in cases where they accept the incentives from the finance provider.

Thus the pre-petition financial arrangement is in most cases so structured that when the DIP candidate embarks on the Chapter 11 pathway, the new finance will already have been secured. In the literature on team production theory, it is sometimes said that the board is displaced only when the company ceases operating or when it is sold to a buyer who does not contract to go along with the existing team contracts.⁵⁸ That, however, does not account for that which is usually the case in a pre-petition finance scenario. It is difficult to avoid the conclusion that the board is simply dispossessed in this kind of scenario.⁵⁹ On the other hand, a single identifiable creditor institution which provides new finance may in any given case be difficult to identify. Negotiation of new finance in Chapter 11 as in so many other aspects of

⁵⁶ Lynn LoPucki (note 1) 757.

⁵⁷ The pre-petition model operative in the U.S. has been used as a template (among many others related to insolvency law) in the UNICTRAL Legislative Guide to Insolvency Law (2004). The model's designers are clearly influential. In this connection, see also the European Bank for Reconstruction and Development (EBRD) 10 Core Principles whose architects take their inspiration from the U.S. system. The 10 Core Principles are available at <http://www.ebrd.com/country/sector/law/insolvency/core/principle.pdf> They were last accessed on May 21st. 2013.

⁵⁸ L Lopucki, "A Team Production Theory of Bankruptcy Reorganization"(2004) 57V and L Rev 781.

⁵⁹ This is taken up by Steven J Lubben in S J Lubben, "The "New and Improved" Chapter 11" (2004-2005) 93 Kentucky Law Journal 4.

the Chapter is necessarily a collective exercise involving many parties. A secured creditor such as a financial institution willing to provide new finance cannot press their interest too forcefully as they may antagonise critically important unsecured creditors. For instance, if an unsecured creditor who provides critically important components to a corporation is treated preemptorily in Chapter 11, that unsecured creditor can remove the possibility of safe passage through the restructuring process for the debtor-in-possession. If that should happen, it would be to the detriment of both the pre-petition finance provider and the other creditors. A collective process involving much negotiation can serve to overcome some of these difficulties. It can also enable the continued existence of the corporation within and beyond Chapter 11. In cases where the board of the DIP is obliged to relinquish decision-making power to a single new finance provider, however, the TPT principles are simply cast aside in favour of conventions set by corporate financial interests.

Briefly stated, the conclusion here is that the DIP will most likely become a hostage to fortune, if new finance is required. If that finance comes from more than one source and if all parties are dependent upon the input upon the strategically important unsecured creditor, the difficult circumstances of the DIP may be somewhat eased.

SECTION 4.3: THE UK CONTEXT – MORATORIA AND FINANCIAL MATTERS

In the UK, the moratorium takes effect from the date on which an application is made to the court for the appointment of an administrator or when the notice of appointment of the administrator is filed at court in the out-of-court procedure.⁶⁰ It is not completely accurate to say that the moratorium stays all litigation (including the continuation of any pre-existing actions) and that it prevents the enforcement of judgements and of security without the leave of the court or the consent of the administrator. It is more correct to say that it provides a partial shield against enforcement actions for some.

⁶⁰ Schedule B of the Insolvency Act, 1986.

The moratorium does not provide a context in which a debtor company is not obliged for a time to pay its bills as they fall due.⁶¹ The moratorium begins when the administrator is appointed.⁶² This contrasts with the legislation which was in place before 1986: in times past, the moratorium commenced when the administration petition was presented to the court. It is very evident that a debtor company is vulnerable in the period immediately prior to their obtaining of an administration order: creditors can quickly move in to enforce their interests. An interim moratorium is obtainable to ward off this possibility. This covers the period between the submission date of the application and the assent or not by the court to administration⁶³ and the period between the initial filing and the time when the administrator takes office.⁶⁴ The power of the interim moratorium is very similar to that of the full moratorium as the provisions in the latter are applicable.⁶⁵ On a point of detail, an interim moratorium will not be brought into being in cases where there are no parties to be informed through court notice regarding the appointment of an administrator.⁶⁶ This can have serious implications: the company is vulnerable to adverse actions on the part of creditors while the documents are being put together. There are other gaps. As originally drafted, the moratorium in insolvency law did not interfere with the autonomy of the directors until the administration order became operative.⁶⁷ This relates to the period between the filing of the relevant

⁶¹ Ian Fletcher, Gavin Lightman Gabriel Moss and Hamish Anderson *The Law of Administrators and Receivers of Companies* 5th ed Sweet and Maxwell London 2011. para 2.040.

⁶² Schedule B of the Insolvency Act, 1986.

⁶³ Paragraph 27(1) of Schedule B1 to the Insolvency Act 1986.

⁶⁴ Paragraph 44 of Schedule B1 to the Insolvency Act 1986. Under paragraph 44(2) , the interim moratorium from the time of notice of intention to appoint has been filed with the court until a period of five business days following the filing.

⁶⁵ Paragraphs 43 and 44 of Schedule B1 to the Insolvency Act 1986 are applicable in the interim moratorium. The reference in those paragraphs to the administrators are inapplicable in the interim bankruptcy context. On a point of detail, an interim moratorium will not be brought into being in cases where there are no parties to be contacted so as to announce the appointment of an administrator. This last is considered by Le Sealy and D Milman *Annotated Guide to the Insolvency Legislation 2012 Vols 1 and 2* 19th edn 2012 Sweet and Maxwell 597.

⁶⁶ See L Sealy and D Milman, *Annotated Guide to the Insolvency Legislation* (2012) Vols 1 and 2 15th edn Sweet and Maxwell 597.

⁶⁷ Paragraph 19 of Schedule B of the Insolvency Act 1986.

documents with the court clerk and the formal appointment of an administrator.⁶⁸ There is, however, a provision in the Insolvency Act 1986 which partially covers the omission. It makes it possible for the court to limit by order the control exercised by management in their corporate capacity.⁶⁹ It works as follows : the order applies at the administrative hearing stage and more specifically in cases where there is no immediate determination of the administrative application one way or the other.⁷⁰ There is a deterrent against a director breaching their fiduciary duties in this context, given the stringent directors' disqualification regime.⁷¹

The full moratorium eliminates the possibility, save in cases where the administrator or the court agrees to it, of enforcement actions in property cases; repossession of goods; the landlord's right of re-entry and other actions against the debtor.⁷² Critically, however, it is not absolute. It has been observed that the United Kingdom differs from the US on such things as the assertion of property rights in a formal restructuring context.⁷³ Paradoxically, in view of what has been said earlier about Chapter 11, the legal mechanisms and practices in the US are such that property rights can be confidently asserted and recognised by the courts; in the UK, matters are more fluid – they are left to judicial discretion.⁷⁴ In addition, while the legal culture in the UK is creditor-friendly, there has been little in the way of theory related to property rights and moratoria.⁷⁵ There have, however, been important judicial decisions on this topic. *Re Atlantic Computer Systems plc* set forth the principles to be considered in

⁶⁸ This was referred to in R Pennington *Corporate Insolvency Law* 2edn (1997) Oxford University Press 361 in the nineties. Pennington stated that the directors could be called to account, if their behaviour amounted to a breach of their fiduciary duties.

⁶⁹ Para 13(3)a of Schedule B 1 of the Insolvency Act, 1986.

⁷⁰ Para 13 of Schedule B 1.

⁷¹ See section 4 of the Company Directors' Disqualification Act, 1986.

⁷² Paragraph 43 of Schedule B1 to the Insolvency Act 1986.

⁷³ G McCormack *Corporate Rescue Law- an Anglo-American Perspective* Edward Elgar, Cheltenham, 2008 at 145

⁷⁴ G McCormack *Corporate Rescue Law- an Anglo-American Perspective* Edward Elgar, Cheltenham, 2008 at 157.

⁷⁵ See the Insolvency Service document on Administration at <http://www.insolvencydirect.bis.gov.uk/technicalmanual/Ch49-60/Chapter%2056-1/Part%205/Part%205.htm> last downloaded on 21st October, 2014.

judging whether or not a creditor's property rights should be upheld.⁷⁶ The principles were these:

- it falls to the person who seeks leave to provide sufficient reasons to the court that s/he be given leave
- if granting leave is not likely to impede the purpose of administration, it should be granted in most cases
- in some cases it will be necessary to balance the interests of the applicant and the interests of the other creditors of the company⁷⁷
- judicial consideration of property interest should be a major feature of the case
- in the ordinary way, it will usually constitute sufficient ground for leave by the court, if significant loss would otherwise result. In cases where the grant of such leave would cause disproportionate loss to others vis-à-vis the applicant for leave such as to outweigh the gain to the applicant, the leave may be refused
- in determining the losses described above, the court will consider the following: the financial status of the company; the content of the administrator's proposals; the period of the moratorium already past and the expected duration of the moratorium; the consequences for the administration if leave were given; the consequences for the applicant if leave were refused; the specific objectives of the administration and the likelihood of those objectives being achieved given the events central to the administration to date.
- a court may allow an action to be undertaken or continued against a company if a given condition or requirement is complied with.⁷⁸

When these matters are being considered, it is often necessary to calculate the probability of the envisioned consequences. In *Magical Marking Ltd & Another v Ware & Kay LLPL*.⁷⁹ the High Court was prepared to grant leave. In that case, the following factors were taken into account in the determination: that the claim was based on property rights and that there were other defendants to the claim and the proceedings were close to trial. It has been suggested

⁷⁶ *Re Atlantic Computers plc* [1992] 1992 Ch 505. "The Court of Appeal held that the computers could not be directly repossessed. In addition, the landlords and hire purchase sellers could not get money as an expense of administrative receivership either, because 'the lessor or owner of goods has his remedies'."

⁷⁷ This principle was again restated by the Court of Appeal in *Innovate Logistics Ltd v Sunberry Properties Ltd* [2008] EWCA Civ 1321; [2009] BCC 164. In that case leave was not granted because the result could have caused the debtor company to decrease in value. That event would have undermined the purpose of the administration.

⁷⁸ Paragraph 43(7) of Schedule B1 to the Insolvency Act 1986.

⁷⁹ *Magical Marking Ltd v Ware & Kay LLP* [2013] All ER (D) 218.

that there is (despite what has been written above) an amount of uncertainty on the part of the judiciary about what is and is not covered by the moratorium.⁸⁰ For instance, it was expressed *obiter* in *Air Ecosse Ltd v Civil Aviation Authority*⁸¹ that proceedings could run only in cases where the plaintiff was a creditor. This view was later rejected in *Re Rhondda Waste Disposal Ltd*.⁸²

The company voluntary arrangement as originally designed did not provide for a moratorium⁸³. What happens in practice today in most cases is that the procedure is usually combined with Administration.⁸⁴ This combined arrangement is expensive. Section 1A of and Schedule A1 to the Insolvency Act 1986 has been introduced to lessen this problem. It has application to a limited number of companies.

4.3.1: EFFICIENT AND INEFFICIENT ASPECTS OF UK MORATORIA

A review of the parliamentary debates relating to the Insolvency Bill 1985 that finally became the Insolvency Act of 1986 causes the reader to appreciate the fundamentally different legal, institutional and commercial culture of the UK in comparison to that of the United States.⁸⁵ UK moratoria are really enablers of what in most instances are corporate recycling exercises. This raises the question of exactly what company moratoria in the UK are for. The question can be asked: 'can recycling exercises be included in the corporate restructuring category?' Davis has answered this as follows:

⁸⁰ Gerard McCormack *Corporate Rescue Law- an Anglo-American Perspective* Edward Elgar, Cheltenham, 2008 159.

⁸¹ *Air Ecosse Ltd v Civil Aviation Authority* [1987] 3 BCC 492.

⁸² *Re Rhondda Waste Disposal Ltd* [2001] Ch 57.

⁸³ There is one exception to this. Loubser observes that s 233 of the Insolvency Act precludes a supplier of gas, electricity, water or communications services from insisting that payments must first be made for amounts outstanding at the start date of the CVA before further supplies can be made available. A Loubser, *Some Comparative Aspects of South African Rescue Law* (2010) PhD Thesis University of South Africa Pretoria

⁸⁴ The Insolvency Act 2000 introduced the provision for small companies (less than £5.7m turnover for example) in financial difficulty to make voluntary arrangements with their creditors by providing the option of a moratorium to give the firm's management time to put a rescue plan to the company's creditors.

⁸⁵ H.C., vol 458, 15th Jan 1985 col 876; H.L., vol. 459, 4th Feb. 1985, cols. 847-78 See Bruce G Carruthers and Terence C Halliday *Rescuing Business: the Making of Corporate Bankruptcy Law in England and the United States* Clarendon Press, Oxford 1998 293.

In my opinion the true meaning of a company rescue is the saving of an entity in whole or in part by satisfying in some measure its unsecured creditors and enabling the company to continue in business. This will also in some measure preserve employment.⁸⁶

A more nuanced analysis would allow for the following: the Enterprise Act has promoted the idea of corporate rescue as the “default model” and has done so in a manner unlike the legislation which has gone before.⁸⁷ To that extent there has been a move at least ostensibly towards what obtains in Chapter 11 (at least as originally envisaged). Whether or not this new objective in UK corporate reorganisation is purely aspirational is quite another matter.⁸⁸ The move from informal workouts to formal moratoria in company rescue exercises has worked to the advantage of certain parties. In a context of much economic, institutional and political change from the late-1970s onwards, the swirl of events has offered opportunities and dangers to differing interests. In the insolvency context, secured creditors lost out somewhat vis-à-vis unsecured ones. By contrast, lawyers have won out: the rigid and coercive form of the moratorium in administration has resulted in lucrative work for them.

An administrator can act in a decisive and swift manner that does not unduly require court activity. The work must be completed within one year. On the other hand, the costs involved can be very high. The procedure is only suitable for large companies. From a TPT perspective, moratoria are of limited value if the insolvency practitioner acting as practitioner views the company as a lost cause and develops strategy and tactics in line with that thinking.⁸⁹ Stand-alone CVA procedures with moratoria⁹⁰ in the UK, particularly in the retail

⁸⁶ Nicholas Davis, *The Rescue Culture in the United Kingdom* (London: HMSO, 1997) 2 Insolvency Litigation and Practice 3.

⁸⁷ The words ‘default model’ are employed by S Frisby in S Frisby, “In Search of a Rescue Regime: the Enterprise Act 2002” (2004) 67 Mod. L. Rev 249.

⁸⁸ S Frisby *In Search of a Rescue Regime: the Enterprise Act 2002* [2004] 67 Mod. L. Rev 2004 at p247.

⁸⁹ This is considered in S Frisby, “In Search of a Rescue Regime: the Enterprise Act 2002” (2004) 67 Mod. L. Rev 272.

⁹⁰ See ss 1-7 of the Insolvency Act 1986. A CVA allows a debtor company to make a proposal to its creditors to restructure its debts and, provided that a statutory majority of over 75% of creditors by value vote in favour of the CVA, it will have binding effect on all the company’s creditors, if not formally challenged. The usefulness of CVAs lies in their extreme flexibility, relative informality and speed. CVAs, unlike schemes of arrangement, are not court-driven processes.

sector are, however, a different matter and can be advantageous to employee team members.⁹¹

In summary, while a nuanced consideration of company restructuring in the UK must take account of positive developments from an employee perspective in the period since the Enterprise Act became law, it remains the case that the creditor interest remains the priority one in UK company restructuring law.

SECTION 4.4: PRE-PETITION FINANCE IN ADMINISTRATION AND CVAs

It is self-evident that that financially-ailing companies will die without new or redirected finance. The commitment to keeping a company in being where there are compelling commercial reasons for doing so and in instances where its valuation indicates that “the entity in itself will be greater than the sum of its parts” would seem to speak in favour of leaving the door open to new finance. This follows from a central proposition of TPT and it is the approach adopted in Chapter 11.⁹² Not so in the UK. There is little appetite in Britain for providing super-priority finance. For instance, the Department of Trade and Industry/ H M Treasury review of company rescue and business reconstruction mechanisms – a publication that preceded the Enterprise Act- signalled the overwhelming reluctance of the credit institutions to favour a policy of providing new finance in any one instance other than where the existing creditors agreed to it.⁹³ As an alternative, the credit institution side indicated that new finance could be provided where there were unsecured assets or secured assets that were not fully collateralised. Another key indicator of the predominant view among power holders

⁹¹ See the reference to the scheme fund arrangement in the Powerhouse case. This is detailed in H F Willan, “Will Company Voluntary arrangements become the UK’s most popular rescue Procedures?” last accessed at <http://www.inhouselawyer.co.uk/index.php/insolvency-and-corporate-restructuring/7937-will-company-voluntary-arrangements-become-the-uks-most-popular-rescue-procedure> on 21st October, 2014.

⁹² Lynn Lopucki (note1). Lopucki’s position is this: from the standpoint of efficiency, the debtor *should* remain in business if the total benefits to team members from continued operation exceed the total benefits to team members from liquidation. In other words, reorganization should occur when it benefits the members of the team in the aggregate.’ The beneficial nature of continued operations for team members will be assumed for the purposes of the argument here.

⁹³ DTI/ H M Treasury report last downloaded on May 30th, 2013 at http://www.insolvencydirect.bis.gov.uk/insolvencyprofessionandlegislation/con_doc_register/con_doc_archive/consultation/condoc/condocreport.htm

is that the House of Lords debates, the government did not allow for an amendment that would have made it possible for super-priority finance to have a statutory basis.⁹⁴ The view was taken there that it was better to have financial institutions determine the worthiness or otherwise of any given rescue candidate.

4.4.1: EFFICIENT AND INEFFICIENT ASPECTS OF FINANCIAL PROVISIONS IN ADMINISTRATIONS AND CVAs

What has been stated above in relation to UK moratoria also has relevance in relation to financial provisions. There are, however, some additional substantive points that are worth considering. It has been suggested that the Enterprise Act, at least by implication and at the margins, allows wide discretion to administrators in financial matters.⁹⁵ For instance, Schedule B1 of the Insolvency Act 1986⁹⁶ allows the administrator to deal with property owned by third parties which is within the company's control in a manner which s/he sees fit. With assets subject to a floating charge, the administrator is at liberty to sell them without consulting the owners and without hindrance by legal limitations within the charge documents. Where this happens, the holder of the floating charge retains the same priority on an asset which represents that which has been sold, although the chargee is entitled only to the proceeds after certain other liabilities have been paid⁹⁷ As regards assets which have a fixed charge or hire purchase goods, the administrator, subject to the court's approval, can

⁹⁴ Lord Hunt, who proposed the amendment expressed the view that the absence of a significant financial dimension in the Enterprise Act would guarantee its ineffectiveness. (Hansard: House of Lords Parliamentary Debates 29th July, 2002 at <http://www.parliament.uk/business/publications/hansard/lords/by-date/#session=66861&year=2002&month=4&day=29> last accessed on May 30th, 2013. Super-priority finance is understood to have application in corporate rescue context where existing assets have been employed as collateral. In such context, there is no incentives for new investors to provide finance. The enhancement of status can change all this for s a financial institution that is a major creditor. See further G McCormack *Corporate Rescue Law- an Anglo-American Perspective* Edward Elgar, Cheltenham, 2008 177. See also James J White 'Death and Resurrection of Secured Credit' Spring 2004 Am Bankr Inst Rev at p139. See also Karen Gross 'A Response to J J White's death and Resurrection of secured credit: Finding some Trees but missing the Forest. Spring, 2004 Am Bankr Inst L Rev at p203.

⁹⁵ G McCormack *Corporate Rescue Law- an Anglo-American Perspective* Edward Elgar, Cheltenham, 2008 at p195.

⁹⁶ Paras 70 and 71 of Schedule B1 of the Insolvency Act 1986.

⁹⁷ Insolvency (Settlement Finality) Regulations 1999 (SI 1999/2979), reg 14(6) 3 and Insolvency Act 1986, Sch B1 paras 70 and 71.

dispose of these, if this disposal advances the purpose of the administration.⁹⁸ Moreover, as regards bank accounts in credit, the administrator would most likely have the power to make use of a credit balance where the charge held by the bank is a floating charge.⁹⁹ More to the point, there are legislative provisions which allow for a robust contention to the effect that the administrator is an agent of the company rather than of the court.¹⁰⁰ This can have a positive consequence for employees of the debtor company during the period of administration, as will be seen below. As it is held in law that an agent of the company is not liable for a contract that s/he negotiates on behalf of the company (except where it is stipulated otherwise in the contract) this would seem to protect the autonomy of an administrator.¹⁰¹ In such a context, it is provided for in the Insolvency Act 1986 that the agent can accept liabilities which have arisen during the course of the administration.¹⁰² These liabilities may rank higher than an administrator's remuneration and expenses.¹⁰³ In this context, sums payable to employees have been acknowledged in a leading Court of Appeal case. In *Powdrill v Watson*, Dillon L J stated that:

Although strictly sums payable are under s 19(5) [of the Insolvency Act, 1986], only payable when the administrator vacates office, it is well understood that administrators will, in the ordinary way, pay expenses of the administration including the salaries and other payments to employees as they arise during the continuance of the administration. There is no need to wait until the end, and it would be impossible as a practical matter to do that...¹⁰⁴

Quite apart from the above, it is worth restating that UK banks which provide lending to commercial entities are fewer in number than their US counterparts and tend to be more

⁹⁸ *RE ARV Aviation Ltd* [1989] BCL 664.

⁹⁹ *Re Spectrum Plus Ltd* [2005] 2 AC 680. The legislative authority which the administrator can exercise is derived from Paragraph 70 of Schedule B1 to the Insolvency Act 1986.

¹⁰⁰ Under paragraph 5, Schedule B1, the administrator is an officer of the court. Under paragraph 69, however, it is stated that the administrator in office is an agent of the company.

¹⁰¹ Paragraph 69, Schedule B1 of the Insolvency Act 1986.

¹⁰² Paragraph 99, Schedule B1 Insolvency Act 1986.

¹⁰³ Section 19, Insolvency Act, 1986.

¹⁰⁴ *Powdrill v Watson* [1994] 2 All ER 531 These matters are discussed at length in G McCormack *Corporate Rescue Law- an Anglo-American Perspective* Edward Elgar, Cheltenham, 2008 at 197.

concentrated operations.¹⁰⁵ They do, however, have dedicated corporate lending departments that are markedly pro-active. A major characteristic of commercial lender company relations is the active intervention by commercial lender teams in the financial affairs of companies when problems arise.

SECTION 4.5: EXAMINERSHIP –THE MORATORIUM AND FINANCIAL MATTERS

Examinership approximates most closely to Chapter 11 in important respects. The moratorium is at the centre of this process.¹⁰⁶ The moratorium becomes operative when an interim examiner¹⁰⁷ is appointed to the company.¹⁰⁸ According to TPT, the team production contract continues while the company is in examinership. Most of the team members continue in their posts during the moratorium, although some may choose to leave the company. Case law is quite clear on the matter. Murphy J in *Re Eden Park Construction Ltd* stated that the examiner cannot:

usurp the functions of the board of the company over which he is appointed and it is the board or its officials who will continue to manage the business of the company during the period of protection and the continuance of the examinership.¹⁰⁹

In addition, adjustments of team member contracts by the board may be engaged in in certain instances. The team members do not, however, negotiate such matters – that is the task of the board. The shareholders have delegated the power to the board. That delegated power is,

OECD Policy Roundtables, “ Competition, Concentration and Stability in the Banking Sector (2010) OECD Paris at page 201 last downloaded on at <http://www.oecd.org/competition/sectors/46040053.pdf> on 3rd November, 2015.

¹⁰⁶ Section 2(2) of the Companies (Amendment) Act 1990 now section 509, Companies Act, 2014. The moratorium becomes operative from the time the court provides protection to the company in an examinership context. Moratoria and examinership are sometimes unavailable for reasons not so far considered. For instance, under the terms of s 4(7) of the Companies (Amendment) Act the court cannot appoint an examiner should an obligation exist on the company’s part in relation to a bank asset that has been transferred to the National Treasury Management Agency (NAMA).

¹⁰⁷ The relevant procedure is stated in Order 74A , S I No225 of 2015 last downloaded at <http://www.courts.ie/rules.nsf/8652fb610b0b37a980256db700399507/da9febb2304f708c80257e76004b4d59?OpenDocument> on December 10th, 2015.

¹⁰⁸ Companies (Act 12014, s509(7)). At the initial *ex parte* stage the court may in certain instances appoint an interim examiner. Ordinarily, the interim examiner is appointed in accordance with Ord 75A, r5(2).

¹⁰⁹ *Re Eden Park Construction Ltd* [1994] 3 IR 126 136.

however, somewhat compromised in the context of an examinership: to some extent the examiner becomes the controller of the company as it continues to trade, although the board members are not removed from office.¹¹⁰ The directors make everyday business decisions, but in all such matters they become subject to the power of the examiner. This contrasts with that which obtains in the United States when Chapter 11 re-organisations are undertaken: in these cases it is the board who put forward the plan of re-organisation. The board in such cases remains in control until one or other of the following scenarios occur: Chapter 11 is completed; the corporation is sold by the board or it ceases to trade. Where there is no default or where the creditors do not move against the board, the board alone decides if and when the team arrangement will no longer be operative. By comparison, the status of a board in an examinership context is much lower. The examiner alone negotiates a scheme of arrangement with creditors on behalf of the company. On the other hand, it is the board who in most instances initiate the petition for the appointment of an examiner. They may do so to remove the possibility of a receiver taking further action. An examiner is not an agent of the board, rather an examiner is a court appointee, but when appointed s/he seeks to preserve the business entity as a going concern and to maintain team production contracts.¹¹¹ In line with this approach, the moratorium in examinership serves to shield the company for an initial period of 70 days from any claims made by creditors.¹¹² The moratorium is no longer operative should the petition be withdrawn or should the court turn the petition down. The expectation is that in the event of an examinership, the examiner will report to the High Court within 70 days.¹¹³ This period may, however, be extended for a further 30 days. Where an extension is offered, the court must be confident that the examiner will complete a report in

¹¹⁰ For instance, under the terms of s524(2) and (3) of the Companies Act, 2014, the examiner can direct that board meetings take place, The examiner can, however, have all the powers of the board exercised by him or her (in accordance with s 524(2) of the same Act).

¹¹¹ There can be a potential conflict of interest should the person providing the independent report is appointed as examiner. In both cases, the person is paid by the company.

¹¹² RSC 1986, Ord 75A, rr5(2) and 6(2).

¹¹³ Companies (Amendment) Act, 2014, s 520(4).

the extra time.¹¹⁴ Often, the 70 day period is insufficient for the examiner's purposes. It is not possible to extend the period of protection beyond 100 days, except in cases where the examiner's report has been presented to court. It is, however, possible for the court to extend the period of protection beyond 100 days, so as to enable the court to determine whether or not it will approve the proposed scheme of arrangement.¹¹⁵ Unlike the Chapter 11 arrangement, examinership clearly does not leave a board in total command of a company's affairs during the moratorium period. It does, however, put a check on the claims of creditors and shareholders, at least in the interim. It can reasonably be argued that in Chapter 11 moratoria cases, by contrast, the debtor-in-possession alone negotiates a reorganisation plan subject to judicial supervision and limits the rights of creditors, at least in the shorter term. Team Production Theory is particularly good for accounting for these phenomena in the insolvency world. In a moratorium the team production contract upheld by the board has a higher priority (even where it is not legally enforceable) than the immediate claims of creditors.¹¹⁶ It is not reasonable to go so far as that when characterising examinership, because the board is given only limited autonomy although the availability of moratoria does suggest goodwill on the part of legislators and judges towards the examinership option.

4.5.1: EFICIENT ASPECTS OF THE MORATORIUM

The moratorium component of examinership is efficient because it provides the shield behind which the examiner as court agent can maximise the value of the company and rationalise the negotiation process. From a TPT perspective, efficiency is achieved if the following obtains: the debtor company remains in business because the total benefits to team members from the

¹¹⁴ Companies Act, 2014, s 534(3).

¹¹⁵ See *In re Tivway Ltd* [2010] 3IR 49 and *In re Michael McLoughlin Pharmacy Ltd and Another* [2011] IEH

¹¹⁶ LoPucki makes the point that as the board are left in full control and as the creditors and shareholders receive only what is theirs by right of their bankruptcy entitlements, the team production contract (which is non-enforceable) necessarily trumps the enforceable rights of the creditors and shareholders. He bases this argument on bankruptcy distribution rights as found in the "best interest test" and the 2cramdown test." L LoPucki, " A Team Production Theory of Bankruptcy Reorganisation" (2004) 57 Vanderbilt Law Review 741 at 758.

continuance of the business exceed the total benefits from liquidation. Another way of saying this is that reorganisation is a good idea in a best case scenario if it benefits the team members as a whole. Plainly expressed, the moratorium delays a scramble for company assets on the part of existing creditors. It facilitates a collective procedure. Both the moratorium within and the legislation on examinership taken together suggest, as does Chapter 11, that the objective of keeping companies in being is an independent policy objective.¹¹⁷

4.5.2: INEFFICIENT ASPECTS OF THE MORATORIUM

Team production theory is most fundamentally a “director primacy” theory.¹¹⁸ In the robust form of this theory directors “are not subject to direct control or supervision by anyone, including the firm’s shareholders.”¹¹⁹ To restate a critical point, in the TPT theory of the firm, neither shareholders nor creditors are in the driving seat. Each is simply a member of the production team. In the Chapter 11 context, when a public corporation makes a filing, the board act for the “debtor-in-possession.”(DIP). They remain in possession of the corporation and as the agent who operates the business. The DIP acts as a fiduciary for all relevant parties and the dip makes all necessary disclosures. Most saliently, the board put together and at the final stages implement a re-organisation plan. In addition, they negotiate the plan details with the interested parties and are the chief force in driving the plan forward. That does not describe the role of the board in the examinership process. The point needs to be conceded that the debtor-in-possession doctrine is perhaps a uniquely American phenomenon. The chief task of TPT is to throw light on why directors remain in control of even corporations that are grossly insolvent. TPT cannot be applied in any simple way to a moratorium arrangement in

¹¹⁷ This point is conceded by the supporters of Creditors’ Bargain Theory. T J Jackson *The Logic and Limits of Bankruptcy Law* Beard Books New York (1986) 25.

¹¹⁸ Stephen M. Bainbridge. “Director Primacy: The Means and Ends of Corporate Governance” (2003) *NWULEV* 547.

¹¹⁹ Margaret Blair & Lynn Stout, “A Team Production Theory of Corporate Law” (1999) *85 VA. L. REV.* 247 at 290.

an examinership. There is an inconsistency in the design features: the US and British features of reorganisation law are brought together in a pragmatic fashion in the examinership model. Perhaps the most positive thing that can be said about this pragmatism is that at least when an examiner is installed, the appointment can serve to signal to institutional and personal creditors that the debtor company's problems are at least being addressed. At a theoretical level, however, the surrounding details of an examinership moratorium are inconsistent with TPT, because they cannot be said to serve the team member interests as such or at least not so in a direct manner.¹²⁰ The moratorium is inefficient because they result in delays and the wasting of resources. From a creditor perspective the moratorium in examinership is usually less welcome than a quick and orderly liquidation.

SECTION 4.6: ON THE FINANCING OF EXAMINERSHIPS

It would seem that on first inspection the mechanisms and dynamics relating to the financing of a successful examinership offer serious challenges to those who would support the team production theory. This may, however, not be the case. Team production theory is sufficiently robust as to allow it to accommodate the formal obligations to creditors of whatever kind. Secured and unsecured creditors do have the capacity to insulate themselves from adverse financial scenarios such as the bankruptcy of some of their debtor clients, by means of asset securitisation or otherwise. More generally, it can be stated that the world of finance is a profoundly sophisticated one. Credit institutions do have the capability of making risk assessments of the market and of their individual clients, even if, for a variety of reasons, they do not always apply themselves to that task.¹²¹ Moreover, Ireland is a leading jurisdiction for the establishment of special purpose vehicles (SPVs). These financial engineering

¹²⁰ A moratorium is a feature of the redesigned scheme of arrangement mechanism under the Companies Act 2014, Part 9, Chapter 1 ss 449 – 454. Irrespective of the positive features they may have for some financially distressed companies, they are also incompatible with team production theory.

¹²¹ The securitisation process involves the isolation of a pool of assets or rights to a set of cash flows and the repackaging of the asset or cash flows into securities that are traded in capital markets.

arrangements can solve commercial funding needs, but they can be employed only by those who are fully aware of their potential downsides. These phenomena do not reflect everyday commercial practice in Ireland.

For institutional investors, the corporation is most usefully seen as a network of contracts that constitute and surround the corporation.¹²² It remains the case, however, for institutional and other creditors, that property rights must necessarily take precedence before all else. On the other hand, this way of thinking may not fully or adequately represent the views of the Irish judiciary - at least if some relevant judgments¹²³ are considered. Examinership in this perspective is more than a quasi-asset recovery exercise. The examinership approach has resulted in the saving of many thousands of jobs in Ireland in the past number of years and it can be seen as a credible and robust formal recovery mechanism. This approach was expressed by Clarke J in *Traffic Group Ltd* in the following terms:

It is clear that the principal focus of the legislation is to enable in an appropriate case, an enterprise to continue in existence for the benefit of the economy as a whole and of equal or indeed greater importance to enable as many as possible of the jobs which may be at stake in such enterprise to be maintained for the benefit of the community in which the relevant employment is located. It is important both for the court and, indeed, for examiners, to keep in mind that such is the focus of the legislation. It is not designed to help shareholders whose investment has proved to be unsuccessful. It is to seek to save enterprise and jobs.¹²⁴

Before an investigation is undertaken regarding this, it may be helpful to frame matters in the following way. In Ireland, as in the UK and the United States, corporate restructuring falls into two categories: that is formal and informal. In Ireland formal restructuring tend to mean examinerships, but in theory receiverships and liquidations can also be used to affect a restructuring. Traditional schemes of arrangement (in accordance with Section 203 of the Irish Companies Act, 1963) as distinct from the redesigned scheme of arrangement (in

¹²² These terms are employed by Carruthers & Halliday. B Carruthers and T Halliday, *Rescuing Business: the making of Corporate bankruptcy Law in England and the United States* (Clarendon Press, Oxford) 2003 6.

¹²³ *Re Traffic Group Ltd* [2008] 3IR 253.

¹²⁴ *Re Traffic Group Ltd* [2008] 3IR 253 at 260.

section 449 of the Companies Act 2014) were rare in the period up to 2014 as were pre-pack receiverships, but not liquidations, but not pre-pack examinerships. In addition, examinerships are relatively few in number. There were as follows.¹²⁵

EXAMINERSHIP							
	2014	2013	2012	2011	2010	2009	2008
Applications received	31	39	43	50	41	40	41
Order made to appoint interim examiner	25	15	16	31	28	36	37
Order made to appoint examiner	35	24	32	37	25	43	39

Table: 4.1.¹²⁶

There are a number of reasons for this pattern during the years of the recession, including:

- (1) Lack of risk appetite and, as a consequence and, for some years, a lack of private equity money to re-capitalise businesses
- (2) an emphasis by major creditors such as banks on balance sheet restructuring and less on profit and loss account issues and
- (3) for many years an archaic personal bankruptcy system.¹²⁷

While it is impossible to quantify the number of informal restructurings, due to the fact that there is no record of such matters, the same issues facing formal restructurings apply to

¹²⁵ Courts service data last downloaded on 4th November, 2015 at <http://www.courts.ie/Courts.ie/library3.nsf/pagecurrent/96A5EE503FACCFEC80257A6E003D2C4A?opendocument> and data from Deloitte, Dublin. last accessed at http://www.insolvencyjournal.ie/ij_news_more_details/business-closures-stabilise-year-on-year on 4th November, 2015.

¹²⁶ CSO data last downloaded on 10th December, 2015 at <https://www.cro.ie/Termination-Restoration/Examinership>

¹²⁷ Regarding personal bankruptcy, things have changed somewhat following the enactment of the Personal Insolvency Act 2012. The duration of bankruptcy in the Irish Republic has now been reduced from twelve years to three. For most people, this aspect of Irish law is quite intimidating. Some bankrupts have chosen to relocate in Britain so as to take advantage of the somewhat more lenient bankruptcy regime operating there.

informal restructurings. There is also the complication that it is very difficult to get all creditors (including the Irish Revenue Commissioners) to agree to restructuring terms: this is required for an informal arrangement to succeed. Examiners and other restructuring professionals tend to find that while in any given instance specific financial or other problems can be resolved, when those problems cluster together solutions will not often be forthcoming.

Both formal reorganisations (examinerships in the Irish context) and informal ones (workouts)¹²⁸ are at a practical level usually unique and are designed in any given case to address a particular set of circumstances.¹²⁹ Given the demanding requirements placed upon candidates at all stages from the petition stage onwards, examiners in successful cases are required to deliver innovative and robust proposals which offer sustainable solutions acceptable to all parties.

The difficulties were compounded until recent years not only by the fact that companies which operate in the domestically traded part of the Irish economy had to face a very adverse trading environment, but also by the fact that at least until the ending of the recession many financial institutions, particularly foreign-owned banks had taken a distinctly aggressive approach to pursuing business debtors.¹³⁰

These financial institutions have often proved zealous in seeking the appointment of receivers and liquidators. Such approaches are not, however, the only options available. Institutional

¹²⁸ Workouts are here understood to be informal negotiations between the debtor company board and creditor institutions with a view to reducing company debt outstanding and extending payment terms.

¹²⁹ Formal re-organisations may also include that facilitated by section 450 of the Companies Act 2014. This can be suitable for small and medium sized enterprises and produce any of the possible outcomes of examinership.

¹³⁰ For instance, Danske Bank in Dublin was the most proactive financial institution in the State so far as pursuing its debtors through the courts for summary judgments, according to an analysis undertaken on behalf of the Master of the High Court. Danske was more than seven times as likely as the leading banks, AIB and Bank of Ireland - as of the first half of 2014- when the number of cases measured against the banks' loan books. A total of 1,354 such cases were recorded up to the middle of May, 2014 for the year 2014 as then recorded. This pattern may be explained in part by the fact that Danske was then withdrawing from the banking market in Ireland. Data last downloaded on 5th November, 2015 at <http://www.irishtimes.com/business/financial-services/danske-bank-most-active-in-taking-irish-debtors-to-court-1.1808487>

lenders tend to be pragmatic: they will be reluctant to have a receiver or liquidator appointed in cases where the debt owed far exceeds the current realisable value of a particular asset class or business. The negotiators for a financial institution in a given instance may also believe that significant additional recovery may be achievable in the future if the business continues as a going concern. One result of this is that out-of-court restructurings (or work-outs) that allow companies to renegotiate their financial obligations in order to continue operations have become increasingly common as an alternative to formal insolvency proceedings. In practice there is a significant level of restructuring activity above and beyond the formal insolvency procedures being reported in the media.

Given the limited number of formal corporate restructurings in Ireland in comparison to those in the US and the UK, it is helpful to briefly consider the financial mechanisms employed and to review the financial dimensions of particular examinerships. The financial building blocks of restructuring are likely to include renegotiated payment terms and the disposal of non-core assets (that is, those assets which are not essential to its business plan). In some cases, important assets may be sold to reduce debt levels or to generate cash. In other cases the sale of the business may be under discussion. A distressed company may seek, or be required by its lenders to seek, potential third-party buyers or investors to acquire or invest in the business. Such transactions will typically not result in any return for shareholders, but may deliver other benefits in the form of the release of personal guarantees or similar security. Debt for equity swaps may also be transacted.¹³¹ Implementing one or other of these arrangements or in combination will invariably be found to be demanding. Hence the need for a moratorium as found in examinerships or a standstill arrangement in less formal contexts while things are being negotiated or put in place. In formal restructurings – as indicated in Chapter 3- a potential restructuring plan will be well advanced or even agreed

¹³¹ This approach was used by the management of Independent News and Media in 2011 in an informal restructuring. See the “The Stellar Rise and Crushing Fall of Tony O’Reilly” *The Irish Times*, 9th October, 2014.

with the principal creditors before the company goes into examinership. The support of the lending banks will always be an important factor to the success or otherwise of an examinership.

Some of the most rapid developments in examinership have occurred in the funding of schemes of arrangement. The finding of fresh investment for the insolvent company is the key part of the process. As referred to in chapter 3, it is common at the initial petition stage of an examinership for evidence to be made available to assist the court in determining that at least one investor is considering investment to facilitate the company coming out of examinership. Examinerships can also be funded from new borrowings such as invoice discounting or the sale of non-core assets of the business. As regards funding, the examiner will be obliged to provide sufficient robust evidence as regards the availability of funding at the confirmation hearing.¹³² The current best practice is for the debtor company or the examiner to establish a designated account to help ensure that monies promised are later paid out.

Some best practice principles promoted by UNICTRAL regarding priority financing are of interest in this context.¹³³ A key principle in the UNICTRAL Guide is that as far as possible existing secured creditors should not have their property rights endangered.¹³⁴ This could be enabled by means of periodic payments or by establishing rights to other assets of the debtor in the event of some existing assets over which the existing creditor had some rights being assigned in part (in the event of default) to the providers of new finance. UNCITRAL has opted for an arrangement by which a court could offer a provider of new finance with a higher priority status in repayment vis-à-vis existing secured creditors. Court approval would

¹³² A much greater degree of rigour is exercised by the Irish judiciary today, as noted in chapter 3. This follows the collapse of the *Antigen* examinership and the litigation which followed it. *Re Antigen Holdings Ltd* [2001] 4 IR 600.

¹³³ UNICTRAL Legislative Guide on Insolvency Law (2004).

¹³⁴ UNICTRAL Legislative Guide on Insolvency Law (2004) at para 105.

be contingent on the existing creditor having the right to be heard in court. The debtor company board for its part would need to prove to the satisfaction of the court that they cannot obtain finance from any source other than the new one identified. Evidence would also need to be provided to the court that the rights of the existing secured creditor would be respected.

4.6.1: THE *Eircom* AND *Muckross* CASES

The Eircom Group examinership of 2012 was both the largest in terms of the overall quantum of debt that was restructured and also the largest successful restructuring through the examinership process in Ireland to date.¹³⁵ The speed with which the restructuring was concluded was due in large part to the degree of pre-negotiation between the company and its lenders before the process commenced. The restructuring was confirmed by the High Court just 54 days after the companies entered examinership. The case demonstrated the degree to which an element of pre-negotiation (between the company and its creditors) could complement the process. Success in pre-negotiation enabled the examiner to proceed with at least one restructuring proposal immediately available: this offered the court certainty of some level of creditor support, a smoother path to implementation and a reduced risk of significant challenge at the confirmation hearing. Moreover, the advantages of the process for large companies were highlighted in the Eircom Group case, in that the arrangement terms proved flexible enough to facilitate both a massive write-down in debt and a change of ownership. In all, €1.4bn of a total debt of approximately €4bn was written off the balance sheets of the Eircom operating companies.¹³⁶ This resulted in the senior lenders becoming the

¹³⁵ *In the Matter of Eircom Ltd & Ors -v- Companies Acts* [2012] 3 JIC 3005.

¹³⁶ The scheme of arrangement included the following salient details. The scheme resulted in first lien creditors, owed €2.7 billion, and swap creditors taking a cut of 15 per cent on their debt and second lien creditors taking a cut of 90 per cent. It also involved the secured creditors taking over the equity of the companies. The €350 million debt figure due to the FRNs (floating rate noteholders) was set at zero. A line of credit was made available by the companies' secured lenders. This put the Group ahead by some €22 million of what had been projected for the year. The effect of this was to reduce the Group debts on the balance sheet by more than 40pc to €2.3 billion, down from an original figure of €4.1 billion. The Group's five year plan ostensibly protected the

new owners of the business. The positive reception internationally of the Eircom examinership has been such that it could serve to attract distressed companies from other EU jurisdictions to undertake a Centre of Main Interest (COMI) shift to Ireland.¹³⁷ It should be pointed out, however, that there were important dimensions of a favourable nature in the Eircom case which may not be present for the majority of debtor companies in this jurisdiction who are considering their restructuring options. For instance, Eircom continued to have a strong cash-generative business, even as its balance sheet was fundamentally unhealthy. In addition, the company has a strategic importance in Ireland that made its continued viability and prospect of survival of great significance: Eircom owned and controlled the primary infrastructure platform that provided the vast majority of access to fixed line telecommunications services throughout the country. In addition, Eircom in early 2012 employed almost 6,000 people throughout Ireland, a fact that was referred to by the court several times in the course of the judgments handed down in the case. The cost of the examinership was €63 million.¹³⁸

While there have been many successful examinerships, there have also been a number of high-profile failures.¹³⁹ A good example of a recent case is the *Muckross Park* case where the

jobs of almost 6,000 employees. There were to be no further job losses beyond the 1,000 figure that had been already announced; these losses were to be sustained in accordance with a programme of voluntary redundancies over the five year plan period. It was announced in late-October, 2012 that the Group was to seek a further 1000 redundancies by the year 2014, beyond those already planned for. News item downloaded from <http://www.breakingnews.ie/ireland/eircom-to-seek-2000-redundancies-572483.html> on April 25th, 2013.

¹³⁷ Centre of main interest. COMI is a creation of European Union law designed to settle conflicts that can arise between jurisdictions in cross-border insolvencies, based on the principles of mutual recognition and co-operation. The EC Regulation on Insolvency Proceedings Council Regulation (EC) 1346/2000 of 29 May 2000, [2000] OJ L 160/1 governs the opening of insolvency proceedings in Member States by laying down rules for deciding where main insolvency proceedings can be opened in circumstances where a company has a presence in more than one Member State. Currently, there is no definition of COMI except in the recitals to the Regulation where it is stated: “The “centre of main interests should correspond to the place where the debtor conducts the administration of his interests on a regular basis and is therefore ascertainable by third parties”. In broad terms this will be the country in which the debtor mainly carries out their trade, profession or self-employment.

¹³⁸ Report downloaded from <http://www.breakingnews.ie/ireland/eircom-to-seek-2000-redundancies-572483.html> on April 25th, 2013.

¹³⁹ These include *In the matter of the Companies Acts 1993 to 2009 and in the matter of Vantive Holdings and Others* [2010] 2 IR 108, *In the matter of Vantive Holdings and Others and in the matter of the Companies Acts 1963 to 2006* [2009] IEHC 409 and *Re O’Brien’s Irish Sandwich Bars Ltd* [2009] IEHC 465.

debtor company (a luxury hotel) sought and obtained interim examinership, but failed to obtain full examinership.¹⁴⁰ The debtor company had lined up 16 credible investment partners in advancing their examinership case. ACC Bank, however, which was owed a €9.2 million opposed an application for full examinership on the basis of a material non-disclosure relating to the ownership of certain lands on which a new wing of the hotel had been built and the creation of a lease-back arrangement relating to that new wing. Charleton J refused the examinership application. He re-appointed a receiver in the expectation that the hotel would continue as a going concern. In his view, a receivership would obtain the same result as would an examinership. The three companies which sought court protection owned half of the hotel and one individual owned the other half. The three companies owed €4.6 million to ACC and the same individual owed another €4.6 million. Charleton J said that the underlying reason for this j was that the court did not have the jurisdiction to restructure the finances of an individual.¹⁴¹

4.6.2: EFFICIENT ASPECTS OF EXAMINERSHIP FINANCING

What must at once be conceded is that the financial aspect of examinership does not sit well with team production theory, at a practical level, whatever about matters of theory. The board continue to represent the corporate team, but they do not do so as negotiators. It can nevertheless be said that if the board have run an efficient operation over many years, it may proceed so as to block a receivership from going further. For instance, the board of a debtor company may use invoice finance or sell off non-core assets. In addition, examinership financing looked at positively from a TPT perspective can be beneficial in so far as it allows for the write down of company debts, but it can sometimes involve a change of ownership

¹⁴⁰ *Muckross Park Hotel Ltd & Others v COS Acts 1963- 2009* 2013 122 COS

¹⁴¹ It is submitted that the judge did not want matters related to personal insolvency to be the substantive issue in an examinership case. In addition, the judge noted that since the debtor company had obtained interim examinership a complicating factor had come to light. This related to the true ownership of a major new wing of the hotel.

and board member and senior management replacement – both significantly negative factors. More positively, funding arranged at the pre-negotiation stage (prior to the seeking of an interim examiner) between the debtor company and investors or existing creditors promotes a more rapid processing of the case. The much more stringent criteria imposed by the courts with regard to pre-petition funding availability for an examinership candidate and the requirement to demonstrate the likelihood of its return to commercial health can serve well to promote realistic expectations by candidates for examinership.¹⁴²

4.6.3: INEFFICIENT ASPECTS OF EXAMINERSHIP FINANCING

There can be no doubt, that for some years following the financial crisis of 2008 the lack of available capital from the banking system in Ireland constituted a real hindrance to corporate restructuring. The loss of one substantial bank in the Irish Republic which catered for the small- and medium-sized company market did not cause the remaining three banks readily to absorb new business from this market sector that might otherwise be available to them.¹⁴³ During these difficult years, the remaining banks tended to reserve their capital for their own customers.¹⁴⁴ This substantially reduced the ability of many financially distressed companies to restructure as in many cases a given company's current bank would also be its bank in a post-restructuring scenario.¹⁴⁵ If the company had a comparatively short business relationship with the bank, it was obliged not to write off relevant debt as the condition of continued support. The effect of this was that while a number of restructuring exercises (particularly

¹⁴² In *Re Tivway Ltd* [2009] IEHC 377 the scheme of arrangement was found not to provide of each of the group companies when the case was appealed to Supreme Court.

¹⁴³ European Central Bank, "The Euro Area Bank Lending Survey" quarterly data from 2008-2015 last downloaded on 6th November, 2015 at http://www.ecb.europa.eu/stats/pdf/blssurvey_201501.pdf?7a1bddab03050b0b033cc26a03eef16c

¹⁴⁴ The evidence for this is necessarily indirect and anecdotal.

¹⁴⁵ See B O'Riordan and D McDonald, "Ireland Corporate Debt Restructuring: Solutions in a Distressed Marketplace" at http://download.pwc.com/ie/pubs/2013_ireland_corporate_debt_restructuring.pdf last downloaded on 22nd October, 2014. Legislation has, however, been passed to establish a new publicly owned bank. The bank can lend up to €5bn to small- and medium-sized companies in Ireland. The new bank is to be called the Strategic Banking Corporation of Ireland. It is based on existing models in countries like France, Germany and Canada. The relevant legislation is Strategic Banking Corporation of Ireland Act 2014 (No 22 of 2014) last downloaded on 7th November, 2015 at <http://www.irishstatutebook.ie/eli/2014/act/22/enacted/en/pdf>

informal ones) in these difficult years served to fix the balance sheet of financially troubled companies by removing historical trade debt (ie trade creditors), they did little else. In these cases, particularly in the informal restructuring context, not enough emphasis was placed on ensuring that a given company's ongoing trading position would prove sufficient to pay future debts.¹⁴⁶ This may have caused some companies to be burdened with a debt level which has remained too high for them while at the same time finding themselves unable to refinance the bank debt. An added complication related to interest rate changes: where these have risen during the lifetime of the loan, the debtor company may not have been in a position to deal with such rises. In examinership cases, it is likely that a court would foresee such potential difficulties from data provided in the scheme of arrangement. It is likely also that the business plan offered by strong examinership candidates would prove sufficiently robust (particularly in regard to investment from new sources) as to preclude the possibility of adverse outturns as outlined above. On the other hand, the extremely harsh approach adopted by the banks may deter some financially distressed companies from considering the examinership option.

A second difficulty related to the absence until recent times of a revamped system of legislation relating to personal debt. This has now been addressed¹⁴⁷ albeit in an imperfect manner.¹⁴⁸ All of the immediately above should be seen in the context of banking practices in Ireland which tend to be the norm here, but do not apply in the same way elsewhere. That is, banks here seek and obtain personal guarantees from directors of limited liability companies for the provision of lending facilities.¹⁴⁹ The result of this arrangement is that while the

¹⁴⁶ For an insight into the debt loading phenomenon generally, see C Keena, "Businesses deliberately loaded with Debt rob the Country of Future Tax Income" last downloaded on 7th November, 2015 at <http://www.irishtimes.com/business/businesses-deliberately-loaded-with-debt-rob-the-country-of-future-tax-income-1.1331640>

¹⁴⁷ The Personal Insolvency Act 2012 introduced three non-judicial debt settlement arrangements and a reform of the existing bankruptcy process. The new arrangements allow for the write down or restructuring of both secured and unsecured debt owed by eligible individuals.

¹⁴⁸ The critical point relates to the discharge period. It is three years. This compares unfavourably with that of other jurisdictions such as the UK. The relevant debts are sums greater than k€20k. The repayment arrangements are at the discretion of the credit provider

¹⁴⁹ The SME lending code for the Central Bank states:

corporate restructuring exercise may sometimes deal successfully with a write down in the corporate debt, the business owner will still be liable under a personal guarantee. Anecdotal evidence would suggest that in the period of the Celtic Tiger, many directors and other financially successful individuals invested in partnerships and co-ownership vehicles with people they scarcely knew at all. As a consequence, they signed up to joint and several guarantees on bank borrowings which in some cases ran to the tens of millions of euro. They then found themselves in a position where they had debt levels not envisaged when they originally participated in the investment partnerships. This personal debt overhang has affected the core trading patterns of thousands of Irish small and medium sized enterprises.¹⁵⁰ Such directors are understandably worried about debts which they will never be able to discharge; this, in turn, affects how they operate their businesses. The personal debt problems of directors has influenced business decision-making in a negative way.

In contrast to this, the SME lending code for the Central Bank states:

“Having due regard to the nature, liquidity and value of collateral, a regulated entity (the bank) must not impose unreasonable capital requirements for providing credit facilities, having regard to the value of the credit being offered.”

“A regulated entity must not impose unreasonable personal guarantee requirements on borrowers.”

Central Bank of Ireland, “Code of Conduct for Business Lending to Small and Medium Enterprises”(2012) at page 7 last downloaded on 7th November, 2015 at <https://www.centralbank.ie/regulation/processes/consumer-protection-code/Documents/Code%20of%20Conduct%20for%20Business%20Lending%20to%20Small%20and%20Medium%20Enterprises.pdf> The lending banks in Ireland are not following this code. This was the finding of the Entrepreneurship Forum Report at page 44. The report was commissioned by the Department of Jobs, Enterprise and Innovation. The report was last downloaded on the 7th November, 2015 at <https://www.localenterprise.ie/Documents-and-Publications/Entrepreneurship-in-Ireland-2014.pdf> The authors of the report also found in the same connection that even for established, profitable, non-leveraged companies, a requirement for personal guarantees is considered normal rather than the exception. In addition, in a statement before the Oireachtas Committee on Access to Finance for Small and Medium Enterprises, Mr Ritchie Boucher of the Bank of Ireland, admitted that the banks did require personal guarantees: “ we say that if we are to provide a loan on a basis that we can accept the risk, then that equity contribution must be recognised by way of a personal guarantee.” Oireachtas Committee meeting dated 15th April, 2014 at page 8. Houses of the Oireachtas, “Joint Committee on Jobs, Enterprise and Innovation: Report on Access to Finance for Small and Medium Enterprises (SMEs)” 16th July, 2014. This committee report was last downloaded on 7th November, 2015 at <http://www.oireachtas.ie/parliament/media/committees/jobsenderpriseandinnovation/Access-to-Finance-for-SMEs-with-links-15-July.pdf>

¹⁵⁰ F McCann and T McIndoe-Calder, “Property Debt Overhang: The Case of Irish SMEs” (2015) Central Bank of Ireland, Dublin.

“Having due regard to the nature, liquidity and value of collateral, a regulated entity (the bank) must not impose unreasonable capital requirements for providing credit facilities, having regard to the value of the credit being offered.”

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6.3.4: REFORM SUGGESTIONS

The task of gathering new investors and formulating a scheme of arrangement in the limited time available within a moratorium is a delicate and critical one for any examiner. Sometimes negotiations with investors can become troubling because of stratagems engaged in by potential investors. The outcomes of these negotiations do not always meet with the courts’ approval.¹⁵⁴ It may be helpful to establish a protocol by which an examiner could have

¹⁵¹ Central Bank of Ireland, “Code of Conduct for Business Lending to Small and Medium Enterprises”(2012) at page 7 last downloaded on 7th November, 2015 at <https://www.centralbank.ie/regulation/processes/consumer-protection-code/Documents/Code%20of%20Conduct%20for%20Business%20Lending%20to%20Small%20and%20Medium%20Enterprises.pdf>

¹⁵² Entrepreneurship Forum Report at page 44. The report was commissioned by the Department of Jobs, Enterprise and Innovation. The report was last downloaded on the 7th November, 2015 at <https://www.localenterprise.ie/Documents-and-Publications/Entrepreneurship-in-Ireland-2014.pdf>

¹⁵³ Oireachtas Committee meeting dated 15th April, 2014 at page 8. Houses of the Oireachtas, “Joint Committee on Jobs, Enterprise and Innovation: Report on Access to Finance for Small and Medium Enterprises (SMEs)” 16th July, 2014. This committee report was last downloaded on 7th November, 2015 at <http://www.oireachtas.ie/parliament/media/committees/jobsenderpriseandinnovation/Access-to-Finance-for-SMEs-with-links-15-July.pdf>

¹⁵⁴ *Re McInerney Homes Ltd* [2001] IESC 409.

recourse to the court for directions if and when negotiations become somewhat intractable. The present statute law on company reorganisation or at least formal corporate restructuring in practice would seem to enjoy a measure of support among the key professional and business groups in this jurisdiction in so far as they have not sought to have it removed from the statute book. That is no reason, however, to avoid asking searching questions or reconsidering details of the best practices abroad which could have relevance here financially stricken companies.

On examinership financing, the identified difficulties – at least during the recession years, whatever about today - were these:

- (1) a lack of risk appetite and, as a consequence, a lack of private equity money to recapitalise companies

In the larger cases, this can be addressed by asset securitisation and through special purpose vehicles.¹⁵⁵ This would be perfectly consistent with team production theory. Asset securitisation would imply that the lender did not wish to be bound by the rules of insolvency law.¹⁵⁶ Supporters of team production theory would respect that. The expectation, however, would be that most lending agents would not take this approach. While a credit institution that transacts a secured loan with a debtor has by doing so agreed to be bound by the rules of insolvency law. This need not preclude the credit institution from contracting again with a defaulting debtor.

¹⁵⁵ For an analysis of special purpose vehicles see the following: Claire Hill, “Whole Business Securitization in Emerging Markets”(2002) 12 Duke J. Comp. and Intl L. 521 (“this mechanism ensures the creditor “receives as security for repayment of the loan fixed and floating charges over all or substantially all of the borrower’s assets and thus becomes a secured creditor of the borrower”). In this connection, see Section 110 of the Taxes Consolidation Act 1997. This is the cornerstone of Ireland’s securitisation regime and permits qualifying Irish resident SPVs to engage in an extensive range of financial and leasing transactions in a tax neutral manner.

¹⁵⁶These matters are considered by L LoPucki (note 1) 741. LoPucki uses the argument found in Steven Schwartz ‘Commercial Trusts as Business Organizations: Unraveling the Mystery’ (2003) 58 Bus. Law. 559. (“The investors, as senior claimants of the trust, get their money back with interest. The company, as residual claimant, receives payment for the financial assets sold to the trust and is entitled to any residual value of those assets once the investors are paid in full. In economic terms, the deal is similar to a secured loan—the quintessential commercial transaction—in which surplus collateral is returned to the debtor once lenders receive principal and interest.”)

(2) The availability of finance for small- and medium-sized Irish companies

In spite of positive developments regarding the restructuring of Irish banking in very recent years, there are major issues which remain unresolved. For instance, a EU/ECB survey on access to finance published in April 2014 showed that access to finance is still a major issue and concern for small- and medium-sized Irish companies.¹⁵⁷ 23% of the surveyed Irish SMEs said access to finance was their biggest concern compared to the euro area average of 14%.¹⁵⁸ 50% of the surveyed SMEs did not obtain the full amount that they had planned for during the six months prior to the survey. 23% of their loan applications were rejected. Some 19% of the companies received less than what they had applied for¹⁵⁹

Lending to SMEs was falling consistently in the period from 2011 to 2014. Gross new lending flows in that period remained between €450 and €750 million per quarter. There was no evident upward trend.¹⁶⁰

The recommendations of the Oireachtas Joint Committee on Jobs, Enterprise and Innovation: in their Report on Access to Finance for Small and Medium Enterprises (SMEs) are pertinent with regard to the above problems.¹⁶¹ For instance, the Oireachtas committee recommended

¹⁵⁷ European Commission Press Release, Brussels, 15th April, 2014.

¹⁵⁸ In the ECB Survey Report for November, 2014 the access to finance figure for Irish smaller sized enterprises was 18%. European Central Bank, “Survey on the Access to Finance of Enterprises in the Euro Area” (November, 2014 at page 4 last downloaded on 8th November, 2015 at <https://www.ecb.europa.eu/pub/pdf/other/accesstofinancesmallmediumsizedenterprises201411.en.pdf>

¹⁵⁹ European Central Bank, “Survey on the Access to Finance of Enterprises in the Euro Area” (April, 2014) last downloaded on 8th November, 2015 at <https://www.ecb.europa.eu/pub/pdf/other/accesstofinancesmallmediumsizedenterprises201411.en.pdf>

¹⁶⁰ The CEO of the Irish Small- and Medium-Sized Enterprises Association (ISME) at the meeting on 13th May 2014 said to Oireachtas Committee on Access to Finance for Small and Medium Enterprises that “the most recent Central Bank statistics for money and banking dated March 2014 indicate to Irish non-financial corporations showed a year-to-year decline of 6.1% in March (2014), following an annual decrease of 5.8% in February (2014). All categories of loans recorded a decline over the year (of 2014). This represents the 16th consecutive month decline in lending.” Houses of the Oireachtas, “Joint Committee on Jobs, Enterprise and Innovation: Report on Access to Finance for Small and Medium Enterprises (SMEs)” 16th July, 2014 at page 6. This committee report was last downloaded on 8^h November, 2015 at <http://www.oireachtas.ie/parliament/media/committees/jobsenderpriseandinnovation/Access-to-Finance-for-SMEs-with-links-15-July.pdf>

¹⁶¹ Houses of the Oireachtas, “Joint Committee on Jobs, Enterprise and Innovation: Report on Access to Finance for Small and Medium Enterprises (SMEs)” 16th July, 2014. This committee report was last downloaded on 8^h November, 2015 at

that consideration should be given by the banking institutions to a redrawing of the criteria appropriate to applications from SMEs for funds. The Oireachtas Committee also considered that the development of non-banking sector funding initiatives for SME enterprises should be strongly encouraged.

Conclusion

This chapter has analysed corporate restructuring moratoria, pre-petition models and distressed company financing in the three jurisdictions selected. The mechanisms employed and the objectives aimed at by the designers of the moratoria systems are quite different one from another. Chapter 11 moratoria were found to work quite well. The inefficiency of the Chapter 11 new finance mechanisms employed from a team production viewpoint was that they necessarily displaced the debtor-in-possession company board from the control position. The new finance provider dictated to the board what they could and could do in major business decisions. On moratoria in company rescue in Britain, matters were considered in the larger context of the Enterprise Act 2002. It was noted that the arrival of the Enterprise Act had promoted the idea of corporate rescue as the “default model” and had done so in a manner unlike the legislation which has gone before. To that extent, there had been a move at towards what obtains in Chapter 11 (at least that of Chapter 11 as originally envisaged). It was also noted that there was little appetite in Britain for providing super-priority finance. It was considered that the moratorium component of examinership was efficient, because it provided a shield behind which the examiner as court agent could maximise the value of the company and rationalise the negotiation process. The financial aspect of examinership,

<http://www.oireachtas.ie/parliament/media/committees/jobenterpriseandinnovation/Access-to-Finance-for-SMEs-with-links-15-July.pdf>¹⁶¹

however, was not found to sit well with team production theory, at a practical level, whatever about matters of theory. The board continued to represent the corporate team, but they did not do so as negotiators.

Chapter 6 considers informal reorganisation.

Chapter 5

A CRITIQUE OF MATTERS CENTRAL TO EXAMINERSHIP

“We need creativity in order to break free from the temporary structures that have been set up by a particular sequence of experience.”

Edward de Bono¹

INTRODUCTION

There is a major puzzle in all of this. Since its enactment in 1978, the legislation relating to Chapter 11-type corporate restructurings and to a much lesser extent the practice of it has influenced the thinking of decision-makers on insolvency law in many jurisdictions. This, in turn, has brought about much in the way of related legislative change on a global basis. While this amount of change has prompted a lot of academic analysis, because of its significance, it is at once necessary to be circumspect in one’s comments. Major concepts, indeed large parts of corporate rescue law of a systems nature have been borrowed by law reformers in individual states from the Chapter 11 model, but much has been left aside. For instance, Ireland –has had for many years a corporate restructuring law model which approximates more closely to Chapter 11 (as originally conceived) than that found elsewhere, but the Government here has not seen fit to incorporate a debtor-in-possession provision of the Chapter 11-type in its rescue legislation. It is necessary, however, to qualify this statement because of the putting in place in recent times of the redesigned scheme of arrangement mechanism as in the Companies Act 2014.² This became operative in June 1st, 2015. In the

¹ E de Bono, *Serious Creativity: How to be creative under pressure and turn ideas into action* (2015) Vemillion London, part 1.

² Companies Act 2014, Part 9, Chapter 1 ss 449 to 454. The scheme of arrangement mechanism, incidentally, has been enhanced in significant ways in recent years. For instance, a comparatively recent decision in the High Court in the UK has shown that the courts are prepared to exercise their powers under the UK Civil Procedure Rules to stay claims brought by dissentient creditors in circumstances where a scheme of arrangement is proposed. *Bluecrest Mercantile NV v Vietnam Shipping Industry Group* [2013] EWHC 1146 (Comm). This may have significant implications for schemes of arrangement in tis jurisdiction.

redesigned scheme of arrangement, the directors remain in control of the distressed company and there is no need to obtain an independent expert's report to commence the scheme of arrangement process. In addition, there is no need on the directors' part to prove to the High Court that the company has a reasonable prospect of surviving.

It is arguable that when a detailed analysis is undertaken, the ripple effect internationally of the American experiment in restructuring law has on many counts been fairly modest. In addition, the BAPCPA model – that is, Chapter 11 for small companies- has not proven to be a success in the United States and does not provide inspiration for initiatives elsewhere.

³Moreover, States with a very sophisticated corporate and legal culture such as the United Kingdom and the Netherlands have opted for insolvency systems which are creditor-oriented to a marked or very marked degree. Each of these countries has firmly rejected a debtor-oriented model. This calls for explanation. Necessarily, a socio-legal investigation can explain something of this, as can the uncommonness of corporate entities in some jurisdictions of a size often found in major Chapter 11 cases. That, however, does not account for matters in the UK or the Netherlands in a satisfactory way. A cogent explanation is still lacking.

In order to provide an answer of sufficient quality, it will, in part, be necessary to go back to first principles. In the first section of this chapter the initial assumptions about the efficacy of American-style corporate rescue legal mechanisms will be reconsidered. As the objective of

³ The findings of the American Bankruptcy Institute's *Commission to Study the Reform of Chapter 11* regarding the US Bankruptcy Code's incapacity to provide workable restructuring solutions to small- and medium-sized companies serve to showcase this. The output of such companies taken together constitutes more than 90 percent of the United States economy. American Bankruptcy Institute, *Commission to Study the Reform of Chapter 11* Alexandria, Virginia 2015 at page 5. Witnesses and commentators suggested to the Commission that companies in these classes are increasingly relying on state and federal insolvency remedies. That is to say, remedies such as receiverships and assignments for the benefit of creditors. The Commission viewed these remedies as "subpar." The general testimony was that, other than facilitating section 363 sales and liquidations, Chapter 11 is simply not working for this sector. The Commission, in response to this, recommended an alternative restructuring scheme for small- and medium-sized companies. The Commission's recommendations for distressed companies in this sector seek to: (1) simplify the formal restructuring process; (2) reduce costs and remove barriers that would otherwise serve to drive these companies away from entering the process and (3) provide legal tools which facilitate effective reorganisations of viable companies. American Bankruptcy Institute, *Commission to Study the Reform of Chapter 11* Alexandria, Virginia 2015 at 290.

this thesis is to investigate the major part of the existing company rescue law in Ireland, that is the Companies (Amendment) Act, 1990, as amended together with the Companies Act 2014 to see whether or not they are efficient mechanisms which are fit for purpose, an investigation of Chapter 11 is engaged in using different presuppositions from those which went before. This is appropriate given the central importance of Chapter 11 as a design model for the architects of the greater part of the company rescue legislation in Ireland.⁴ Team production theory, it is at least arguable, is a very useful means of evaluating the fundamental principles which undergird Chapter 11 and comparable legislation and management as a mediating hierarch is central to the theory. This has been used as a comparator in this thesis and arguments in its favour have already been put forward.⁵ The purpose of this evaluation is not to adopt a critical approach for its own sake; rather it is to identify – at least from another perspective- where and when these methods and concepts are of value, if that is indeed the case. The evaluation continues in Section 3: this considers BAPCPA and the CVA/Administration processes available for small companies in the US and UK respectively and analyses developments in the Irish context. Section 4 relates to quality issues as applied to examinership and related performance yardsticks. This is followed by a summing-up.

This chapter addresses the central research question by providing an argument as to why an efficient, reasonably priced and user-friendly company rescue mechanism that is geared for small companies and that meets their specific requirements would be a good thing in Ireland today. It also details a model of what such a mechanism would look like. It throws some light on why some western European countries have chosen by and large or not at all to employ

⁴ That is to say, examinership together with the redesigned scheme of arrangement mechanism. Both are found in the Companies Act 2014 (Part 10 Chapter 1, and Part 9 Chapter 1ss 449 -454 respectively).

⁵ See L M Lopucki, “ A Team Production Theory of Bankruptcy Reorganization”2004 57Vand L Rev 741.

debtor-oriented company rescue models. This is done by a comparatively brief consideration of the theory that views corporate insolvency as a governance mechanism. Quality issues related to examinership are addressed.

In the opening section, an experiment is conducted involving a change of theoretical perspective. Corporate insolvency in this exercise is viewed as a governance mechanism in contrast to the arguments offered in the earlier chapters. Two kinds of governance arrangements are considered: that is, debtor-oriented and creditor-oriented regimes. It is argued that a debtor-oriented system is applicable to large corporations while a creditor-oriented system is applicable to small- and medium-sized companies. The overwhelming majority of business enterprises in Ireland are SMEs.⁶ These companies – both in Ireland and abroad- are often beholden to a secured bank lender while those suited to a debtor-oriented regime are often found to have a dispersed ownership. These two governance arrangements, moreover, give rise to different trade-offs in both debtor- and creditor- oriented insolvency law systems. If the contention about governance arrangements is correct, it has important implications in any determination about whether or not an intervention of the kind found in examinership should be attempted for small and possibly medium-sized companies. It would also follow that pre-pack receiverships or similar approaches would prove more beneficial in many insolvency cases, because they would suit the corporate governance structures of those companies. Reasons will, however, be offered as to why an examinership option or something similar rather than a purely corporate governance approach would often have less adverse consequences for a substantial minority of small Irish companies in financial distress.

⁶ In 2011, SMEs accounted for 99.8% of active enterprises. 68.6% of persons engaged in the economy as employees or management, 50.1% of turnover and 46% of gross value added (GVA). CSO, “Business in Ireland in 2011” CSO Dublin November 2013 at page 5.

SECTION 5.1: CORPORATE INSOLVENCY AS A GOVERNANCE MECHANISM – THE IRISH CASE

In contrast to much of what has gone before in earlier chapters, another way of thinking about insolvency law – as already noted in chapter 1- is to consider it as a governance mechanism. This is useful in making comparisons about the efficiency of the Irish corporate rescue model vis-à-vis those in other states. Corporate governance arrangements and efficiency measurement results are closely interlinked. This approach is borrowed from the law and economics literature.⁷ It is helpful to consider two types of corporate entity at opposite ends of the spectrum: the SME-type company and the plc with a dispersed ownership. Looking at the governance structure more closely, it is possible to argue that the debt configuration of a business is a central locus in investigating difficulties related to insolvency. It follows that in any review of insolvency law arrangements, it may be wise to examine carefully the critical role of debt in corporate governance questions. Franken observes that the key question for insolvency law is who is to take control of the company in the event of an outturn that threatens the company's survival.⁸ Viewing matters from a corporate governance perspective, the configuration of debt becomes the central question. A key observation by Franken is that specific debt configurations will give rise to corporate governance arrangements which are distinct one from another.⁹ For policy-makers to disregard this key observation, the argument continues, runs the risk of producing insolvency legislation which is misguided. The underlying assumptions being entertained here – those relating to incomplete contracts and property rights- are fundamentally different from the

⁷ M.C. Jensen and W.H. Meckling, "The Theory of the Firm: Managerial Behaviour, Agency Costs and Ownership Structure" (1976) 3 *Journal of Financial Economics* (1976). 305, M.Harris and A. Raviv, "Capital Structure and the Informational Role of Debt" (1990) 54 *Journal of Finance* 322 and O.E. Williamson, "Corporate Finance and Corporate Governance" (1988) 43 *Journal of Finance* 1568.

⁸ S Franken, "Creditor- and Debtor-Oriented Bankruptcy Regimes Reconsidered" (2004) 5 *European Business Organisation Law Review* 647.

⁹ S Franken, "Creditor- and Debtor-Oriented Corporate Bankruptcy Regimes Revisited" (2004) 5(4)*European Business Organisation Law Review* 645 at 645.

approach adopted earlier.¹⁰ This is particularly so with regard to the principal-agent model of management.¹¹ This model is much more frequently employed in both the academic and business worlds than is the team production theory model. In this approach, financial institutions as secured creditors play a valuable role in monitoring and screening business proposals and also in providing a second opinion that would otherwise not always be as easily available to management in SMEs. This kind of defence of the role of credit institutions in the context of SME company restructuring complements the defence at the other end of the spectrum of the beneficial effects of Chapter 11 for companies whose shares are owned by a wide spectrum of parties. More technically, Chapter 11 has positive value because it efficiently enables the reallocation of control as a consequence of the reconstruction. In many cases that kind of result would not be possible for companies with a complex capital structure without going through Chapter 11. More generally, if this approach is correct, it may prove useful to think of insolvency law arrangements in any one jurisdiction as being efficient to the extent that they provide fundamentally different solutions for SME and public companies in financial distress where, simplifying somewhat, the members of each category have different capital structures from those in the other category. Inefficiency is understood to relate to the factors making for sub-optimal investment behaviour (which cause substantial indirect costs: the larger part of the costs) on the part of company directors, shareholders or creditors. Thus insolvency law provisions which impact both on distributions and control of a given company's assets trigger agency costs. These occur because of under- or over-investment depending on the case being considered. Franken contends that

¹⁰That is to say the Team Production Theory employed in Chapter 2 and elsewhere.

¹¹ This theory provides insight into a context in which a principal, within predefined terms, assigns a task to an agent who carries out the task on the principal's behalf. It first was applied in the economic context. The theory's constructors were concerned with matters related to aligning incentives applicable to the agent and monitoring the agent's actions after the fact. There is a difficulty in principal-agent arrangements, because sometimes the agent is motivated in his/her best interests rather than those of the principal. Among the pioneering works of scholarship in principal-agent theory is : M Jensen & W Meckling, "Theory of the Firm: Managerial Behaviour, Agency Costs and Ownership Structure"(1976) 3(4) Journal of Financial Economics 305.

insolvency law arrangements can produce efficient results to the extent that they are a good fit for the corporate governance characteristics of the particular company.¹² One size does not fit all. Creditor-oriented regimes do not have an automatic advantage over debtor-oriented regimes or vice versa.

Working from first principles it may be said that the focus of insolvency law considered from a traditional law and economics perspective is about finding an insolvency solution that is cost efficient. Costs come in two forms: direct and indirect.¹³ Direct costs are incurred by what relates to the formal legal process. Indirect costs arise due either to losses of suppliers, decision-makers within the company and customers or –ever more critically – by poor decisions made at a high level within the company. This way of thinking, as already noted, has as its foundation the principal–agent theory of the firm. Franken in this analysis spotlights the second aspect of this theory; that is, the distinct interests of the corporation’s creditors and shareholders.¹⁴ The first critical insight is Franken observes:

Bankruptcy law provisions that affect the distribution to creditors and shareholders, as well as those that affect the control over the distressed firm’s assets, induce agency costs in the form of over-investment and under-investment incentives among the firm’s shareholders, creditors and managers prior to (ex ante) as well as after (ex post) the start of a bankruptcy procedure. Over-investment occurs if the company invests in projects that reduce firm value, whereas under-investment occurs if the company fails to invest in projects that would have increased firm value. From a law-and-economics perspective, the aim of bankruptcy policy-making should be to reduce the ex ante and ex post suboptimal investment incentives created by corporate bankruptcy law in order to enhance the value of the firm’s assets.¹⁵

A creditor-oriented regime can serve SME companies quite well. The company’s bank (that is, its chief lender) may help to serve –together with the company’s accountant, lawyer and

¹² S Franken, “Creditor- and Debtor-Oriented Corporate Bankruptcy Regimes Revisited” (2004) 5(4)European Business Organisation Law Review 645 at 649.

¹³ The writer is indebted to the pioneering work of S Franken in “Creditor- and Debtor-Oriented Bankruptcy Regimes Reconsidered” (2004) 5 European Business Organisation Law Review 645.

¹⁴ The first aspect relates to the corporation’s separation of ownership and control, that is, the principal agent arrangement.

¹⁵ S Franken, “Creditor- and Debtor-Oriented Bankruptcy Regimes Reconsidered” (2004) 5 European Business Organisation Law Review 649.

possibly its business advisor/ mentor- as the company's doctor. Efficient monitoring¹⁶ by the bank may serve to prompt the company's management to move away in good time from commercially self-defeating strategies and tactics. The legal position of the company's bank is such that it is well placed to determine whether or not the latter will close should it near an insolvency condition. This lever is a very powerful one: it means that a company's management has no choice but to comply with the bank's requests. The influence of the bank in this regard can be a very positive one; it limits the risk of an adverse insolvency outcome. Another important advantage of the creditor-oriented regime for SMEs is that it prompts financially distressed companies which are at risk to restructure outside of formal procedures. By so doing, a company at risk reduces its costs to a minimum. Technically, this is known as ex ante efficiency: the risk of over-investment is reduced. There is evidence from the Netherlands that this approach serves to rescue a considerable proportion of financially distressed companies.¹⁷ The negative side of a creditor-oriented regime is that when liquidations occur, they may involve a very large decline in the given company's asset price. Franken states the following simple rule to account for cases such as that outlined in the paragraph immediately above: "corporate bankruptcy law intervene(s) in the governance structure of a firm's assets, if the firm's governance conditions are suboptimal."¹⁸ This rule does not, however, apply so readily, in companies with a complex capital structure: the

¹⁶ This can arise only in the context of relationship banking. Most Irish banks now have SME relationship managers. The Institute of Bankers in Ireland offers a professional diploma in SME credit. The fact remains, however, that reliable information on SMEs is rare and costly for financial intermediaries. On relationship banking see: T Baas and M Schrooten, "Relationship Banking and SMEs: A Theoretical Analysis" (2006) 27 *Small Business Economics* 127 and M Binks and C Ennew, "The Relationship between UK Banks and their Small Business Customers" (1997) 9 *Small Business Economics* 167.

¹⁷ S Franken in "Creditor- and Debtor-Oriented Bankruptcy Regimes Reconsidered" (2004) 5 *European Business Organisation Law Review* 662. Informal rescue in the Netherlands is put at 60-80% as reported by Franken in "The Debtor-Oriented Model versus the Creditor-Oriented Model of Corporate Bankruptcy Law: A US-Dutch Comparison" (2003) *Tilec Discussion Paper* 21. The statistics on informal restructuring quoted by Franken relate to those presented at a seminar by a banker A M van Amsterdam. For a report on the seminar see S Franken *Verlag nibe-Svv seminar d.d. 18 september 2002: Modernisering faillissementsrecht: wat wordt de positieve van de bank?.* TvI 2002/6, 336. With regard to the statistics, no dates are given.

¹⁸ S Franken "Creditor- and Debtor-Oriented Bankruptcy Regimes Reconsidered" (2004) 5 *European Business Organisation Law Review* 658.

identification of who should exercise the residual right of control ex ante can here be contested. In such circumstances it can be argued that it will be necessary for a third party to determine how assets should be shared out in an ex post context. Hence the requirement for a debtor-oriented regime for larger companies. It would not necessarily follow that a debtor-oriented regime –such as Chapter 11 - would preclude very significant creditor influence in restructuring decision-making or that it would lead to interminable court processes.¹⁹ The difficulty with large companies from a secured creditor’s perspective is that the secured creditors do not have a clear view of corporate management activity. Their control is limited to that of specific assets, rather than the company more generally. They cannot constrain management activity and they do not have access to management information systems. In such a context where critical information is not easily available – according to Franken- bad news travels relatively slowly to the market. Thus, unlike the situation which obtains in the case of SMEs, creditors’ and other interested parties monitoring large companies can only act ex post. It is reasonable to suggest, therefore, that a debtor-oriented regime is a good fit for such large companies. Franken adds – perhaps in a manner that is at risk of sounding a little oversimplified- that a debtor-oriented regime gets over the difficulty of tardiness on management’s part about releasing unwelcome news regarding financial distress: management in such cases can overcome the hazard of losing their positions in short order by releasing substantive information in good time.²⁰ Thus, the advantage of the debtor-in-possession mechanism within Chapter 11 –something which can be seen as a reward for a management team that is in part creditor-compliant- in that it serves the creditors by enabling the release of critical information. It also closes off the possibility of over-investment in the period prior to formal corporate rescue.

¹⁹ Franken supports this contention by reference to E.R. Morrison, “Bankruptcy Decision-Making: An Empirical Study of Small-Business Bankruptcies” (2003) Columbia Law and Economics Working Paper No. 239.

²⁰ S Franken “Creditor- and Debtor-Oriented Bankruptcy Regimes Reconsidered” (2004) 5 European Business Organisation Law Review 658 at 666.

Franken also offers a further critically important argument in favour of a Chapter 11-type mechanism: such a mechanism can help avoid many of the difficulties of informal capital structure renegotiation. He says that the explanation for debtor-oriented regimes is that they promote efficient negotiation ex post. It is often the case that large corporations will have excessive debt. The problem for the institutional creditor is that the corporate bonds it holds do not allow it to constrain corporate borrowing. From time to time, the excessive debt held by the corporation will compel renegotiation. Complex negotiations, however, are inherently costly and always include the risk of breakdown in the negotiation process. There can also be a problem caused by hold-outs. Out-of-court restructurings are costly and more prone to break down. Debtor-oriented restructurings make more sense. They reduce transaction costs and allow for majority voting and cram down mechanisms.²¹

There are additional advantages in employing Chapter 11. The willingness to find solutions for the financial distress of large corporations after the fact incentivises outside financial monitors to employ their skills in a context where information asymmetry still applies. Thus the market mechanism begins to reapply ex post – in the Chapter 11 context. It takes the form increasingly, particularly in the United States, of turnaround scenarios involving debtor-in-possession, lending institutions and plans negotiated prior to court proceedings.

Thus, to sum up this part of the argument, an insolvency regime is taken to be efficient ex post if it minimises malinvestment at either end of the spectrum while the company is undergoing formal insolvency. System efficiency is understood here as the facilitation of recovery for commercial entities which are fundamentally sound and the elimination of all others. The one difficulty in this is that parties other than the management do not have access

²¹ S Franken, “Creditor- and Debtor-Oriented Bankruptcy Regimes Reconsidered” (2004) 5 *European Business Organisation Law Review* 658 at 666.

to actionable information.²² This in turn impacts adversely on company decision-making where management may pursue their own agenda at the expense of others. The point and purpose of insolvency law, therefore, from this perspective is to structure arrangements so as to limit the possibility of information asymmetry between management and other interested parties. Any other arrangement would increase the risk of asset misallocation. From a law and economics perspective, the chief aim of insolvency policy-making must be to reduce the ex ante and ex post suboptimal investment incentives created by corporate insolvency law in order to enhance the value of the company's assets.

Central to Franken's analysis therefore is the extent to which capital structures of companies provide for an ex ante mechanism to transfer the residual right of control when corporate financial results are poor or, instead, are incomplete in that they do not –and cannot – provide for such a mechanism from an ex ante time perspective. It is suggested by Franken that the best solution for financially ailing small- and medium-sized business is that they assign ex ante a contingent residual right of control to the concentrated secured bank lender. As a consequence, the role of bankruptcy law in such cases is to confirm the residual right of control of the relational bank lender. By contrast, the capital structure of the prototypical publicly held company does not facilitate the ex ante assignment of the contingent right of control. Besides, no bank is in the position to undertake the task of monitoring the capital structure in such cases as the costs involved in doing so would be prohibitive. The role of insolvency law, in such cases, it is suggested is to provide an ex post mechanism that facilitates the transfer of the residual right of control.²³

²² Franken uses the term "information asymmetry." S Franken "Creditor- and Debtor-Oriented Bankruptcy Regimes Reconsidered" (2004) 5 European Business Organisation Law Review 649.

²³ S Franken, 'Creditor- and Debtor-Oriented Bankruptcy Regimes Reconsidered' (2004) 5 European Business Organisation Law Review 645. The approach adopted by Franken relies upon the major propositions of the principal-agent theory of the company. The focus is heavily upon the impact of agency costs and how it impacts upon relevant parties' decisions.

The above results have very large consequences for this thesis and need to be investigated more closely. Quite plainly, the existing insolvency law system in Ireland is significantly, but not exclusively, creditor-oriented. Franken's argument would do nothing to overturn this arrangement. Examinership lite would not be a suitable vehicle for the great bulk of financially-ailing companies in Ireland, because of their smallness. The role of rescuing such companies would seem to fall naturally to that of the banks. Traditional examinership (that is, pre-examinership lite examinership) would, however, be suitable only for larger companies, but these cases would be few in number. In response to Franken, it may be said examinership of whatever kind – including the models envisaged by the CLRG Interim Report 2012 and the Deputy Donnelly proposals²⁴- is likely to remain an important though marginal phenomenon in the Irish insolvency law context.²⁵ Given the fact, however, that the overwhelming majority of Irish companies are small to company rescue if at all possible, it is difficult and perhaps unwise to dismiss examinership for small companies out of hand. In an economy that is only now recovering from a major recession,²⁶ some companies which are at risk of succumbing to financial distress may not be restored to health, if they do not opt for examinership. Moreover, examinership guarantees that no secured creditor will be worse off than they would be given any other outcome, although unsecured creditors would lose out, if the company was subsequently liquidated. A streamlined administratively-focused examinership mechanism for small companies – it can be argued- would also be cost efficient from the banks' perspective. It could on many counts perform better than many other approaches currently used by the banks. It could also in critically important ways perform

²⁴ The Donnelly model is detailed later in this chapter.

²⁵ Company Law Review Group, *Report on Proposals to Reduce the Cost of Rescuing Viable Small Private Companies* (2012) Department of Jobs, Enterprise and Innovation, Dublin. This is appended to the CLRG Annual Report 2012. Companies (Amendment) Bill 2014 [No 5 of 2014] as presented to the Dáil by Deputy Donnelly. This is covered in chapter 2 of this thesis.

²⁶ Unemployment is at 9.5% at the time of writing (September, 2015). This is the lowest percentage for employment in six years. There were 206,500 persons officially unemployed in the Irish Republic in late August, 2015 according to figures released from the Central Statistics Office on September 1st, 2015. Data from the Central Statistics Office released on July 30th, 2015 show that gross domestic product (GDP) increased by 6.5% year-on-year while gross national product increased by 7.3% year-on-year.

better than the redesigned scheme of arrangement mechanism (as found in the Companies Act 2014) for the purposes of restructuring financially distressed companies.²⁷ It is, however, the case that the new scheme of arrangement mechanism would be more suitable than examinership would be for companies that merely seek to wind down their operations in an orderly fashion with the support of their major creditors including the banks.²⁸

SECTION 5.2 CORPORATE RESCUE AND SMALL COMPANIES

Even if the propositions favourable to examinership in the earlier section of this chapter and elsewhere are accepted, the following difficulties remain.²⁹ There are reasons, perhaps compelling ones, to be sceptical about the usefulness of corporate rescue legislation applied to small companies, if not to large- and medium-sized ones. As the overwhelming majority of companies in Ireland are relatively small in size, this scepticism and unease about something so central to the thesis question cannot be lightly dismissed.³⁰ The evidence from the United States and the UK suggests that the processes available in those countries which closely resemble examinership and which are specifically focused on the rescue of small companies are not much used. In the United States, the BAPCPA system, although it has brought about a streamlining of court processes for small companies, has also added to their administrative burdens, because of the necessity of complying with detailed and costly provisions regarding disclosure statements.³¹ In the UK, CVA with moratoria are little used. Administration under the Enterprise Act 2002 together with a cva would seem to provide a better solution for distressed small companies, but it too is not widely popular with such companies. This

²⁷ This is discussed later in this chapter. Companies Act 2014, Part 9, Chapter 1 ss 449 to 454 covers the scheme of arrangement.

²⁸ This is also discussed later in the chapter.

²⁹ For propositions favourable to examinership, see chapters 2 and 3.

³⁰ Central Statistics Office, "Business in Ireland 2012" (2014) CSO Dublin last downloaded on 16th December, 2015 at

<http://www.cso.ie/en/media/csoie/releasespublications/documents/multisectoral/2012/businessinireland2012.pdf>

³¹ The authors of the ABI Report - American Bankruptcy Institute, *Commission to Study the Reform of Chapter 11* (2014) ABI Alexandria at page 277- quite explicitly state that BAPCPA does not work to rehabilitate small companies. It is viewed as too slow and too cumbersome

section of the chapter considers the implications of the above for the rethinking of examinership and other processes in this country.³²

5.2.1: LESSONS FROM BAPCPA AND CVA/ADMINISTRATION

Much seems to hinge on the argument of Baird and Rasmussen regarding a distressed small company's capacity to have a going concern surplus:

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.³³

The question of whether all the assets of small companies can be used as well elsewhere when applied to the Irish context is complex. Certainly, a pre-pack receivership may, for its part, achieve a good deal, but in the domestically-traded part of the Irish economy that was relatively flat during the recession years and is only in recent times recovering³⁴ it does not follow that this is always the best solution. In pre-pack receiverships, there are casualties: aggrieved unsecured creditors and employees who may be made redundant. On the other hand, this riposte to the Baird and Jackson argument does not necessarily imply that the Irish courts are obliged to treat such company debtors in an excessively lenient way. The default position remains that most insolvent companies, be they small or large, can expect to be ultimately wound up.³⁵

Small companies in Ireland as elsewhere do not usually form a microsystem by which the loss of one could have severe repercussions for the others. Nevertheless, the liquidation of a

³² The central argument in this section is informed by G McCormack "Rescuing Small Businesses: Designing an "Efficient" Legal Regime"(2009) *Journal of Business Law* 299 and related references. Aspects of this paper have already been considered in Chapters 2 to 4.

³³ D G. Baird and R K. Rasmussen, "The End of Bankruptcy" (2002) 55 *Stan. Law Review* 758.

³⁴ This, of course, does not apply to the export-driven part of the Irish economy. Ireland's recovery is the strongest in the Eurozone. In the first nine months of 2014, GDP grew by close to 5%. Data downloaded from IBEC Quarterly Economic Outlook 2014 Q4 last downloaded on 16th December, 2015 at <http://www.cso.ie/en/media/csoie/releasespublications/documents/multisectoral/2012/businessinireland2012.pdf>

³⁵ This proposition was restated by the Company Law Review Group. The *Company Law Review Group, "Report on Proposals to Reduce the Cost of Rescuing Viable Small Private Companies"* is contained in the CLRG Report 2012 (2012) Department of Jobs, Enterprise and Innovation, Dublin at 17.

company at the local level can have very damaging consequences. Not all businesses are reconstituted and funds are not easily available always for viable new commercial projects. Arguments regarding the utility or otherwise of reconstituting small businesses which are offered by scholars from elsewhere in the English-speaking world³⁶ may need to be evaluated cautiously before being applied to Ireland. Nevertheless, none of the above would in themselves seem to provide compelling reasons towards a robust defence of examinership for small companies, although they may be necessary ones.

As detailed in Chapters 2 and 3, there are characteristic difficulties for small companies in distress which are associated with both the BAPCPA and the cva processes (or the Administration and cva processes, as appropriate). These difficulties for small companies are no less substantive in the case of examinership. As noted in chapters 2 to 4, besides being little used in practice, the relevant legislation in both BAPCPA and the cva processes has been inexpertly drafted. The extent of the duties of nominees in the case of cvs and trustees in the case of BAPCPA processes are therefore ambiguous.³⁷ Moreover, BAPCPA cases, although they are streamlined, presuppose that a candidate has ‘all its ducks in a row’ with regard to accounting information. Given the fine level of detail required, this would not usually be the case³⁸ The relevant legislation is merely a ‘bolt on’ to the existing Chapter 11 arrangement.³⁹ The level of information that must be formally disclosed by a BAPCPA candidate is formidable: the task may well be beyond the resources of most potential candidates.⁴⁰ The BAPCPA process is therefore not user-friendly for the most part.

³⁶ T Papworth, “The Trading Dead: The Zombie Firms Plaguing Britain’s Economy and what to do about them” (2013) Adam Smith Institute Research Trust London.

³⁷ G McCormack in “Rescuing Small Businesses: Designing an “Efficient” Legal Regime”(2009) *Journal of Business Law* 304.

³⁸ A Haines Jr J B and P J Hendel, “No Easy Answers: Small Business Bankruptcy After BAPCPA” (2005) 47 *B C L Review* 78.

³⁹This term is employed by G McCormack in “Rescuing Small Businesses: Designing an “Efficient” Legal Regime” (2009) *Journal of Business Law* 331.

⁴⁰ The plan filing and confirmation deadlines, together with the increased financial reporting requirements and the enhanced role of the trustee in small business cases have proven to be counter-productive. The information

5.3.2: ARGUMENTS AGAINST EXAMINERSHIP FOR SMALL COMPANIES

McCormack gives three reasons for the marked failure of formal rescue process for small businesses in both the US and the UK.⁴¹ The first is path dependence. Once a jurisdiction is set on a particular historical path it is very difficult to change direction and move down a different path. In the United States, the experience prior to the 1978 Bankruptcy Code militated against the enactment of a separate reorganisation chapter for small businesses in the 2005 BAPCPA reforms. Instead what was enacted was a “bolt on” to the complex Chapter 11, leading to further complexity. In the United Kingdom, the underlying suspicion of “debtor-in-possession”-led reconstruction, as well as the redesign of the more established administration procedure in the Enterprise Act, may have doomed CVAs with a moratorium to infrequent use.⁴² Administration for its part, like examinership, has proven in most cases to be prohibitively expensive for small companies. The middle course under the UK Insolvency Act 2000 of CVAs involving both a debtor-in-possession and an appointment of an external examiner has been proven to be an arrangement that was at the initially stages poorly thought out.

There are parallels here with the examinership experience. The examinership lite legislation⁴³ appears to be a bolt on-arrangement and an imperfect attempt at cost reduction for SMEs who go forward as examinership candidates.

The path dependency explanation, for its part, when applied to examinership does have much to offer. There was an element of accommodation for special interests in the Irish approach to examinership. Although there was a commitment to company rescue legislation as

required under the new processes is of a level of detail that is not easily available in the accounting systems of most small businesses.

⁴¹ G McCormack in “Rescuing Small Businesses: Designing an “Efficient” Legal Regime” (2009) *Journal of Business Law* 330.

⁴² G McCormack in “Rescuing Small Businesses: Designing an “Efficient” Legal Regime” (2009) *Journal of Business Law* 330.

⁴³ Companies (Miscellaneous Provisions) Act 2013 and Part 10, Companies Act 2014.

evidenced by the Companies Bill 1990, as noted earlier, the precipitating factor in the enactment of the Companies (Amendment) Act 1990 was the Goodman Group crisis of that year. The legislation was suitable for large companies, but it was not suitable for small- ones whatever about medium-sized companies. The facts bear this out. Relatively few companies in Ireland other than the large ones have ever made use of the formal company rescue mechanisms. The path dependency principle in the Irish case would seem to apply also in the Government's limited response to the recommendations of the Company Law Review Group relating to examinership.⁴⁴ The Group made substantive recommendations regarding formal rescue mechanisms for small companies, but they were not acted on or indeed widely discussed. Specifically, the Review Group included among their recommendations that an independent expert should be appointed to a company that had become insolvent or that was moving towards insolvency and where its directors and shareholders sought court protection for it. The term "expert" is here understood as approximating to that described within Section 501(2) of the Companies Act 2014. The task before the independent expert would be to do an assessment on the company to determine whether or not it was suitable for examinership. In cases where examinership was thought worthwhile, the expert would put together a report indicating that. The next stage would involve the independent expert filing his/her report with the Irish Insolvency Service. This agency would determine whether or not the company was likely to survive. If the thought that the chances of survival of the company were high, they would issue a protection certificate. A dissenting creditor would in such cases have a right of appeal against this decision to the Circuit Court. When a certificate was filed at the office of the Circuit Court, this would, in the ordinary way, stay creditor actions vis-à-vis enforcement on their part. When a certificate was issued, the Insolvency Service would then appoint an examiner to the case. The notice of appointment would be filed with the Circuit Court. The

⁴⁴ See Company Law Review Group, *Report on Proposals to Reduce the Cost of Rescuing Viable Small Private Companies* (2012) Department of Jobs, Enterprise and Innovation, Dublin which is appended to that report. a

examiner's proposal when available would first be submitted to a creditors meeting. The Circuit Court should as a practical matter -and quite apart from the possibilities that the existing examinership legislation afforded the Circuit Court so to do- take on the task of hearing examinership cases involving small companies

On the last point, the Review Group recognised that there could be potential conflicts of interest were the examiner and the expert (as referred to above) to be one and the same person. On cost grounds, however, the Review Group did not find fault with possible outturn of the examiner and the expert being the same person.

While the Government did not act on the Review Group's recommendation to put in place an examinership mechanism for small companies which would initially entail a non-judicial administrative procedure and (in suitable cases) would be subject to confirmation by the Circuit Court, they did offer an examinership process for small companies that would be within the context of the Circuit Court and would be shorn of any non-judicial administrative procedure at the initial stages (examinership lite).⁴⁵ They did, however, bring forth some months later the redesigned scheme of arrangement mechanism in ss 449 – 454 of the Companies Act 2014 in place of this.⁴⁶

McCormack suggests that another reason for the failure of both BAPCPA and the CVA (or administration and cva) was because the relevant legislation was deficient.⁴⁷ These deficiencies have already been outlined in Chapters 2 and 3. The deficiencies in the Companies (Miscellaneous Provisions) Act 2013 as now found in ss 508 to 558 of the

⁴⁵ Section 2(9) of the Companies (Miscellaneous Provisions) Act 2013 last downloaded on 17th December, 2015 at <http://www.irishstatutebook.ie/eli/2013/act/46/enacted/en/pdf> This is now in section 509 of the Companies Act 2014.

⁴⁶ This is described in Chapter 2 at section 2.4.1 above. The redesigned scheme of arrangement mechanism makes it possible for a company to restructure liabilities largely without court involvement: an application must be made to the High Court to have the scheme approved. Companies Act 2014, Part 9, Chapter 1 ss 449 to 454.

⁴⁷ G McCormack, "Rescuing Small Businesses: Designing an 'Efficient' Legal System" (2009) *Journal of Business Law* 299 at 321.

Companies Act 2014 are these. The costs for ailing small companies of court appearances remain high. The involvement of the courts in the examinership lite process, it may be argued is excessive. This is particularly so when examinership lite is compared with the cost efficient new scheme of arrangement mechanism, although they differ significantly in their design features and they meet different needs.⁴⁸ The usual defence offered against this is that court involvement is necessary to protect property rights guaranteed by the Constitution.⁴⁹ While the constitutional protection of property rights is particular to the Irish context, it would seem reasonable for the court while respecting property rights would involve itself directly only at the approval stage of the examinership process.⁵⁰ If this approach were taken further all questions relating to the company's fitness for examinership and the appointment or not of an examiner could be determined by an agency of the state outside the courtroom context.⁵¹ This may be to presume too much, given the very limited availability of state resources for new undertakings, although this may overstate possible difficulties.⁵² Even as things stand, however, the drafters of the Companies (Miscellaneous Provisions) Act 2013 seem to have presupposed a considerable amount in thinking that the Circuit Court would have the resources to handle examinership lite cases.

The third reason offered by McCormack is probably the most damning one. He considers that the focus upon business reorganisation rather than going concern or asset sales – when applied to small businesses in both the United States and the UK- is simply mistaken.⁵³

⁴⁸ This is considered in more detail later in the chapter.

⁴⁹ Article 40.3.2 and Article 43 of Bunreacht na hÉireann (the Irish Constitution).

⁵⁰ This was recommended in CLRG 12. Company Law Review Group. See Company Law Review Group, "Report on Proposals to Reduce the Cost of Rescuing Viable Small Private Companies" (2012) Department of Jobs, Enterprise and Innovation, Dublin appended to the CLRG Interim Report 2012 at page 15.

⁵¹ *ibid.*

⁵² For instance, some critics have noted that the drafters of the Companies (Miscellaneous Provisions) Act 2013 seem to have presupposed a considerable amount in thinking that that the Irish Circuit Court system would have the resources to handle examinership cases. K Tyrell, "Examining Examinership (2013) *Accountancy Ireland* 12.

⁵³ G McCormack, "Rescuing Small Businesses: Designing an 'Efficient' Legal System" (2009) *Journal of Business Law* 299 at 321.

When that question is asked about examinership – the question being: is it mistaken to put the focus upon business reorganisation rather than going concern or asset sales in the case of small businesses? – the following needs to be considered. In comparison to what obtains in the UK and the United States, formal court based processes are very rarely used. For instance, in the UK, about 20% of insolvencies are resolved through the administration option. In the United States, 25% of insolvency cases are resolved by means of Chapter 11 processes. In Ireland the corresponding percentage is 2%.⁵⁴ This may be due to a number of factors such as lack of awareness of the examinership mechanism, lack of credit to fund investment or misperceptions in cases where funds do exist, negative publicity surrounding previous examinership cases, tardiness on the part of distressed companies in going forward as examinership candidates, the costs involved and the prolonged nature of the process. Considered broadly, it is difficult to think of examinership whether traditional or lite as having been designed with the great majority of small companies in mind.

Given the resources both human and financial of most small companies, common sense would suggest that judicial involvement in rescue exercises for them must necessarily be light touch. That is to say that court involvement in a small company examinership case should be – at most- to sanction or not to sanction an examiner’s scheme of arrangement and nothing more. The rest could be done largely informally, provided that a survival plan passes the initial scrutiny of a government agency and an examiner is appointed by the agency on foot of this.⁵⁵ One difficulty with this is that if costs are reduced, it is likely to force out

⁵⁴Deputy Donnelly’s speech in the Dáil 5th February, 2014 Dáil Debates last downloaded on July 13th 2014 at [debates.oireachtas.ie/dail/](https://www.gov.uk/government/organisations/insolvency-service) See <https://www.gov.uk/government/organisations/insolvency-service> for relevant UK statistics; see <http://www.uscourts.gov/Statistics/BankruptcyStatistics.aspx> for relevant US statistics and www.insolvencyjournal.ie for relevant statistics relating to the Irish Republic.

⁵⁵ Potential candidates could be one or other of the following: the Office of the Director of Corporate Enforcement; the Companies Registration Office and the IASSA. The Company Law Review Group have already made this suggestion. See Company Law Review Group, “Report on Proposals to Reduce the Cost of Rescuing Viable Small Private Companies” (2012) Department of Jobs, Enterprise and Innovation, Dublin. It may be difficult to gain Government support for this administrative arrangement, however, given the existing work commitments of these agencies and the restrictions on further spending.

professional advisors – excepting the independent experts at the first stage - from the process. That could compromise the quality of small company examinerships.⁵⁶

5.3.3: A RECONSIDERATION OF THE ARGUMENT IN FAVOUR OF STREAMLINED EXAMINERSHIP FOR SMALL COMPANIES

Each of the three reasons given by McCormack would seem substantial as arguments against formal court-based rescue for small companies, Taken together, they seem to be sufficient as support for the author’s conclusions. The following, nevertheless, must also be considered. There was a clear intent on the part of the Irish Courts to save enterprises and jobs as ends in themselves. It would be naive to understate commercial factors in all of this, but it remains the case that the judges cannot overlook the original intent of the legislators.⁵⁷ The courts have expressed the purpose of examinership as being wide-ranging, particularly with regard to the retention of employment, where possible.⁵⁸

On the other hand, the Irish judiciary are fully cognisant of the potentially harmful effects upon well-run companies in the exercise of assisting ones that may not be. Mr Justice Fennelly expressed it as follows: “The court will weigh the existence and degree of any such prejudice in the balance.”⁵⁹

In summary, there is substantial evidence that most formal company rescue court-based processes of the kind currently available in the United States and the UK when applied to small companies in those jurisdictions have not proven to be a success.⁶⁰ This prompts caution when considering the options available in the Irish case. The present company rescue legislation –focused very much on High Court proceedings- has proven its capacity to work well for a significant minority of large- and medium- sized companies. It has not worked well

⁵⁶ This, however, does not necessarily follow, if the courts and the relevant government agencies have demanding standards.

⁵⁷ *Re Traffic Group* [2008] 3 IR 253 at para 23.

⁵⁸ *Re Traffic Group Ltd and the Companies Acts 12 3 IR 253* at para 23. See also *Re Irish Car Rentals* [2010]IEHC 235 (*ex tempore*).

⁵⁹ *Gallium Ltd and the Companies (Amendment) Act 1990* [2009] IESC 8 at para 47.

⁶⁰ It is necessary to draw a distinction between court-based company rescue processes in the United States which operate at federal level and those which operate at state level along with the out-of court assignments for the benefit of creditors. This has already been considered in chapter 2. See M R Cohen and J L Challacombe, “Assignment for Benefit of Creditors – A Contemporary Benefit for Corporations” (1989- 1990) 2 DePaul Law Journal 269.

for small ones in so far as few small companies would to this day consider entering as examinership candidates. Examinership lite is not being taken up and there is some anecdotal evidence that small companies in financial distress who opt for examinership are choosing the High Court route. Given these difficulties, it is necessary at least to entertain other possible options. The Donnelly proposal which is detailed in the paragraphs below and which is consonant with one recommendation of the Company Law Review Group- would seem to offer a considerable amount. Those who support the Donnelly approach contend both that the complexity and legalistic nature of the examinership processes currently available drive up the costs hugely and make them vulnerable to exploitation by well-resourced creditors. The Donnelly design model is superficially similar to examinership lite, but many of its features are considerably different from that found in examinership lite.⁶¹

Deputy Donnelly put forward a private members bill in the Dáil in January, 2014 It was entitled the Companies (Amendment) Bill, 2014.⁶² It did have a second reading. Simply stated, the first objective of the Donnelly bill was to reduce the average cost of examinership from more than €70,000 to €20,000. In Deputy Donnelly's view, the proposed legislation would attain this objective by allowing business owners and creditors to interact outside the courtroom first with the purpose of agreeing to a deal. At that point, they would go before the court so as to receive its approval for the agreed rescue plan. The proposed legislation would give more powers to examiners, thus allowing them to impose lending conditions on secured

⁶¹ The relevant Bill sponsored by Deputy Donnelly is the Companies (Amendment) Bill 2014. The original legislation relating to examinership lite was the Companies (Miscellaneous Provisions) Act 2013. The Companies Act 2014 now covers examinership matters.

⁶² The Companies (Amendment) Bill 2014 was introduced to the Dáil on 30th January 2014. It had its second stage before the Dáil on 4th and 5th of February, 2014. The pdf version last downloaded on 17th December, 2015 at <http://www.oireachtas.ie/documents/bills28/bills/2014/514/b514d.pdf>

lenders.⁶³ There would be a right of appeal for creditors to the Circuit Court.⁶⁴ It would also impose changes in leases in order to allow more SMEs to survive.⁶⁵

The proposed amendments to the examinership lite process that Deputy Donnelly puts forward involve identifying specific existing failures and providing workable solutions to each.

5.3.4: EXISTING POLICY FAILURES AND POSSIBLE REMEDIES:

1. High Court proceedings incur high legal costs.

The solution here for sme cases – as accepted by the Parliament- has been to move proceedings to the Circuit Court.⁶⁶

2. Automatic court involvement drives up costs unnecessarily

In cases where the analyses of two independent financial experts (i e the independent accountant and the examiner) indicated that the company had a prospect of survival, the Donnelly model would allow for the company to enter examinership. The model would also do away with court involvement in examinership, except in cases where unfair prejudice was claimed. All appeals would be made to the Circuit Court.

3. Secured creditors foreclosure of viable companies

In the Donnelly model, an examiner may impose lending conditions on secured lenders. This would extend over a five year period and be based on the minimum altered lending amount which would be to the value of the underlying security plus 7%. Thus, secured creditors could not impose “on demand” repayment terms.⁶⁷

4 Landlord-imposed upward only rent review clauses that force the closure of viable businesses

The Donnelly model would give the examiner the ability to impose changes to the lease for a five year period. This would be based on the minimum term of interest in the market plus 7%⁶⁸

5 Creditors try to drive up the costs of examinership through vexatious court appeals

⁶³ Clause 36(G), Companies (Amendment) Act 2014.

⁶⁴ Clause 36(D), Companies (Amendment) Act 2014.

⁶⁵ Clause 36(J), Companies (Amendment) Act 2014.

⁶⁶ The entry criteria with regard to candidates for small company examinership under the Donnelly proposals are set out in the Companies (Amendment) Bill 2014, s2.

⁶⁷ Companies (Amendment) Bill 2014, s 36K.

⁶⁸ Companies (Amendment) Bill 2014, s 36J.

Donnelly would restate the principle whereby in instances where a creditor engaged in court proceedings for vexatious or frivolous reasons, they would be at risk of an order for costs incurred by the examiner and/or the company in defending the appeal⁶⁹

4. Instances where trade creditors offering goods or services essential to the company refuse to trade with the debtor company unless special guarantees are provided by the debtor

Donnelly would enable the examiner to give priority of payment to such creditors⁷⁰.

The process proposed by Deputy Donnelly is both cost effective and swift. It also manages to face down critical objections. It respects the constitutionally guaranteed property rights of creditors and vindicates their rights to object to a given scheme of arrangement. It upholds the principle that no creditor would be less well-off under a scheme of arrangement than under any other possible outcome. It is feasible and is a measure worth considering in the very difficult economic circumstances from which small companies in particular have only in recent years begun to extricate themselves.⁷¹ It does, however, have its risks. If a badly managed company is given a reprieve, it may, in the medium to long-term pull down some creditors. Prudence therefore is appropriate. Nevertheless, given the composition of the Irish economy and what is particular to it, a reasonable case could be made out for a Donnelly-style low cost examinership arrangement targeted at small companies and with limited court oversight. Donnelly is more ambitious; the examiner lite arrangement, for its part, only dealt with the reduction of court costs.

The Donnelly model differs from the examinership lite model in that it provides an effective mechanism to resolve landlord imposed upward only rent clauses between landlords and commercial tenants.⁷² The Donnelly approach in this can produce something approaching certainty for the distressed company; the corresponding part in examinership lite allows for a

⁶⁹ Companies (Amendment) Bill 2014, s 36 (4).

⁷⁰ Companies (Amendment) Bill s 36G.

⁷¹ The fact remained that as late as April, 2013, of the €50 million lent to the sme sector by domestic banks €25 million was in arrears. This was noted by Fiona Muldoon, the director of the credit institution supervision division at the Central Bank at the Cantillon Conference, Tralee, Ireland on April 11th, 2013.

⁷² See *Ickendel Limited v Bewley's Café Limited* [2014] IESC 41 for insights into the relevant law.

larger measure of judicial discretion.⁷³ Moreover, there are good reasons to believe that the whole matter of rents has become the key question in examinership today.⁷⁴

It is worthwhile to contrast the Donnelly model not only with what is offered in examinership lite but also with the recommendations in CLRG Report for 2012.⁷⁵ Having ruled out the possibility of an administrative or other arrangement for the rescue of financially distressed companies, the group opted for an examinership arrangement that would be subject to the approval of the Circuit Court. The group also proposed that candidates should enter administration by approval of a government agency such as an Insolvency Service.⁷⁶ The view was taken by the CLRG that a scheme of arrangement within examinership and in which creditors' rights were being both circumscribed and diminished would necessarily require judicial sanction. This was their view, because of the existence of Article 40 of the Irish Constitution which guarantees property rights. This, however, does not pierce the armour of the Donnelly model, because in Donnelly all creditors would be guaranteed a

⁷³ The Government's advisors could argue that the point and purpose of examinership lite was to address the upward only rent clause difficulties for sme businesses in Ireland without antagonising landlords. From this perspective, the legislation might seem to promise more than it might often deliver. A reasonably sound argument could be made for the contention that in some instances the law should not intervene where market forces could resolve the matter. In this view, difficulties experienced by business tenants with commercial rents would be a temporary problem. In the retail sector, for instance, inefficient businesses in difficult trading conditions would thus be weeded out to make room for other parties. Besides, the argument continues, demand has slowly begun to grow in the retail sector in Ireland today. There would thus be reasonable grounds for expecting that other companies could replace the ones that fail in a business sector like retail which is demand driven. These other companies could operate at a lower cost base and with more appropriate rents. Those who would use this argument are at risk of sounding to others as a trifle panglossian. It is important to remember that the retail sector or the part of it comprised of companies in financial distress) forms only part of the overall number of sme companies in financial distress. In addition, it is helpful to remember that approximately one-half of loans from commercial banks were – as of 2013- in arrears.

⁷⁴ It would appear that – as of the time of writing in August, 2015- rents are being heviewed by many , as already noted, as being the key matter in examinership today. An important new development has occurred in this context. New landlords have purchased retail park and shopping centre assets from the National Assets Management Agency (NAMA). When these assets were controlled by NAMA, some rent reductions were given to tenants. This is no longer the case. The new landlords are seeking to revert to the full rent lease amount. They are also seeking rent payments in advance. The new landlords are uninterested in having a sustainable tenant mix. They simply want to generate the maximum return. These points were made in a letter to the editor of the Irish Independent on the 23rd July, 2015 by David Fitzsimons, the Chief Executive of Retail Excellence Ireland.

⁷⁵ Company Law Review Group. Interim Report 2012 “ Report on Proposals to Reduce the Cost of Rescuing Viable Small Private Companies” (2012) Department of Jobs, Enterprise and Innovation, Dublin appended to the CLRG Interim Report 2012, 15.

⁷⁶ Company Law Review Group. Interim Report 2012 “ Report on Proposals to Reduce the Cost of Rescuing Viable Small Private Companies” (2012) Department of Jobs, Enterprise and Innovation, Dublin appended to the CLRG Interim Report 2012, 15.

higher return in that form of examinership than would otherwise be available in any alternative arrangement. The Donnelly approach would not accept the assumption that judicial sanction was necessary in such a context, but it would be quite different if the creditors were to suffer losses. In addition they (the creditors) would always have a right of recourse to judicial proceedings, if they felt aggrieved.

The other significant development in Irish company rescue law in recent times – briefly ,to recap- has been that of the new scheme of arrangement in the Companies Act 2014.⁷⁷ On a first reading, its terms would seem to rival examinership lite or indeed the Donnelly model, but this impression would be both incorrect and superficial. The new scheme of arrangement process does seem to cater for the same category of companies as examinership lite. It allows structured payments of tax arrears. It allows some tax losses to be retained. It is legally binding. It provides for a moratorium. It avoids the need for a detailed investigation of the affairs of the company. If the scheme is successfully implemented, there is no possibility of the directors facing reckless trading or fraudulent trading allegations or of them being subject to restrictions or disqualification. It is likely to cost less than other insolvency procedures including receivership, liquidation or examinership. (That includes Donnelly model examinership). There are additional advantages. Unlike examinership petition cases, the business need not be viable.⁷⁸ It entails less publicity. There is no need for an independent expert's report to commence the process. There is no need for approval of the scheme by the High Court to enter the process.⁷⁹ In a scheme of arrangement of the new kind, it is much less likely that the shareholders will lose control of the company. This contrasts with

⁷⁷ Companies Act 2014, Part 9, Chapter 1 ss 449 to 454

⁷⁸ Thus, these schemes of arrangement may be used to wind up a company's affairs. In such an outturn, a greater dividend can be paid to investors. Monies can also be set aside for voluntary strike off.

⁷⁹ This can be particularly relevant when the directors, have, for example, deliberately understated the company's tax liabilities. In such instances, in an examinership petition, this might cause the court to reject the petition.

examinership where, in some instances, shareholders have found themselves ousted by a new investor. In addition, the new schemes of arrangement have no strict deadlines to adhere to.

There are, however, some serious disadvantages for financially distressed companies in the new scheme of arrangement. The bank may in some instances appoint a receiver to the company. Trade creditors may claim retention of title. There is no provision for compulsory repudiation of leases. In addition, leasing companies may repossess assets. The voting threshold for a scheme of arrangement is also higher. It is 75%.⁸⁰ This compares with a simple majority in examinership.

Briefly stated, the last two paragraphs might suggest that the new scheme of arrangement mechanism might be suitable for some companies, but not for many others. On its face, it would at critical points seem to leave financially distressed companies who wished to trade out of their difficulties as hostages to fortune. Creditors can still endanger a company that may be viable. On the other hand, some new scheme of arrangement candidates might simply wish to wind down without publicity. It would be very suitable for them. The new scheme of arrangement would not seem at this time to be a serious rival to examinership lite. It is not a rival to the Donnelly model, because it does not shield candidates adequately from powerful creditor interests.

SECTION 5.4 EVALUATING THE QUALITY OF THE EXAMINERSHIP PROCESS

It has been remarked that it is not easy to evaluate the quality of a formal rescue process.⁸¹

The processes have many components, both formal and informal and it is difficult to establish boundaries, particularly so when considering what obtains in the US and the UK. Parties involved in an insolvency case have different interests and they employ different criteria

⁸⁰ Section 453, Companies Act 2014.

⁸¹ V Finch, "Corporate Rescue Processes: The Search for Quality and the Capacity to Resolve" (2010) *Journal of Business Law* 502. This pioneering paper has lit the way in studies related to the quality of company rescue regimes. The writer in the preparation of this section owes a great deal to the substantive work of V Finch.

when evaluating company rescue exercises. Consensus is not easily arrived at. There are subtleties in this. Finch refers to them as follows:

In evaluating a “rescue regime” care has to be taken to identify the element of the regime that is related to the outcome at issue. It can be questioned, for example whether an aspect of poor performance is attributable to such matters as the substance of a rule, its drafting, the status and force of the rule, the type of party charged to apply the rule or the process used to implement or review the rule. Similarly, it may be difficult to say whether certain corporate problems are due to the rescue regime that is applied or to broader factors such as the rules and practices that govern lending, general company law constraints, the financial regulatory regime or the taxation system.⁸²

In addition, there is very little scholarly work on this subject and none at all in the Irish context. Clarification of policy goals would seem to be a prerequisite prior to any further legislative initiatives in this area. What follows in this section is the identification and analysis of input and process quality criteria vis-à-vis examinership as well as optimal processes which can be successfully implemented. Given the complexity of these matters a modest overview is offered in the paragraphs below.

5.4.1: THEORETICAL QUESTIONS

The values promoted by mechanisms such as examinership would include rescuing companies which are viable; defending the rights of creditors and seeking to preserve employment. (These values are not easily reconciled). There is a general commitment to equitable treatment of all parties. There is, in addition, a commitment to transparency and accountability. Court procedures allow for all parties with substantive interests to be heard. An emphasis is placed upon reason and the taking of judicial decisions based on sound evidence. Finch identifies two issues which need to be addressed in any investigation into this matter. These are:

- (1) the identification of performance indicators related to these values

⁸² V Finch, “Corporate Rescue Processes: The Search for Quality and the Capacity to Resolve” (2010) *Journal of Business Law* 505.

(2) the reconciliation of these values.⁸³

Finch⁸⁴ writes as follows:

Performance measures can generally be divided into four types according to their focus on: inputs, processes, outputs or outcomes. Input based assessments would look, in rescue, to such matters as the resources that are devoted to rescue processes--how much money, for instance, is being expended on insolvency or turnaround specialists and what body of skills is being applied to rescue purposes. Process-based assessments tend to look to the degree to which there is adherence to procedural requirements and other laws, policies or guidelines. In the rescue context, attention might be paid to the quality of rescue processes and indications of this would be perceptions of such matters as transparency, openness and fairness. Output-based assessments are less common and, regarding rescue, would look to such indicators as the numbers of rescues attempted and the average time that is taken to process cases.

The most costly in all of these are outcome-based assessments. These assessments cover such matters as survival rates of successful rescue cases and returns to creditors. The specific yardsticks applicable to process objectives, output objectives and outcome objectives are detailed in the next section and applied to examinership.

Finch provides a nuanced and substantive argument about identifying what things in formal company rescue processes could be relevant in any evaluation of those processes and the attendant difficulties of attempting to achieve good results with these processes. In addition, even if the parties are in agreement about yardsticks, they may not share the same ideas about quality.⁸⁵ Another consideration is this: for Finch “rescue processes are complex mixtures of procedures, actors and institutional arrangements--each combination of which may be separately assessable.”⁸⁶ It is also possible at a fundamental level to view rescue processes from a narrow or from a broad focus; that is to investigate details individually or to think purely in holistic terms. The one observation that can be made about the Irish context is that

⁸³ V Finch, ‘Corporate Rescue Processes: The Search for Quality and the Capacity to Resolve’ (2010 Journal of Business Law 514.

⁸⁴ V Finch, ‘Corporate Rescue Processes: The Search for Quality and the Capacity to Resolve’ (2010 Journal of Business Law 514 at 523.

⁸⁵ V Finch, ‘Corporate Rescue Processes: The Search for Quality and the Capacity to Resolve’ (2010 Journal of Business Law 518.

⁸⁶ V Finch, ‘Corporate Rescue Processes: The Search for Quality and the Capacity to Resolve’ (2010 Journal of Business Law 518 at 530.

there are somewhat less difficulties in evaluation than is the case in the UK, because the processes available are fewer in number. The terrain, however, does have its challenges for the scholar. At governmental policymaking level, there is very little evidential material available. This is unlike that which obtains in the UK.⁸⁷ The issues must therefore be addressed in a simpler and more mundane way. There is some evidence in the Irish case of inconsistent policy choices.⁸⁸ For instance, at the second stage reading of the Companies (Amendment) Bill 1990 in the Dáil, the sponsoring Minister, Mr O'Malley, employed the following language:

To use a medical analogy, these provisions are intended to be of use to companies that are temporarily “sick”— I would not normally expect to see them being used by healthy companies or indeed in the final analysis by companies that are terminally ill.⁸⁹

This pragmatic approach has remained a consistent feature of policy regarding examinership: it was restated by the Company Law Review Group (CLRG) in their 2012 report.⁹⁰ Some critically important deficiencies (or ostensible deficiencies) of examinership have not, however, been addressed until recent times.⁹¹ One of these has been the fundamentally unworkable nature for small companies from the beginning of the existing examinership process. On the other hand, there is some evidence that both the independent CLRG and the government itself would wish to apply unconventional approaches to formal rescue. For instance, the Minister for Jobs, Enterprise and Innovation in 2012 requested the Company Law Review Group to examine the feasibility of introducing a differently-structured and non-

⁸⁷ See V Finch, ‘Corporate Rescue Processes: The Search for Quality and the Capacity to Resolve’ (2010) *Journal of Business Law* 515- 517 for a review of relevant documents.

⁸⁸ That is to say that examinership from a policy perspective was initially thought of very largely as a mechanism of helping fundamentally sound companies such as the Goodman Group get over a major, but temporary, difficulty. It was thought of to a significant degree in commercially pragmatic terms, but not exclusively so. The more encompassing vision of examinership came later.

⁸⁹ Companies (Amendment) Bill 1990, Second Stage, Tuesday, 28 August 1990, Dáil Debates, Vol 401, no 8.

⁹⁰ Company Law Review Group. See Company Law Review Group, “Report on Proposals to Reduce the Cost of Rescuing Viable Small Private Companies” (2012) Department of Jobs, Enterprise and Innovation, Dublin at page 14.

⁹¹ The CLRG in the same report expressed things as follows: “The Review group considers that examinership in its form currently available to small private companies is inadequate by reason of the costs involved” at page 14.

judicial commercial debt settlement and enforcement system for small companies. This was the original seedling for what would be an examinership ‘lite’ model, the details of which have already been provided. This ministerial request was made in connection with the commitment included in the “Programme for Government” to allow small businesses to restructure their debts outside of the courts’ system.⁹²

5.4.2: MEASURING QUALITY IN THE EXAMINATION PROCESS

In spite of the brief review above, the examinership model fares quite well when assessed in terms of the key criterion of quality identified by Finch. This criterion is the “capacity to resolve.” This criterion has its origin in political science and regulatory affairs.⁹³ Finch writes as follows:

How might an insolvency regime's capacity to resolve be assessed? Such an evaluation might involve investigating such matters as whether, say, the administration process, and the ways in which the judges oversee this, contributes to workable understandings on such matters as the consultative duties of the office holder--and whether such understandings extend across relevant actors sufficiently to allow implementing actions to be taken and the fostering of certainty, efficiency and openness in the rescue process more generally. This is not so much a matter of bringing different interests and perceptions into complete alignment--parties will not be separable from their starting positions that easily--it involves creating the degree of mutual understanding that will suffice to permit the taking of organised and timely actions in response to problems.⁹⁴

Examinership specifically as an agent of resolution – at least in cases involving large and medium-sized companies- does well in so far as it is fair, transparent, inclusive and rigorous.

The following offers an analysis of process inputs, process objectives, output objectives and outcome objectives of the kind identified by Finch when applied to examinership.⁹⁵

⁹²“Programme for Government “ (2011) last accessed July 22nd, 2014 at <http://www.merriestreet.ie/index.php/about/programme-for-government/> .

⁹³ V Finch, ‘Corporate Rescue Processes: The Search for Quality and the Capacity to Resolve’ (2010) Journal of Business Law 520.

⁹⁴ V Finch, “Corporate Rescue Processes: The Search for Quality and the Capacity to Resolve” (2010) Journal of Business Law 520.

⁹⁵ V Finch, “Corporate Rescue Processes: The Search for Quality and the Capacity to Resolve” (2010) Journal of Business Law 514.

5.4.3: THE PROCESSES

On processes inputs, examinership fares poorly. It is prohibitively costly – likely to be in excess of €100,000⁹⁶- if proceedings are conducted in the High Court. If conducted in the Circuit Court costs may be far lower, but there is always the risk that a creditor will engage in legal action against a debtor company and thus escalate costs. As things stand, examinership is not perceived (or is simply misperceived) by most small companies in distress as an option open to them.⁹⁷ This is critical as small companies constitute more than ninety-nine percent of existing Irish companies.⁹⁸

On process objectives, debtor and creditor interests are dealt with fairly in decision and policy processes. From the debtor company's perspective, the court protection period provides a shield from creditor actions for a period of up to one hundred days. The company is subject only to the right of set off on the part of a financial institution, subject only to the examiner's approval.⁹⁹ From the creditors' perspective, things are less positive. They are subject to a "drastic abridgement of rights."¹⁰⁰ To state matters simply and without traducing a complex and extensive area of law, creditors are hampered in the enforcement of rights to

⁹⁶ Examinership fees vary significantly, but are nearly always high. For instance in *Re Sharmane Ltd* [2009] 7 JIC 3002 at para 22, Finlay Geoghegan J cut a bill of €1,072,126 by 18%. The determination of Examiner's fees is governed by section 29 of the Companies Act 1990 now section 554 of the Companies Act 2014. In a successful examinership, the Examiner's costs, fees and expenses are paid out of the new investor funds and are subject to the deal struck between the examiner and the investor. If the examinership is unsuccessful, the Examiner's fees are paid out of the funds available at the time of the subsequent receivership or liquidation. In these cases, it is the company's bank which will bear the cost. Where an examinership fails, the High Court determines the level of the Examiner's fees. The High Court has capped the maximum hourly rate that can be charged by the Examiner and his legal team.

⁹⁷ There were 14 examinerships completed in 2014. The examinership lite legislation became operative in July, 2014. Already there is anecdotal evidence from the legal professions that small companies who have embarked on examinership in the last eighteen months have opted to have the case heard in the High Court. They have done this, because the existing legal expertise (other than what is available from the law firms) is found in the High Court. It is submitted that the cost issue for small companies has not been resolved.

⁹⁸ Business in Ireland 2011 (2013) CSO Dublin 15

⁹⁹ Order 75A of the Rules of the Superior Courts (2015).

¹⁰⁰ The words are taken from Keane J in *Re Butler's Engineering Ltd* (1st March, 1996 unreported) High Court at page 10 of the transcript. That is to say that creditors are not permitted to pursue their claims against the company. Besides, the sums of money owed to them may be drastically reduced.

which they are otherwise entitled and there is an almost absolute stoppage on discharging pre-petition liabilities.¹⁰¹

On questions related to dealing with different creditors' interests fairly in decision and policy processes, it is evident that the priority status of unsecured creditors is lower than that of the examiner's fees, the amount owed to financial institutions and the Revenue Commissioners. On the other hand, if the scheme of arrangement advanced by the examiner is claimed to impair the rights of an unsecured creditor, the court must determine that the scheme is fair and equitable vis-à-vis the class of unsecured creditors taken together. These matters can, however, give rise to complications. For instance, if there is a disparity between the dividends available to different classes of creditors under a scheme of arrangement, "the court will distinguish between proposals which are prejudicial to the interests of the objector and proposals which are extremely prejudicial." in accordance with s 25(1)(d) of the Companies (Amendment) Act 1990.¹⁰² If that disparity were to be very great, the court could rule against the scheme of arrangement.

On the matter of examinership being transparent and free from abuse, the evidence presented in chapters 2 to 5 of this thesis would seem to bear that out.

Insolvency proceedings are both collective and inclusive: witness the class of creditor arrangement under the scheme of arrangement and the scrupulous nature of the confirmation hearing.

Examinership is in most cases not a speedy process, although in larger cases it is increasingly streamlined.¹⁰³

On output objectives:

The rules governing insolvency and rescue in this country are sufficiently rigorous to preserve market confidence both domestically and internationally.

¹⁰¹ T Courtney, *The Law of Companies* Bloomsbury Professional West Sussex 2012 1410.

¹⁰² This is now contained in section 543 of the Companies Act 2014. See also I Lynch-Fannon and G N Murray, 2nd edn, *Corporate Insolvency and Rescue* (Bloomsbury 2012) at page 581.

¹⁰³ Most successful examinerships in the High Court are now well-planned and executed operations. Witness the *Eircom* examinership.

The objectives of examinership:

It has already been stated that it is not easy to reconcile policy objectives. What is notable about insolvency law policy in Ireland is its extreme pragmatism. There is a full realisation in these circles that the offering of a reprieve to a lame duck company that is badly managed may in the longer-term bring about the collapse of healthier and better managed ones. Thus the reasonable prospect of survival test is central to company rescue law in this country. Moreover, much light has been cast by Supreme Court cases on the correct interpretation of the Companies (Amendment) Act, 1990 as amended to provide useful guidelines (eg *Re Gallium Ltd* [2009]IESC 8).

5.5: PROFESSIONAL FEES

Among the first observations that can be made about examinership is that it is both an intensive process and an expensive one.¹⁰⁴The immediate costs relate to the accountant's fees for the report on the potential examination candidate's viability and to the examinership application papers put together by the legal team. The immediate costs are a small proportion of examinership costs overall. The substantive costs of examinership relate to the work done by the examiner once he/she is appointed.¹⁰⁵ The variables relate to the size of the company, the number of creditors and creditor tactics.¹⁰⁶ Again, the matter of the status of the court which hears the case does not affect the complexity and amount of work to be done by the examiner. In cases where the examinership is successful -from the debtor company perspective- fees, costs and expenses are paid out of the funds available from the new investor. Where the examinership is unsuccessful, the High Court determines the level of the examiner's fees, costs and expenses by capping the maximum hourly rate that can be charged by the examiner and his/her legal team.¹⁰⁷There have been no officially sanctioned costs reviews of examinership processes.

¹⁰⁴ I Lynch-Fannon and G Murphy, *Corporate Insolvency and Rescue* (2012) 2nd edn Bloomsbury Professional 608.

¹⁰⁵ In *Re Missford Ltd* [2010] the court determined on controlling the cost of examinership by reducing the remuneration claimed by the examiner under s 29 of the Companies (Amendment) Act 1990 as well as limiting the expenses an examiner may certify under s 10 of the same Act.

¹⁰⁶ *Re McInerney Homes Ltd* [2011] points to the watchfulness of the courts in avoiding prolonged legal processes to no good purpose.

¹⁰⁷ Companies (Amendment) Act 1990, section 29(1). In *Marino Ltd and Others and the Companies Acts* [2010] IEHC 394 Clarke J said the following:

As an incidental matter, the remuneration of insolvency practitioners in the UK and expenses incurred by them has been subject to some scrutiny in recent times. The Kempson Review was published in March, 2014.¹⁰⁸ The focus of the review was the impact of these costs upon the position of unsecured creditors and personal debtors in insolvency cases.¹⁰⁹

Professor Kempson made the following suggestions to improve fee oversight:

- (1) Insolvency work should be subject to competitive tendering
- (2) More information should be disclosed regarding fee estimates and there should be greater transparency in these matters
- (3) There should be increased unsecured creditor engagement. In particular there should be increasing involvement from HM Treasury and the UK Redundancy Payments Service and the Pension Protection Fund. If the Crown were to act as overseer on behalf of unsecured creditors, the potential should be investigated of allocating unclaimed account and reserve fund monies from insolvencies that are currently returned to HM Treasury. as well as creditor representation by commercial organisations
- (4) The basis of remuneration should be changed
- (5) The process of oversight necessary for unsecured creditors should be simplified.
- (6) There should be a greater degree of compliance monitoring by regulators of fees in corporate insolvencies than is currently the case.
- (7) If it should turn out that it is not possible to achieve reforms relating to the points above then consideration should be given to some form of independent oversight such as that found in Scotland in the form of court reporters for insolvency
- (8) Low cost mediation/adjudication services for fee disputes should be available

The Kempson Review has much relevance to the Irish context. For instance, the suggestion that the HM Treasury and the UK Redundancy Payments Service participate more fully in the oversight of UK insolvency practitioner fees could be applied to the equivalent agencies in this country. Competitive tendering could well be unworkable in the Irish context. The fee oversight recommendation also has merit.

I propose allowing €375.00 per hour for those at partner level in this case. On the same basis, it seems to me that the rate for Associate Director should be €300.00 per hour, that for Manager €260.00 per hour, that for Senior Accountant €200.00 per hour, and that for Trainee Accountant €80.00.

Re Missford Ltd [2010] IEHC 240, [2010] 3 IR 756 offers important insights into remuneration for professional services in examinerships.

¹⁰⁸ E Kempson, *Review of Insolvency Practitioner Fees: Report to the Insolvency Service* (2014) London.

¹⁰⁹ Office of Fair Trading, *The Market for Corporate Insolvency Practitioners: A Market Study* (2010) London.

5.6: EXAMINERSHIP AND THE SIX PRINCIPLES IN THE EU RESTRUCTURING RECOMMENDATION

There are six core principles emphasised in the Commission's recommendations for a "preventative restructuring framework" in each Member State.¹¹⁰ These principles should be taken together when used in any evaluation of examinership in this country.

(1) *The early recourse principle:*

(The Commission recommends that a debtor be able to have recourse to the restructuring framework at an early stage, before factual insolvency.¹¹¹ Adherence to this principle would require a change in the law. The Commission does not, however, recommend unrestricted access to its restructuring framework)

Clearly, examinership or any other formal legal system currently available here does not meet this test.

(2) *The minimised court involvement principle:*¹¹²

Clearly, one again, examinership does not fare well using this criterion, but the new scheme of arrangement system would fare better.

(3) *The debtor-in-possession principle*¹¹³

This does not apply in the Irish context.

(4) *The court ordered stay;* (5) *the ability to bind dissenting creditors principle* and (6) *the protection of new finance principle are applied in this jurisdiction.*¹¹⁴

It is difficult to determine the extent to which these principles weigh upon the shoulders of political decision-makers and legislators in this country. The evidence to date is that the principles have not been taken up in countries throughout the European Union.

¹¹⁰ EU Commission, "Commission Recommendation on a New Approach to Business Failure and Insolvency" (2014) Brussels last downloaded on 17thth November, 2015 at http://ec.europa.eu/justice/newsroom/civil/news/140312_en.htm

¹¹¹ EU Commission, "Commission Recommendation on a New Approach to Business Failure and Insolvency" (2014) Brussels last downloaded on 17thth November, 2015 at http://ec.europa.eu/justice/newsroom/civil/news/140312_en. at para 6(A).

¹¹² EU Commission, "Commission Recommendation on a New Approach to Business Failure and Insolvency" (2014) Brussels last downloaded on 17thth November, 2015 at http://ec.europa.eu/justice/newsroom/civil/news/140312_en. at para 7.

¹¹³ EU Commission, "Commission Recommendation on a New Approach to Business Failure and Insolvency" (2014) Brussels last downloaded on 17thth November, 2015 at http://ec.europa.eu/justice/newsroom/civil/news/140312_en. at para 6(b).

¹¹⁴ EU Commission, "Commission Recommendation on a New Approach to Business Failure and Insolvency" (2014) Brussels last downloaded on 17thth November, 2015 at http://ec.europa.eu/justice/newsroom/civil/news/140312_en. at para 6.

CONCLUSION

This chapter advanced the central research question by detailing a company rescue model that would be suitable for the SME sector in Ireland. It threw some light on why some western European countries have chosen by and large or not at all to employ debtor-oriented company rescue models. Quality issues related to examinership were also addressed. In the opening section, an experiment is conducted: corporate insolvency was viewed as a governance mechanism in contrast to the arguments offered in the earlier chapters. Two kinds of governance arrangements were considered: that is, debtor-oriented and creditor-oriented regimes. The argument that a debtor-oriented system was applicable to large corporations while a creditor-oriented system was applicable to small- and medium-sized companies was carefully detailed. It was noted that the overwhelming majority of business enterprises in Ireland are SMEs. It was observed that there are reasons, perhaps compelling ones, to be sceptical about the usefulness of corporate rescue legislation applied to small companies, if not to large- and medium-sized ones. On the other hand, it was accepted that account must be taken of what was particular to the Irish economy and the fact that it was composed overwhelmingly of small companies. Regarding company rescue principles, what was applicable elsewhere might not be applicable to Ireland. It was remarked that it is not easy to evaluate the quality of a formal rescue process.¹¹⁵ The processes had many components, both formal and informal and it was difficult to establish what fitted the Irish case. Suitable yardsticks were identified and they were applied to existing company rescue law in Ireland. The professional fees issue was addressed and examinership was considered with regard to the six principles of the EU Restructuring Recommendation.

Chapter 6 relates to bargaining in the shadow of formal restructuring law.

CHAPTER 6

BARGAINING IN THE SHADOW OF FORMAL CORPORATE RESTRUCTURING LAW

INTRODUCTION:

The bulk of corporate restructuring work is undertaken at a great distance from the courtroom. That is to say that it is not necessarily the intention of the parties involved that all questions should be resolved from the beginning in the courtroom. For instance, the parties may set out to achieve a swift resolution through the courts –through an administration or receivership in the UK following on from a pre-pack arrangement or through an examinership here following on from a pre-pack in the same way. The purposes of this chapter are as follows. The first objective is to consider informal restructuring (in this context out-of-court restructuring or restructuring activities that are to some extent conducted out-of-court) as something that is not in opposition to the formal models considered before.¹¹⁶ Both the formal restructuring models (of the kind involving much court activity) and those considered here together constitute a spectrum: there are gradations of difference as one moves from one end to the other. At the extremes, these difference are much more evident, one from the other. Simply stated, out-of-court restructuring in Ireland relates to private restructuring arrangements between companies and their stakeholders that can be agreed between themselves. The kind of out-of-court cases which are spotlighted by the media – a minority overall of informal restructuring/insolvency processes- are those which involve a

¹¹⁶ See T Bond, “A Global Approach for Multi-Creditor Out-of-Court Restructurings – A New Initiative and the Wider Issues” (2001-2002) 17 Conn. J. of International Law 41.

pre-negotiation that then leads on to a formal insolvency process such as examinership. Uncommonly, schemes of arrangement or other compromises may come within this last sub-category. The second objective is to describe these models more carefully. These range from private arrangements between a debtor and creditor to procedures which are buttressed by norms of professional conduct and procedures. At the end of that part of the spectrum, the level of formality increases: in these cases the process of arriving at agreement is likely to involve court activity. The third objective is to offer tentative suggestions for what might usefully – with modifications- have application in a small open economy. This last would not be to suggest that some of these models and techniques are not at this time being employed in Ireland by insolvency professionals. The fourth purpose is to discuss briefly the arguments pro and contra each of the existing informal restructuring models.

The work in this chapter is to follow through on answering that part of the central research question that relates to informal reorganisation. That question involves identifying suitable models for corporate restructuring law or suitable models in the shadow of corporate restructuring law in a small open economy. At a very practical level in this jurisdiction, it involves consideration of pre-pack receivership (to the extent that it is a hybrid process) and how it might serve to displace examinership. The major task is to decide on a legal framework that facilitates simplified restructuring procedures without itself becoming obtrusive.¹¹⁷ This chapter takes the following form. Section one introduces informal restructuring. It offers a commentary on how formal and informal methods can complement each other. Section two presents arguments pro and contra informal restructuring. Section two introduces the topic of informal restructuring in detail. Section three identifies suitable informal restructuring models in the Irish context. Section four investigates these models

more closely and suggests possible modifications which would make them applicable to an Irish context. This is followed by a conclusion.

SECTION 6.1: INFORMAL RESTRUCTURING

The model that is applicable in any one instance involving corporate distress depends on the given circumstances. There can be little doubt, however, that non-formal approaches of whatever kind limit the adverse consequences commercially for management entering negotiations on behalf of financially troubled companies. They can also be more effective than court procedures. T Copeland et al offers the critically important observation that informal reorganisation has – in addition- much relevance outside of insolvency.

The principles of informal reorganisation can also be applied to companies which are not in an immediate crisis situation as such, but which will be in that situation sooner or later, if no action is taken. Even more relevant is the possibility that the principles and underlying ideas of informal reorganisation may be exceptionally suitable for healthy companies. The periodic screening of a company for (possible) negative developments and the implementation of strategic, financial and operational changes where required, is indeed not the easiest of methods; however, it is the most effective method to prevent liquidation. Retaining value by taking small steps from time to time leads to results which cannot be matched by even the most extensive rescue operations.¹¹⁸

One definition of out-of-court restructuring is the following:

Out-of-court debt restructuring involves changing the composition and/or structure of assets and liabilities of debtors in financial difficulty, without resorting to a full judicial intervention, and with the objective of promoting efficiency, restoring growth, and minimizing the costs associated with the debtor's financial difficulties.¹¹⁹

There are two kinds of workouts:

(a) Bilateral workouts which involve a debtor and a creditor.

If they are successful, they result in rescheduling of payments and debt forgiveness.

(b) Multilateral negotiations between the debtor and the major creditors.

¹¹⁸ T Copeland, T. Koller and J. Murrin, "Valuation: Measuring the Value of Companies" (2000) McKinsey & Company Inc, 18.

¹¹⁹ J M Garrido, A Rouillon and Y Yadav, *Out-of-Court Debt Restructuring* (2011) World Bank last accessed on 18th December, 2015 at elibrary.worldbank.org/doi/book/10.1596/978-0-8213-8983-6 at page 7.

If these kinds of negotiations work out successfully, they also result in debt rescheduling, debt forgiveness and the offering of incentives to the debtor party.

In an Irish context, the most well-known vehicles of this kind that are employed are: pre-pack examinership, pre-pack receivership (especially the accelerated sale process) by means of Section 449 of the Companies Act 2014, mergers and acquisitions and debt equity swaps. Section 449 of the Companies Act 2014 is a hybrid process that involves the preparation of a compromise proposal and an application to the Irish High Court for an order and later a sanction by the High Court, if the compromise proposal meets with creditor approval. These matters are considered below. The initial task is to provide directions.

Informal restructuring consists of two halves: operational and financial restructuring. Given the focus of the thesis, the operational half will not be emphasised here. There are three types of informal restructuring on the financial side: purely contractual restructuring, enhanced restructuring (bolstered by professional norms) and hybrid restructuring.¹²⁰ The third type is the one of most significance in the present context. In this last but also in enhanced restructuring, formal and informal structures are frequently connected. It is useful to think of all of these procedures (both formal and informal) as making up a spectrum which consists of the following: “informal out-of-court restructuring, enhanced restructuring, hybrid procedures, formal reorganisation and formal insolvency.”¹²¹ There is no direct connection between the complexity of the financial difficulties facing a distressed company and the restructuring vehicle chosen. The approach adopted can be counter-intuitive: a difficult case can sometimes be processed through informal restructuring. The key informal method in Ireland – the hybrid method, in the case of pre-pack examinership - consists of both the

¹²⁰ These terms are employed by the authors in J M Garrido, A Rouillon and Y Yadav, *Out-of-Court Debt Restructuring* (2011) World Bank.

¹²¹ J M Garrido, A Rouillon and Y Yadav, *Out-of-Court Debt Restructuring* (2011) World Bank last accessed on 30th November, 2013 at elibrary.worldbank.org/doi/book/10.1596/978-0-8213-8983-6 para 5.

informal workout stage and formal court procedures.¹²² Thus there is an overlap between the two systems. While in most instances an informal procedure will move from a pre-pack arrangement to possibly an examinership or liquidation or alternatively a conventional examinership followed by a liquidation the combinations of elements involved can range considerably. An insolvency law system that has a multiplicity of options and flexibility in approach must necessarily be a positive thing provided that there is no conflict of interest on the part of those facilitating a workout or in an enhanced restructuring. An example of a conflict of interest would be where a facilitator of a pre-pack (a process that necessarily excluded some creditors) went on to become the examiner in the given case. This could present difficulties.¹²³

It is possible to view the relations between formal and informal restructuring methods from a number of perspectives. Formal proceedings can be seen as an alternative to or part of a series including or a complement to out-of-court debt restructurings.¹²⁴ An informal workout can effectively be an alternative to court proceedings such as an examinership or a liquidation.¹²⁵ The complementary perspective can be seen as a hybrid procedure¹²⁶ may in certain instances set the ball rolling for a reorganisation to take place. There may, however, be obstacles to advancing matters: creditor holdouts or executory contracts. In such instances the formal restructuring approach must be used.¹²⁷ A debtor company can more easily avoid such difficulties within a formal restructuring process.

¹²² Pre-pack receiverships do not usually involve court procedures.

¹²³ The difficulties could arise because of the possible conflict of interest. The potential for greater fee earnings could not be seen to trump professional obligations.

¹²⁴ J M Garrido, A Rouillon and Y Yadav, *Out-of-Court Debt Restructuring* (2011) World Bank last accessed on 30th November, 2013 at elibrary.worldbank.org/doi/book/10.1596/978-0-8213-8983-6 para 11.

¹²⁵ J Adriaanse, *Restructuring in the Shadow of Law, Informal Reorganisation in the Netherlands* Kluwer Deventer 2005.

¹²⁶ A hybrid corporate rescue process is one that shares both formal and informal insolvency law characteristics.

¹²⁷ An executory contract is a contract in which both sides have important performance elements remaining to be completed.

SECTION 6.2: ARGUMENTS PRO AND CONTRA

The advantages of the three classes of informal procedures – the informal contractual, the enhanced contractual and the hybrid – are these. They are flexible; they are conducted away from media scrutiny and they offer a greater level of control to existing management than would be available in a formal restructuring law context. The flexibility allows for the generation of solutions which best meet the present requirements of the case: this may, for instance, involve an agreed reprioritisation of monies to be repaid to creditors by the creditors themselves. There are few initial rules. The parties most directly involved determine the outcome. In addition, negotiations can be successfully concluded about new funding for the distressed company such that the new funding will be prior to all existing financial arrangements. As regards the discrete nature of the negotiations, the advantage here is that it goes far to remove the possibility of suppliers, other bankers in the market or clients from not entering into relations with the debtor company or from doing so on terms that are no less than onerous for the latter.

The disadvantages are these. In an informal negotiation it may not be possible to disclaim contracts. This has proven highly onerous in property leasing arrangements in the UK, for instance.¹²⁸ (The UK practice contrasts markedly with what obtains in examinership and liquidation cases in Ireland which have a property leasing dimension).¹²⁹ A second major difficulty –applicable to both the UK and Ireland- is that it is necessary to achieve unanimity among the major creditor interests before a workout can be attained. This contrasts very markedly with a process such as formal examinership where an acceptance by at least one class of creditors whose interests would be impaired is sufficient to cause the process to go forward.¹³⁰ In addition,

¹²⁸ P Ashford, “Disclaiming Onerous Contracts” last downloaded on 18th November, 2015 at http://www.crippslink.com/index.php?option=com_content&view=article&id=452:disclaiming-onerous-contracts&catid=77:insolvency-corporate-recovery&Itemid=599

¹²⁹ Dillon Eustace, *Repudiation and Disclaimer of Leases in Examinership and Liquidation* (2010, Dillon Eustace). If left unresolved, these leasing arrangements in the UK can constitute an insuperable obstacle to success in informal rescue negotiations. In the Irish context, repudiation of leases are governed by section 20 of the Companies (Amendment) Act 1990 and is now governed by section 537 of the Companies Act 2014.

¹³⁰ C (A)A 1990 s24(4)(a).

all rights of employees in accordance with the EU (Protection of Employees on Transfer of Undertakings) Regulations¹³¹ are enforceable against the debtor company.

SECTION 6.3: INFORMAL RESTRUCTURING MODELS

6.3.1: PRE-PACKS

Pre-pack receiverships are usually undertaken outside a courtroom context. Pre-pack examinerships are a hybrid form and involve significant court activity. Other models include contractual workouts, enhanced restructurings (another hybrid form) and debt to equity swaps.¹³² Mergers and acquisitions are outside the scope of the present study. The first two mentioned in the list –pre-pack liquidations and pre-pack examinerships- will receive careful attention, the others much less so. Given the absence of formal reporting requirements for pre-packs, there are no statistics available on their usage in Ireland.

Pre-packs enable the financially distressed debtor company to continue trading without interruption. In practice most pre-packs are implemented through a receivership. (A rationale for including pre-pack receiverships in this chapter would be that these vehicles can save companies and jobs in an efficient manner. Most unsecured creditors in these case do, however, lose out. In addition, the pre-pack receiverships model is the one serious challenger to the examiner lite model in the context of distressed company rescue in Ireland). Receivership pre-packs involve a secured lender appointing a receiver over the assets of a company experiencing financial difficulty. Prior to the formal appointment of the receiver, a purchaser is identified and terms of sale are agreed for the sale of the assets in question. The receiver then implements the pre-agreed terms immediately on or subsequent to his appointment. When things run smoothly this process is supported by both the secured creditor

¹³¹ Council Directive 2001/23/EC of 12th March, 2001.

¹³² A hybrid corporate rescue process is one that shares both formal and informal insolvency law characteristics. For the methods of appointment of a receiver see Lynch-Fannon and G Murray, *Corporate Insolvency and Rescue* (2nd edn. Bloomsbury 2012) chapter 6.

and the management of the company. The key issues to be considered prior to the closure of any sale include that of determining the status and obligations of onerous contracts, dealing with critical creditors and the implications of the Transfer of Undertakings (Protection of Employee) Regulations¹³³ in the given case. Matters move at a quick pace: it may take as little as a few hours. This includes accelerated due diligence. Decisions are made discreetly. The usage of pre-pack insolvency sales has developed in recent times¹³⁴ This is evidenced by the asset sales structured through pre-pack receiverships in Ireland in the last three years.¹³⁵

Recent Irish cases have been characterised by the following features:

- (a) A business that is financially under water, but which retains commercial potential;
- (b) A secured lender in the negotiations who has a right to appoint a receiver;
- (c) There is the possibility of new investment that would be such as to mollify the secured lender who has the power to introduce a receiver;
- (d) There is the possibility of the retention of some or all of the debts in the rump business with the probability of losses being suffered by assorted unsecured creditors

The A Wear case in 2012 was the first Irish pre-pack sale in this jurisdiction. The examinership process was not suitable as the business did not have and could not call upon sufficient funds to trade through a period of examinership.¹³⁶ The pre-pack receivership preserved the goodwill value for the affected creditors and employees and also optimised the outcome.

¹³³ Transfer of Undertakings (Protection of Employee) Regulations 2003 (S I No 131 of 2003).

¹³⁴ European jurisdictions often require the involvement of a court or the sanction of other creditor groups.. The UK approach to pre-packs is unique in so far as it does not involve courtroom activity or the obtaining of agreement from different classes of creditor. In recent years pre-pack administrations have been the preferred option for many financially distressed companies in the UK. Estimates of their occurrence varies: on some estimates they range from 27-29%; on others, the estimate is between 50 and 80%. This is considered in the following paper: S Frisby "The Second-Chance Culture and Beyond: Some Observations on the Pre-Pack Contribution" (2009) *Law and Financial Markets Review* 242. In the United States, pre-package corporate bankruptcy, to use the American term, can be undertaken, if the consent of the required majority of creditors is obtained prior to the filing of the Chapter 11 petition and if the pre-bankruptcy solicitation of acceptances meets certain statutory criteria. On the distinction between pre-arranged and pre-packaged Chapter 11 cases see Chapter 3 of this thesis. Pre-packs of the kind found in the UK are called "363 sales." This refers to section 363 of the Bankruptcy Code, which authorises sales free and clear of liens and interests outside of a plan.

¹³⁵ Recent examples of successful pre-pack receivership in Ireland were the sale of A-Wear retail and the sale of the Superquinn grocery chain to the Musgrave Group in 2013. The A-Wear case was the first Irish pre-pack receivership sale. The examinership process was not suitable for this case, as the business did not have sufficient funding available to trade through a period of examinership.

¹³⁶ Another pre-pack case in Ireland in 2012 was the sale of the Superquinn supermarket chain to the Musgrave group.

The next model to be considered is that of accelerated or pre-packaged examinership. The leading example is the *Eircom* case.¹³⁷ Pre-pack examinership is the mechanism through which debt may be restructured and equity investment obtained quickly and informally. This contrasts to the pre-packaged receivership which is a sale of all or part of the business and assets of an insolvent company (and which is negotiated before enforcement and concluded shortly after the receiver is appointed). In the case of accelerated examinership, this process can cut down dramatically in court activity, if the informal negotiations are professionally directed. A further advantage of this approach is that in the informal process may depend upon the later-stage formal court-based reorganizational arrangement. It is thus understood that matters can be resolved in a formal court-based context. There is, as a consequence, at least a possibility in some instances of quick resolution of pre-pack negotiations, although this must not be overstated. The task overall is to reduce the time spent in the Irish High Court to a period of weeks, rather than the three months which could otherwise apply in the examinership.¹³⁸

6.3.2: STANDSTILL AGREEMENTS

A reference was made to a variant of workouts, the standstill agreement model. This relates to moratoria organised by banks with financially distressed companies. These moratoria are

¹³⁷ *Re Eircom Ltd and Others* [2012] IEHC 158.

¹³⁸ On Pre-packs, see Welland and Walton note the fact that pre-pack sales to connected-party purchasers attract very considerable criticism, even if, from a commercial standpoint, such sales have benefits for a wide variety of parties in the longer-term. They also note that “the second chance rationale” has found favour with Frisby (The Second Chance Culture and Beyond: Some Observations on the Pre-Pack Contribution”(2012) Law and Financial Markets Review 242) and the UK House of Commons Select Committee inquiry into the Insolvency Service (House of Commons Business, Innovation and Skills Committee inquiry into the Insolvency Service announced 30th November 2011). Given that “second chance” ventures can be highly successful, Welland and Walton propose a model by which the directors of such business ventures should be compelled from the income of the business to those creditors who have not fared well as a result of the pre-pack. M Wellard and P Walton, “A Comparative Analysis of Anglo-Australian Pre-packs: Can the Means be Made to Justify the Ends”(Winter 2012) 21 International Insolvency Review 3 143; B Xie, “Role of Insolvency Practitioners in the UK Pre-pack Administrations: Challenges and Control (June 2012) 21 International Insolvency Review 2 85 and P Walton, “Pre-packin’ in the UK” (June 2009) 18 International Insolvency Review 2 85.

purely contractual agreements with some enhanced agreement features.¹³⁹ During the moratorium period the distressed company is afforded breathing space while the bank analyses the company to see whether or not a formal restructuring process should be initiated to save the company. The informal approach can also be pursued over the longer-term.¹⁴⁰ A significant benefit of a standstill agreement is that the evaluation can take place without drawing the attention of a company's customers or suppliers to the fact that the company might be facing difficulties. Standstill agreements can range from simple agreements where a secured creditor (usually a bank) agrees not to take enforcement action for a period of time while the parties discuss options, to more multifaceted agreements that can include periods of forbearance while an independent review of the company is being undertaken. This is undertaken by a third party. In the given case, this is followed by a formal restructuring of the business and of the existing facilities. The purpose of the independent business review is to assess the business of the company. This includes an appraisal of such factors as the company's prospect of survival, additional funding requirements, confidence in the company's management team and the terms whereby the existing financial facilities might need to be restructured.¹⁴¹

A workout negotiation – again, a purely contractual arrangement operating outside the courts system- is in being when a company debtor and its creditors negotiate on the terms of a private restructuring agreement or a debt composition or rescheduling contract. Debt workouts are usually between a debtor company and its secured creditors, although the debtor

¹³⁹ In enhanced agreements what would otherwise be contractual agreements are subject to the norms established by professional associations of lawyers, accountants, bankers and others.¹³⁹ International Finance Corporation *Corporate and SME Workout: A Manual for Best Practice* (2011) World Bank Group Washington DC. Part 1 at pages 16 to 19 : re Dunning letters, acceleration letters, set-off letters as well as guarantees, completion agreements and comfort letters.

¹⁴⁰ International Finance Corporation *Corporate and SME Workout: A Manual for Best Practice* (2011) World Bank Group Washington DC. Part 4.

¹⁴¹ P Kent, "Corporate Workouts: A UK Perspective"(Winter 1997) 6 *International Insolvency Review* 3 165. S Chatterjee and P Hedges, *Loan Workouts and Debt for Equity Swaps: A Framework for Successful Corporate Rescues* (Wiley 2001).

company may engage with immediate stakeholders such as bond holders, customers and/or suppliers. In order for a workout to operate effectively, creditors must be willing participants and must be agreeable to engage in forbearance. At a minimum, the provision of accurate and complete information to creditors is essential for the process to be successful. The object of a workout is to ensure that a company can repay its debts and that its financial commitments can be funded going forward. Typically a debt workout¹⁴² might involve splitting debt into a number of categories or parts with, for example, some parts being serviced fully with interest and repayment, some parts being interest-only repayments for a term and some parts of the debt being parked for a longer period, with write-down a possibility at some point.¹⁴³

The enhanced restructuring model, for its part, has some advantages over the workout model, because it addresses the coordination problem which besets purely contractual negotiations.¹⁴⁴ A contractual workout model has very little usefulness when creditors who are likely to lose out in any proposed agreement bring enforcement actions. To avoid such outcomes, it is often necessary to make use of mediation, negotiation and other techniques in addition to the informal workout.¹⁴⁵ Enhanced restructurings are advanced by means of master contractual agreements or by means of alternative dispute resolution. In the case of banks facing financial distress, matters can be resolved by the intervention of the financial regulator.¹⁴⁶

¹⁴² For a perspective on workouts and the Irish banking system in recent years see P Honahan, “ Resolving Ireland’s banking Crisis” (2009) 40(2) *the Economic and Social Review* 207.

¹⁴³ INSOL International Statement of Principles last downloaded at <http://www.insol.org/pdf/Lenders.pdf>: on 28th October, 2014. See also C L Hyun , “ Efficient and Inefficient Debt Restructuring: A Comparative Analysis of Voting in Workouts” (2007) 40 *Cornell University International Law Journal* 61 and C Kirkham and J Taylor, “Working through a Workout: A Practitioner’s Guide from the Perspective of Private Equity Sponsors, Venture Capital Funds and other Significant Equity Investors” (2009) 5 *Hastings Business Law Journal* 355.

¹⁴⁴ The coordination problem arises because of the number of interacting participants who may have very different expectations and levels of financial risk aversion.

¹⁴⁵ J M Garrido, A Rouillon and Y Yadav, *Out-of-Court Debt Restructuring* (2011) World Bank last accessed on 30th November, 2013 at elibrary.worldbank.org/doi/book/10.1596/978-0-8213-8983-6 49. The role of mediation in informal restructuring processes is something that cannot be understated. In an Irish context, it is worthy of scholarly investigation.

¹⁴⁶ This includes the “London Approach” in the UK context. It is of limited relevance in an Irish context.

6.3.3: DEBT EQUITY SWAP

In the debt equity swap model, a bank will convert debt owed to it by a company into one or more classes of that company's share capital.¹⁴⁷ As a consequence the original shareholders' stake in the company is generally diluted. Typically the proposals for a debt equity swap arise where a borrower is struggling with its repayments on borrowings due to cash flow problems. The bank can opt for this approach, however, because the value of the company's underlying assets provide an incentive for the bank to take an equity stake in it in exchange for a reduction in the debt. The bank in certain instances sells its debt to a third-party investor prior to the appointment of a receiver. It thereby negates the secured creditor's requirement to fund the company during the receivership period. The third-party investor in this sub-category of cases then appoints a receiver to implement the sale of the business. (Debt equity swaps are found more commonly in the UK than in Ireland, although proportionately this is slowly changing. The most prominent case of a debt equity swap in this jurisdiction has been that of Independent News and Media (INM) case. It occurred in 2013. This swap by the consortium of eight banks entailed writing off €138 million (one-third of INM's debt) in return for a stake of up to fourteen percent in the company. This was alongside a shareholders' contribution of €50 million).

From a bank's perspective, the debt-equity model can in some cases have merit. If the bank analysts see the distressed company as a viable entity in the longer term, they can opt to reduce the company's short-term repayment burden. The objective here will be to promote the rise in the company's valuation in the longer-term and thus recoup their losses on the write-down. While many insolvency law measures will realise only partial value for creditors or certain classes of creditors, a debt equity swap has the potential to create long-term appreciation in value for all stakeholders.

¹⁴⁷ S Wallenstein and J Silkenat, "Investment Funds and Debt-Equity Swaps" (1988) 12 *Fordham International Law Journal* 8.

Given the fact that the focus in this thesis is on corporate restructuring law, further references to contractual workouts, enhanced restructurings and debt to equity swaps will be limited – with the exception of enhanced workouts- in what follows. These topics were introduced to map accurately the options available to at least some financially distressed companies in Ireland. Pre-pack receiverships and pre-pack examinerships are, however, the main focus in this thesis.

SECTION 6.4: A CRITIQUE OF THE MOST RELEVANT MODELS

Pre-pack receivership can have serious disadvantages for some parties. For instance, in comparison to examinership, there is no judicial oversight or independent consideration of whether or not a given set of proposals are in the best interests of the wider spectrum of creditors. The arrangement lacks transparency. Third parties – such as employees or other stakeholders- know little or anything of what is to ensue until the transaction is completed. The purchasing party can cherry pick what is of value in the business and leave the remainder to be liquidated. These kinds of developments prompted the Minister to consider undertaking a review of the pre-pack receivership phenomenon.¹⁴⁸

Another phenomenon that is often associated with pre-pack receivership is the practice whereby the previous owners sell the company on to a connected person.¹⁴⁹ Company law in this jurisdiction, however, reduces the likelihood of this occurring. For instance, in the case of a substantial property transaction between the company and one of its directors, formal

¹⁴⁸ The Minister for Enterprise, Mr Bruton, asked his officials to consider undertaking an investigation into pre-pack receivership. This matter arose following the controversial *Crosbie* receivership. T Lyons, “Pre-pack Receivership under Spotlight” last downloaded on 19th November, 2015 at <http://www.independent.ie/business/irish/prepack-receiverships-under-spotlight-29226541.html>

¹⁴⁹ For a consideration of the more restrictive Australian approach to this problem see M Wellard and P Walton, “A Comparative Analysis of Anglo-Australian Pre-packs: Can the Means be Made to Justify the Ends” (Winter 2012) 21 *International Insolvency Review* 3 143. See footnote 136 above.

sanction by the members is required under section 238 of the Companies Act 2014.¹⁵⁰ A further consideration is this. Receivers are prohibited from selling significant assets to officers or connected persons of the company without giving the creditors 14 days notice. Any party who enters into negotiations in a pre-pack receivership context is obliged to be conscious of the possibility that a transaction may have been initiated with the singular purpose of intentionally defrauding creditors. All of this has particular significance, because pre-pack receivership processes constitute one of the main options other than examinership for small and medium sized distressed companies.¹⁵¹

In practice, a receiver is obliged to get expert legal and valuation advice so as to comply with the statutory duty to “obtain the best price reasonably obtainable”.¹⁵² In addition, it is simply prudent for the receiver to apply the relevant guidelines stipulated in UK Statement of Insolvency Practice (SIP) 16.¹⁵³ The key guidelines in SIP 16 include the following:

- (1) independent valuations of all assets should be performed by third-party professionals;
- (2) alternative exit and/or sale options (should be) considered by the insolvency professional prior to concluding a sale; creditors (should be) consulted by both the insolvency professional and the company’s management and the connection between the insolvent company and the investor/purchaser is clearly understood and judged acceptable by the insolvency professional.

The existence of these guidelines is the main reason why pre-pack receiverships have not until recent years been undertaken frequently under Irish law, as they now provide a defence

¹⁵⁰ Evasion of this rule may not, however, be a difficulty in the case of directors with substantial shareholdings in the company. For a consideration of directors’ duties see D Ahern, *Directors Duties: Law and Practice* (2009) 1st edn Round Hall, Dublin.

¹⁵¹ Companies Act 2014, section 439. See K Prendergast, “Pre-Pack Receiverships: The New Game in Town” (September 2013) *Accountancy Plus* Issue No3. for an analysis of pre-pack receiverships. See also “Pre-Pack Receiverships need Statutory Framework” *The Irish Times*, 24th February, 2014.

¹⁵² In a share receivership, the receiver can bypass the second statutory duty regarding sale of a non-cash assets to a related party since the definition of a non-cash asset in the Act states that “For the purposes of this section, a non-cash asset is of the requisite value if at the time the arrangement in question is entered into its value is not less than €1,269.74, but subject to that, exceeds €63,486.90 or 10% of the amount of the company’s relevant assets.” Companies Act 2014, section 238.

¹⁵³ Ireland lacks the detailed guidelines operative in the UK for the conduct of pre-packs – that is the guidelines found in the Statement of Insolvency Practice 16. These guidelines were adopted by professional bodies there and approved by UK regulators.

by a receiver to justify his/her actions in a court of law. All that is likely to be required is that the receiver should comply with these guidelines.

A brief comparative study of pre-pack administration as found in the UK with what operates here may prove instructive, because of the more widespread use in the UK of these processes. In the UK, a company can elect to go into administration without involving the court.

Like pre-pack receivership in this jurisdiction, in the UK the pre-pack administration process has its critics.¹⁵⁴ It too is not a transparent process. The valuation applied may be unreasonably low, particularly in cases where the new owner is identical to the previous one or is closely connected with the previous owner. Where the process is misused the pre-pack process may be a means of defrauding future creditors of the new company. Unsecured creditors of the old company will have lost out in any event. Most pre-pack administrations, however, do not benefit the existing directors in that way. In fact, banks are often reluctant to agree to pre-pack administrations, if the composition of the management does not change radically.¹⁵⁵ Most directors of financially distressed or insolvent companies do not generally set out to fail. In any event, where there is abuse of pre-pack administrations, affected creditors may refuse to deal with the new company, if the directors are the same as those in the old company. It would appear that more sophisticated creditors like the UK Inland Revenue are able to demand VAT and now PAYE deposits from the new company, before it is allowed to commence trading. It is difficult to determine the extent of directors' misconduct vis-à-vis prepack administration, because of the poor level of statutory

¹⁵⁴ See B Xie, "Role of Insolvency Practitioners in the UK Pre-Pack Administrations" (Summer 2012) 21 *International Insolvency Review* 85; G McCormack, "Apples or Oranges? Corporate Rescue and Functional Convergence in the Us and the UK" (2009) 18 *International Insolvency Review* 2; M Wellard and P Walton, "A Comparative Analysis of Anglo-Australian Pre-packs: Can the Means be made to Justify the Ends?" (Winter 2012) 21 *International Insolvency Review* 143 and Y Rotem, "Small Business Financial Distress and the 'Phoenix Syndrome' – A Re-evaluation" (Spring 2013) 22 *International Insolvency Review* 1.

¹⁵⁵ What evidence there is regarding this is anecdotal. It is significant, however, that one of the recommendations in the Graham Review related to the inappropriateness of connected parties taking over the new company following the pre-pack administration. T Graham "Graham Report into Pre-pack Administration" (2014) HMSO London.

compliance by management in some companies. SIP 16 has, nevertheless promoted some transparency and the provision of relevant data.¹⁵⁶

A further criticism voiced in the UK is that the facilitator of the pre-pack – the insolvency practitioner/ administrator- may be open to the charge of bias in so far as the appointment to the distressed company was at the behest of the floating-charge holder. It is also likely that the insolvency practitioner will have advised the floating-charge holder or the company or both. This conflicts markedly with the duty of the insolvency practitioner/ administrator to represent the interests of all the creditors.¹⁵⁷ The UK *Insolvency Code of Ethics* (something distinct from SIP 16) does address this matter: it suggests that objectivity in corporate valuation methods can be attained by getting an independent valuation and engaging in a full review of the potential purchasers.¹⁵⁸

To sum-up, both government and other interested parties in the UK have given indications that suggest major misgivings about key aspects of pre-pack administration, such as the comparative lack of transparency and the strong possibility of insider transactions. This is seen in the putting in place of the SIP 16 of 2009 and the publication of a Select Committee report on Pre-pack Administration in 2013.¹⁵⁹ The UK announced in 2013 the establishment

¹⁵⁶ *Annual Report on the Operation of Statement of Insolvency Practice 16* (2009).

¹⁵⁷ Sch B1, para 3(2) of the Insolvency Act, 1986.

¹⁵⁸ The Code was put together by the Joint Insolvency Committee and applies to all recognised professional bodies in the UK. In addition, the Code at paragraph 24 obliges the person who moves sequentially from being administrator to liquidator to make disclosure to the Court or creditors of the threat to objectivity that such a change in roles at least potentially presents. If no objections are raised, and safeguards are in place to eliminate or reduce such a threat, matters may proceed. The stipulation in the UK Code that administrators should engage in a full review of potential purchasers is in the Irish case something that the examiner, but not the receiver, is necessarily obliged to undertake. For the relevant rule in this last which obliges the examiner to consider all creditor interests see C(A)A 1990, s24(4)(a)

¹⁵⁹ The Business, Innovation and Skills (BIS) Commons Select Committee, *Pre-Pack Administration* (2013) last accessed on 5th January, 2014 at <http://www.publications.parliament.uk/pa/cm201213/cmselect/cmbis/675/67507.htm>

of an independent review into the pre-pack procedure and this led to the Graham Report discussed earlier.¹⁶⁰

Turning to pre-pack examinership, there are a number of serious difficulties with it that are often not easily bypassed. For instance, the approach adopted by the debtor company's bank often proves decisive in determining the success or otherwise of this kind of examinership. Should the bank be supportive, all can go well. This, however, is not always the case and from the bank's point of view there can be reasons to be wary of pre-pack examinerships. During the examinership, the secured creditor will have no control of the manner in which the debtor company's finances will be restructured. It will, in addition, be necessarily precluded from taking action to collect its debt and enforcing its rights during the examinership protection period. Moreover, a secured creditor will be subject to the rule whereby the examiner's expenses have priority status over the claims of secured creditors.¹⁶¹ What is likely to happen in practice is that the secured creditors will take a pragmatic view on the best way forward. In cases where asset valuations have declined, they may be obliged to accept a lesser sum than expected. For instance, in *Re McInerney Homes Ltd* the Irish High Court approved that proposals for a scheme of arrangement which were to result in a written-down sum being paid in full satisfaction of a debt.¹⁶² The rule applicable would seem to be that the written down value of the debt must reflect or be in excess of what the court considers to be the market value of the security held. The determining factor in any assessment of whether the scheme is unfairly prejudicial to the interests of a secured creditor is whether the secured creditor would do better in the alternative (i.e. receivership) or any other method by which its security could be realised.

¹⁶⁰ L Conway, "Pre-Pack Administration Procedure"(2013) House of Commons library, Home Affairs Section 1 last accessed on 29th October, 2014 at www.parliament.uk/business/publications/research/briefing-papers/SN05035/prepack-administration-procedure

¹⁶¹ S.29 of the Companies (Amendment) Act 1990 establishes this priority status.

¹⁶² *Re McInerney Homes Ltd* [2010] IEHC 340.

6.4.1: STATUTORY REQUIREMENTS AND PRE-PACK EXAMINERSHIP

There are other fundamental questions. The question arises as to whether or not it is possible to employ the examinership process to implement a pre-pack restructuring given the statutory obligations placed upon the examiner under Part 10 of the Companies Act, 2014. There is no statutory restriction upon parties agreeing the terms of a company restructuring and putting together the necessary investment before the distressed company files for examinership. The statutory requirements to hold formal meetings of members and to obtain High Court confirmation of the scheme of arrangement cannot be dispensed with, although the time frame for following these processes can be shortened.¹⁶³

Putting things in the most positive way possible, if detailed planning is undertaken in these matters, the process can be much speeded up. The terms can be agreed with the proposed investor and a scheme of arrangement put together before the case reaches the High Court or Circuit Court. This can result in the court hearings being reduced to a matter of weeks as opposed to what would otherwise be at least three months. It is necessary in such cases for the examiner to take careful note of the specific concerns of the banks involved. As already noted, there are good reasons for this: in the event of an examinership (irrespective of whether or not it is enabled by a pre-pack process), the bank(s) role in any restructuring of the debtor company's finances will be much reduced.¹⁶⁴

The *McInerney* case¹⁶⁵ provides an insight into how the courts will view the reduction of secured creditors rights in examinership. An examiner had proposed a scheme of arrangement under which a banking consortium would receive a little over 20% of the monies advanced in full and final settlement of a €113 million loan provided to the debtor company. The scheme was opposed by the banking syndicate on the basis that it could recover more of its debt

¹⁶³ Order 75A of RSC 1986 provides for this.

¹⁶⁴ For a good example of this kind of pragmatism see *Re McInerney Homes Ltd* [2011] IEHC 4.

¹⁶⁵ *Re McInerney Homes Ltd* [2001] IEHC63.

through a long-term receivership workout plan. The High Court did not confirm the scheme. Clarke J held that the scheme was unfairly prejudicial to the banking syndicate. He accepted that the syndicate could receive a more favourable outcome by a controlled long-term receivership. It was also held that the court could approve a scheme of arrangement provided that the write down of secured creditors was not unfairly prejudicial to them. The case was returned to the High Court following the transfer of some of the syndicate loans to NAMA (the National Debt Management Agency).¹⁶⁶ It was argued for McInerney that the syndicate would not be then in a position to carry out its long-term receivership plan. The Court determined that in the changed circumstances some members of the syndicate were no longer prejudiced by the scheme, although the remaining one was. The Court again refused to confirm the scheme. The McInerney Group then appealed the case to the Supreme Court. The appeal was dismissed. The Supreme Court confirmed that the onus of proving that the scheme is not unfairly prejudicial to any involved party rests with the examiner and confirmed the High Court finding that in this case the onus had not been discharged.

CONCLUSION

Pre-pack receiverships and pre-pack examinerships occur much less frequently in this jurisdiction than they do in the UK. This is not surprising in view of the absence of detailed guidelines applicable to insolvency professionals, although these last almost invariably follow the UK SIP 16 rules. In any event, the yardstick applicable here is that the receiver or examiner should ensure that the best possible price is obtained at the time of sale for assets sold.¹⁶⁷ If this yardstick is complied with, there are no absolute barriers to the successful

¹⁶⁶ *Re McInerney Homes Ltd* [2001] IEHC340.

¹⁶⁷The most notable and successful pre-pack receiverships undertaken in recent years are the following: the Superquinn case in 2011. The business was sold to the Musgrave grocery chain and rebranded as Supervalu. It was probably the largest pre-pack transaction to date in this market. A Wear was another success, at least in the shorter term. The successful Eircom pre-pack examinership is the most significant case of its kind to date in this jurisdiction.

completion of a pre-pack sale: creditor concerns can sometimes be allayed.¹⁶⁸ Moreover, in this jurisdiction, the statutory requirements to hold formal meetings must be complied with as must the requirement to obtain High Court confirmation. The processes can, however, be much speeded up. It may be said that the negotiation component of the process is often the key enabler for the successful completion of these cases.

It would be advantageous to employ the services of negotiation professionals (probably lawyers) on a selective basis in early stage pre-pack examinerships where bottlenecks are likely to occur, because of the intransigence of powerful creditors. It is difficult to offer positive suggestions about pre-pack receiverships because of their questionable nature – because new owners can walk away from contracts with unsecured creditors- but the following might be tentatively suggested. Wellard and Walton have detailed a reengineered pre-pack receivership model whereby a connected-party purchaser would be obliged to make a future income contribution in favour of the insolvent company whose company had been rescued.¹⁶⁹ This would promote a more equitable solutions for a broader spectrum of stakeholders in any given case.

The advantages of informal insolvency arrangements over examinership is that they are flexible. They promote ease of negotiation. For instance, the kind of negotiation process may be determined by the parties in advance. They are efficient in the use of time and facilitate a proactive approach. Unlike examinership, they can to a point protect confidential communications and remove the risk of stigma that might otherwise attach to a debtor company engaged in a formal insolvency process. In addition, out-of-court negotiations allow for the continuation of the business and the retention of management. Creditors, for their part,

¹⁶⁸ This, of course, did not occur in the SIAC cases detailed earlier.

¹⁶⁹ M Wellard and P Walton, “ A Comparative Analysis of Anglo-Australian Pre-packs: Can the Means be Made to Justify the Ends” (Winter 2012).

are not impaired as regards their legal rights. They may, for instance, enforce their rights in the courts at any time. The disadvantages can sometimes constitute the downside of the positive features in out-of-court processes: for instance, the retention of all rights by creditors can derail informal negotiations. As well as that, informal negotiations are often opaque and they can effectively exclude some creditors although codes of conduct and other mechanisms can be employed to reduce this possibility. This chapter has advanced the central research question because it has identified alternative means of resolving corporate rescue problems for at least some of the larger companies. In so doing, it has offered a new perspective on formal court-based corporate rescue mechanisms, particularly from the points of view of efficiency and practicality. Having placed the informal insolvency approaches in context, the following chapter, chapter 7 offers a general summing up.

CHAPTER 7: THE WAY FORWARD

“When the image is new, the world is new.”

Gaston Bachelard¹

INTRODUCTION

One way of determining the quality of a legal regime is to assess its capacity to adapt to local and changing circumstances.² The rethinking and reform of corporate rescue law in a small open economy such as that of Ireland and whether or not such law is worthwhile in that context are among the most challenging problems facing legal scholars, legislators and businessmen, at least at the national level. It is an area of law in which consensus is not easily arrived at, if at all.

The Companies (Amendment) Act, 1990 as amended has proven to be one of the most controversial piece of commercial legislation introduced in the State. It has been subject to significant criticism, especially by some members of the accounting and legal professions. Its defenders have been few in number. At the level of principle, creditors, secured or otherwise, have viewed the legislation as threatening their legitimate business interests. It was contended by various parties in times past that most companies facing dire financial difficulties could best have those difficulties resolved through a receivership or even a scheme of arrangement under section 201 of the old Companies Act, 1963.³ According to this way of thinking, examinership as originally conceived under the Companies (Amendment) Act, 1990 – whatever about “examinership lite”- was suitable only for a very limited number

¹ G Bachelard, *The Poetics of Space* (1994) Beacon Press.

² T Beck, A Demirgüç-Kunt and R Levine, “ Law and Finance: why does Legal Origin matter?”(2003) # 31, 653–67.

³ D de Lacy, “Examinership not the Best Model to save SMEs”in the Irish Independent online of 6th May, 2013 last downloaded on 21st November, 2015 at <http://www.irishexaminer.com/business/examinership-not-best-model-to-save-smes-230409.html> The statement by de Lacy can, of course, be contested on several grounds. For instance, anything that de Lacy recommends would at least fall short of rescuing the bcompany rather than the business.

of companies. These companies were likely to be suffering from trading rather than financial difficulties and their awkward challenges were in most cases of a short-term nature⁴

Quite apart from any other criticism of examinership as it currently exists, it can be stated that processes under the Companies (Amendment) Act 1990 and now found in Part 10 of the Companies Act 2014 has promoted an explosive growth of bargaining not only over commercial rights, but also over substantial and procedural ones. This has proven to be counter-productive. The point made by Baird and Rasmussen in their criticism of aspects of Chapter 11 is worth recalling: nothing of substance can be achieved by arguing at length over procedural rights (that is, non-bankruptcy entitlements) when the time should be spent determining substantial rights. Too often, re-organisations in the past have become bogged down in such matters⁵

Returning to the fundamentals, the central research question introduced in Chapter 1 has involved an investigation of formal company rescue law in Ireland, that is the Companies (Amendment) Act 1990, as amended, together with the Companies (Miscellaneous Provisions) Act 2013 now found in Part 10 of the Companies Act 2014 and the other relevant parts of the Companies Act 2014, so as to determine whether or not they were efficient mechanisms which were fit for purpose. In addition, an investigation was undertaken to determine whether or not it was possible to identify suitable models for corporate restructuring other than examinership (as it currently exists) or the redesigned scheme of arrangement mechanism or suitable informal restructuring models which might work in the shadow of a corporate restructuring law system particular to a small open economy.

⁴ I Lynch-Fannon I, J Marshall and R O’Ferrall 1st edn, *Corporate Insolvency and Rescue* Butterworth, Dublin 1996 515.

⁵ D G Baird, ‘The Uneasy Case for Corporate Reorganisations’ (1986) 15 *Journal of Legal Studies* 127.

SECTION 7.1 THE CENTRAL FINDINGS

It is reasonable to conclude that examinership to date has been successful in catering for a comparatively limited number of large and medium-sized Irish companies in distress. Those who designed it in its original form did not intend it for small companies or did not give the question much consideration. If such is the range of consideration, examinership using the yardsticks developed by Finch is at least efficient and has been substantially a success.⁶ Moreover, prepack examinership of the kind exemplified in the *Eircom* rescue has proven itself to be very worthwhile. On the other hand, examinership to date has had very little to offer most Irish companies. Examinership-lite, for its part, has yet to prove itself. Given the systemic impediments for small- to medium-sized companies in the examinership process, it is difficult to be optimistic about the examinership lite development.⁷ In addition, the drafters of the Companies (Amendment) Act 2013 (now found in Part 10 of the Companies Act 2014) choose not to follow the recommendation of the Company Law Review Group of facilitating entry into examinership by suitable companies through an administrative rather than a court process.⁸ This can only serve to drive up costs and thus reduce the incentive for small companies in distress to opt for examinership. This thesis has been concerned at a thematic level with the reconsideration of the present form of corporate rescue law in this country. It has addressed the question of what is the point and purpose of company rescue law in a small open economy and it has sought to identify company rescue law solutions which are appropriate to companies in this country. The answer is that there is sufficient evidence to indicate that an examinership mechanism has a role in the rescue of Irish companies, even if it is chosen only by a minority of distressed companies which are usually larger ones by Irish standards. In its present forms, however, it has, at a practical level, little point or purpose for the generality of Irish companies. If examinership is to have meaning for small companies in

⁶ These yardsticks were detailed in chapter 5.

⁷ This was discussed in chapter 2, 3 and 4.

⁸ Company Law Review Group *Annual Report* 2012 15.

Ireland, it could take the form of that outlined in the Donnelly proposal; that is to say an examinership mechanism which would allow for recourse to the Circuit Court, but would not be court driven.⁹ In this model it would not be necessary to obtain the approval of the Circuit Court for any scheme of arrangement that the examiner would recommend. This would allow creditors to receive at least as much as they would in any other possible outturn. In addition, the small company in distress would be incentivised to use this approach because of the drastically reduced costs involved. It would also be necessary to ensure that legal expertise regarding insolvency law was available in depth at Circuit Court level. It should be added that there is no reason to think that this kind of examinership would necessarily be abused by rogue directors of distressed companies: a vigilant judiciary would see to that.

It was noted that one of the significant difficulties for at least a minority of such companies with regard to SME restructuring is that these companies are either family businesses or are mostly run by their original founders. When the time comes for restructuring, these founders often cease to take appropriate action, because they expect that their equity interest will be wiped out, if they opt for examinership. A possible solution would be to allow for the original founders to hold on to some of their voting rights in the reorganised company, even if that equity interest were to be 20% or less. Such an arrangement would recognise their status to some extent, even if it meant making concessions to creditors.

The new scheme of arrangement in the Companies Act 2014 is a positive development.¹⁰ Pre-pack receiverships and pre-pack liquidations could also prove useful as options, but none of these are substitutes for examinership. Nevertheless, the words of Baird and Rasmussen regarding a distressed small company's capacity to have a going concern surplus – as already noted- seem apposite in this context:

⁹ See Chapters 2, 3 and 5 respectively.

¹⁰ Companies Act 2014, Part 9, Chapter 1 ss 449 to 454.

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.¹¹

The assets of small companies in Ireland may not, however be so easily redeployed.

More generally, it can be said that market generated company restructuring arrangements which operate in the shadow of the law are most likely to predominate in the larger cases.¹² One important development is that outlined by Adriaanse and briefly referred to in Chapter 6 of the thesis. That is the concept of proactive informal reorganisation outside of the context of threatened insolvency. Adriaanse took the view that the principles of informal reorganisation could be thought of as an exceptionally useful method for checking the health of fundamentally sound companies. For many companies it may be a good means of avoiding liquidation.¹³

Regarding the measurement of quality in the examinership process, it was concluded in chapter 5 that the examinership model fares quite well when assessed in terms of the key criterion of quality identified by Finch.¹⁴ This criterion is the “capacity to resolve.” It does quite well in so far as it is fair, transparent, inclusive and rigorous. This assessment is applicable, however, only to examinerships for large- and some medium-sized companies. When the process input criterion is considered, examinership fares poorly. It is prohibitively expensive, if proceedings are conducted in the High Court. If conducted in the Circuit Court costs may be far lower, but will nonetheless reduce the pool of available assets. Regarding process objectives, debtor and creditor interests are dealt with fairly in decision and policy

¹¹ D G. Baird and R K. Rasmussen, “The End of Bankruptcy” (2002) 55 Stan. Law Review 758.

¹² A good example of this is *In re Eircom Ltd* [2012] IEHC. As a pre-pack, most of the planning and negotiation were completed prior to the petition stage.

¹³ J A A Adriaanse, “Restructuring in the Shadow of the Law: Informal Re-organisation in the Netherlands”(2005) Doctoral Dissertation. University of Leiden. The original quotation is from Copeland in T Copeland, T. Koller and J. Murrin, “Valuation: Measuring the Value of Companies” (2000) McKinsey & Company Inc,18.

¹⁴ V Finch, ‘Corporate Rescue Processes: The Search for Quality and the Capacity to Resolve’ (2010) Journal of Business Law 520.

processes. On questions related to dealing with different creditors' interests fairly in decision and policy processes, unsecured creditors usually do less well than others, because of their lower priority status. Examiner's fees, amounts owing to financial institutions and to the Revenue Commissioners are all placed ahead of them. This may, unfortunately, be unavoidable. Examinership proceedings are both collective and inclusive: witness the class of creditor arrangement under the scheme of arrangement and the scrupulous nature of the confirmation hearing. Examinership is in most cases not a speedy process, although in larger cases it is increasingly streamlined. On output objectives, it can be said that the rules governing insolvency and rescue in this country are sufficiently rigorous to preserve market confidence both domestically and internationally. It is not, however, always easy to reconcile an insolvency law system which is, excepting for the moratorium phenomenon in company rescue law – at least arguably - creditor friendly with some of the rescue aims of examinership. Policy planners and legislators have thus tended to opt for pragmatic solutions in addressing company rescue law questions.

Moreover, examinership in its present forms does not come near complying with two of the core principles of the EU Recommendation on a New Approach to Business Failure and Insolvency.¹⁵ That is, examinership does not conform to the early recourse principle or the minimised court involvement principle.¹⁶

SECTION 7.2: OTHER FINDINGS

With regard to the efficiency of the planning mechanism in both the Companies (Amendment) Act 1990, as amended, together with the Companies (Miscellaneous Provisions) Act 2013, as now found in Part 10 of the Companies Act 2014, it can be concluded

¹⁵ EU Commission, *Commission Recommendation on a New Approach to Business Failure and Insolvency* (2014) Brussels last downloaded on 17th November, 2015 at http://ec.europa.eu/justice/newsroom/civil/news/140312_en.htm

¹⁶ EU Commission, *Commission Recommendation on a New Approach to Business Failure and Insolvency* (2014) Brussels last downloaded on 17th November, 2015 at http://ec.europa.eu/justice/newsroom/civil/news/140312_en.htm

that it is efficient to the extent that both the independent accountants report and the scheme of arrangement components narrow the possibility of an unwelcome outcome for the examinership candidate report¹⁷. Only strong candidates, therefore, can hope to succeed from the outset. The costs involved in going forward as an examinership candidate in the High Court, however, deny this option to most companies and thus cause it to be substantially inefficient. As discussed in chapter 2, the “bolt on” legislation of examinership lite does not remedy this difficulty in a substantial way. The reorganisation plan mechanism points to the hybrid nature of examinership generally, that is the mixing of strictly commercial values with some aspirational ones of a broader social nature. The plan involves a rearrangement of creditors’ and shareholders interests by means of a new investment agreement. Although there is a commitment to preserving employment, this is not the primary consideration among decision makers. Many of the companies who most easily pass through traditional examinership processes today are likely to have deep pockets and to have opted for the pre-pack examinership approach prior to the planning stage.

The negotiation and approval stages of examinership, as outlined in chapter 3, are not at all efficient. Plainly stated, the relevant case law has served to expose the weaknesses of existing statutory formulations, such as the original threshold test for admission to examinership. These formulations allow for too great a measure of judicial discretion because of the absence of defined terms or objective tests in deciding matters. For instance, as Lynch-Fannon and Murphy observe, there is a requirement to define what an objectively reasonable creditor might demand of a debtor company.¹⁸ As things stand, the burden falls upon the examiner to persuade the court that the proposals have not prejudiced the interests of creditors. In addition, there is a burden placed upon the judiciary to come to a decision on this question

¹⁷ Companies Act 2014 s511 and s 533.

¹⁸ I Lynch-Fannon and G N Murphy 2nd edn *Corporate Insolvency and Rescue* Bloomsbury West Sussex 2012, at 566.

without having acceptable guidance available to them. It is somewhat ironic that examinership candidates – who presumably are suffering from revenue generating and other difficulties – are called upon in their hour of need to pay for a legal process that is on any reckoning extraordinarily expensive and that works against the interest of existing creditors. The system is not efficient. It adds to costs. There are good reasons for a thorough review of the existing legislation.

The moratorium dimension works quite well. The pragmatic approach characteristic of both business and legal life in Ireland reasserts itself here. Regarding the external financing of an examinership candidacy from the perspective of the debtor company – discussed in chapter 4 – matters must be viewed in a much less sanguine way. Corporate restructuring in Ireland for much of the last ten years must be seen in the context of what appeared to be the impending collapse of the domestic banking system.¹⁹ This substantially reduced the ability of many financially distressed companies to restructure as in many cases a given company’s existing bank would also have been its bank in a post-restructuring scenario. This, however, has changed very significantly. The country now has a credible post-crisis economic model.²⁰ In addition, the banking crisis has given rise to new thinking by decision-makers at government level about alternative funding options for SMEs.²¹ For instance, the Government has now

¹⁹ B Clarke and N Hardiman writing in 2012 stated that the cost to the taxpayers of bank recapitalization was eventually estimated at approximately €62.8bn (Minister for Finance, 2011); Ireland’s total GDP in 2011 was €155bn (Central Bank, 2012). Almost half of these losses are attributable to a single bank, Anglo Irish Bank, which (along with the Irish Nationwide Building Society) is now re-titled Irish Bank Resolution Corporation Limited (IBRC). Most of the remaining losses were incurred by the two oldest banks, the Bank of Ireland, and Allied Irish Bank. B Clarke and N Hardiman, “Crisis in the Irish Banking System” UCD Geary Institute Discussion Paper Series (2012) at 2 last downloaded at [http://irserver.ucd.ie/bitstream/handle/10197/4925/Clarke and Hardiman, Crisis in the Irish banking system . 2012.pdf?sequence=1](http://irserver.ucd.ie/bitstream/handle/10197/4925/Clarke%20and%20Hardiman,%20Crisis%20in%20the%20Irish%20banking%20system%202012.pdf?sequence=1) on October 23rd, 2015.

²⁰ J McMahon, “The Irish Banking Crisis: Lessons Learned, Future Challenges” Address to Mazars Banking Conference Dublin 26th May 2010 at 3. For a thorough analysis of on what they describe as “Ireland’s catastrophic experience of financial crisis,” see B Clarke and N Hardiman, “Crisis in the Irish Banking System” UCD Geary Institute Discussion Paper Series (2012) at 1 last downloaded at [http://irserver.ucd.ie/bitstream/handle/10197/4925/Clarke and Hardiman, Crisis in the Irish banking system . 2012.pdf?sequence=1](http://irserver.ucd.ie/bitstream/handle/10197/4925/Clarke%20and%20Hardiman,%20Crisis%20in%20the%20Irish%20banking%20system%202012.pdf?sequence=1) on October 23rd, 2015.

²¹ Intertrade Ireland, *Access to Finance for Growth for SMEs on the Island of Ireland* Newry 2013 last downloaded at <file:///E:/3304Access%20finance%20report.pdf> on 23rd October, 2015.

established a credit guarantee scheme for SMEs.²² The thinking here is that the SME sector should have access to more appropriate and less costly funding options.²³

SECTION 7.3: HOW THIS THESIS HAS ADVANCED SCHOLARSHIP

This thesis has contributed to the debate on corporate rescue, because it has investigated a topic that has been mostly under-investigated in the English-speaking world: that is, the usefulness of a formal company rescue mechanism in a small open economy that is mostly populated by small companies. It has also made a real contribution to scholarship regarding the Irish corporate rescue regime. A discursive gap was identified regarding the Irish corporate rescue regime in chapter 1.

This thesis has looked at a specific company rescue mechanism in a small country with a very particular path dependency; a country with a specific economic history. Much of the development of that mechanism would seem to have been a reaction by rational actors (including its developers) to the blind buffeting of events. The developers, moreover, may have had limited options and comparatively limited institutional resources. What has happened is in no way comparable to that of a logician setting out with very elementary propositions to build a vast logical edifice. Company restructuring law in Ireland could have been put together differently. Given what has happened to date, however, the challenge now being faced is to build an examinership mechanism for distressed small companies that is efficient both from the perspective of administrative logic and that of cost. The consequences of embarking on this course cannot be fully foreseen and it is best to think of it as being experimental in nature. The analysis of these phenomena and deliberation on the possible consequences of initiatives undertaken in the Irish context is what enables this thesis to contribute to the literature.

²² Regarding the Government sponsored credit guarantee scheme for SMEs, see Appendix 3 of this thesis.

²³ Intertrade Ireland, *Access to Finance for Growth for SMEs on the Island of Ireland* Newry 3013 at 10 last downloaded at <file:///E:/3304Access%20finance%20report.pdf> on 23rd October, 2015.

SECTION 7.4: SCANNING THE HORIZON

Looking at restructuring matters across the spectrum, it can be stated that of necessity consensual restructuring will be the default position. For larger cases which entail much complexity, nevertheless, formal restructuring is inevitable. These larger cases may involve a number of banks. Debt overhang may also be a major problem and the debt may need to be cut off from the underlying trading entity. Such cases involve a considerable amount of financial and legal engineering. On the legal side, an examinership, a liquidation, a receivership and a sale of debt may all be called for in a given case. As it is necessary in business life to think of matters holistically, the role of financial institutions in debt forgiveness and company restructuring in so many of these questions cannot be entirely overlooked.

With regard to the limitations of the research undertaken, it must be stated that there has been a very considerable dependence on scholarly work from abroad, rather than from Ireland. This has created two problems. The relevant work available in English in the great majority of cases did not relate to small open economies. Work from the financial economics and business journals (on such matters as corporate governance) was often insightful, but needed to be treated with caution when considered in an Irish context. What was absent from the Irish literature was legal empirical work on corporate restructuring and to a slightly lesser degree quantitative studies undertaken by financial and business economists. It was therefore necessary to proceed circumspectly.

On recommendations for further research, it would be important to reaffirm the suggestion made by Lynch-Fannon and Murphy that a review and possibly a major reform of the examinership legislation should be undertaken to take account of the very considerable accumulation of relevant case law.²⁴ This may be unlikely, given that the Companies Act

²⁴ I Lynch-Fannon, and G N Murphy, 2nd edn, *Corporate Insolvency and Rescue* (Bloomsbury 2012) at page 558.

2014 has recently come into being, but that does not take away from the point that it would be good to return to first principles. Furthermore, formal company rescue for smaller companies must be both simpler and more straightforward than what presently obtains.

This thesis concludes that any model or models of company rescue legislation in this jurisdiction should be governed by the following principles and should approximate more closely to them than in the way that at present obtains:

- (1) The model should simplify the process, particularly with regard to cases involving small companies, to the extent that that is possible
- (2) Costs should be reduced to the greatest extent possible
- (3) The system should provide tools to facilitate informal reorganisation for viable companies

In addition, the next two could be advocated more strongly:²⁵

- (4) A new regulatory philosophy should be entertained in accordance with which a debtor company could have recourse to insolvency proceedings as soon as there was a strong likelihood of its becoming insolvent
- (5) The debtor company in this new regulatory context should have recourse to a pre-insolvency restructuring procedure without the need to obtain court approval.

With regard to principles (4) and (5), it is likely that they would have application to Irish companies larger than those found in the SME sector. Any processes that might be put in place would need to include procedural safeguards. What is offered in the following is merely a sketch. Much more detailed work could be undertaken on these matters in the future.

It would be necessary for candidates applying to enter pre-insolvency processes to make a declaration of solvency with regard to their cash flow and balance sheet status. This could be certified by such as an accountant. As an alternative to this, a restructuring plan could be put together that would be judged to be viable where it received very broad creditor assent, that is, by a 75% majority. Under this last-mentioned arrangement, no dissenting creditor would receive less than in the cases where a company was liquidated. It would also be imperative to

²⁵ They are in accordance with the European Commission, *Recommendation of 12 March 2014 on a new approach to business failure and insolvency*, C(2014) 1500 final.

encourage companies to seek rescue at an earlier stage than is the case with most financially distressed companies in Ireland today.

An independent expert, different from an examiner in so far as he/she would not commandeer the company in any way, could be appointed by the High Court following the filing of the petition to initiate the early stage restructuring process. This would serve to separate viable from non-viable companies and also serve as an early warning system in cases of abuse by candidate companies.

The process should be undertaken along the same lines as a debtor-in-possession model, although it would be unlike that operating in the United States in so far as it would also involve the appointment of a supervisor by the High Court. The supervisor's task would be to guard the interests of creditors and other interested parties. It could prove useful to introduce a neutral third party, that is, an additional party, into the process: the task of this person would be to ensure that a powerful creditor did not abuse their dominant position in the restructuring process. This may serve to motivate financially distressed companies to file the petition at an early stage.

Regarding professional fees in examinership, although the judiciary have laid down a fee structure in these matters,²⁶ it would seem appropriate also to establish some form of independent oversight of fee costs overall. This would seem appropriate given that the interested parties (i.e. the associations of business and legal business professionals on the one hand, and the business community and other interested parties on the other) are unlikely to agree matters.

Finally, it can be said that significant advances in the articulation of ways of solving problems related to both formal and informal company restructuring have made this an exciting time for insolvency law scholars, not least those in Ireland. It will fall to the

²⁶ *In re Sharmane Ltd and the Companies Acts* 4 IR [2009] 285 at pages 287.

theoreticians, the politicians and parliamentary draftspersons to redesign company restructuring law in a way that is a better fit for that which then operates or which offers more to an economy composed mostly of small companies. In any event, there are good reasons to think that, at a minimum, a redesigned examinership process for small companies would be a positive development. In the case of larger companies in distress, a more widespread use of the pre-pack examinership process that complies with the statutory requirements and that could be completed quickly would be welcome.

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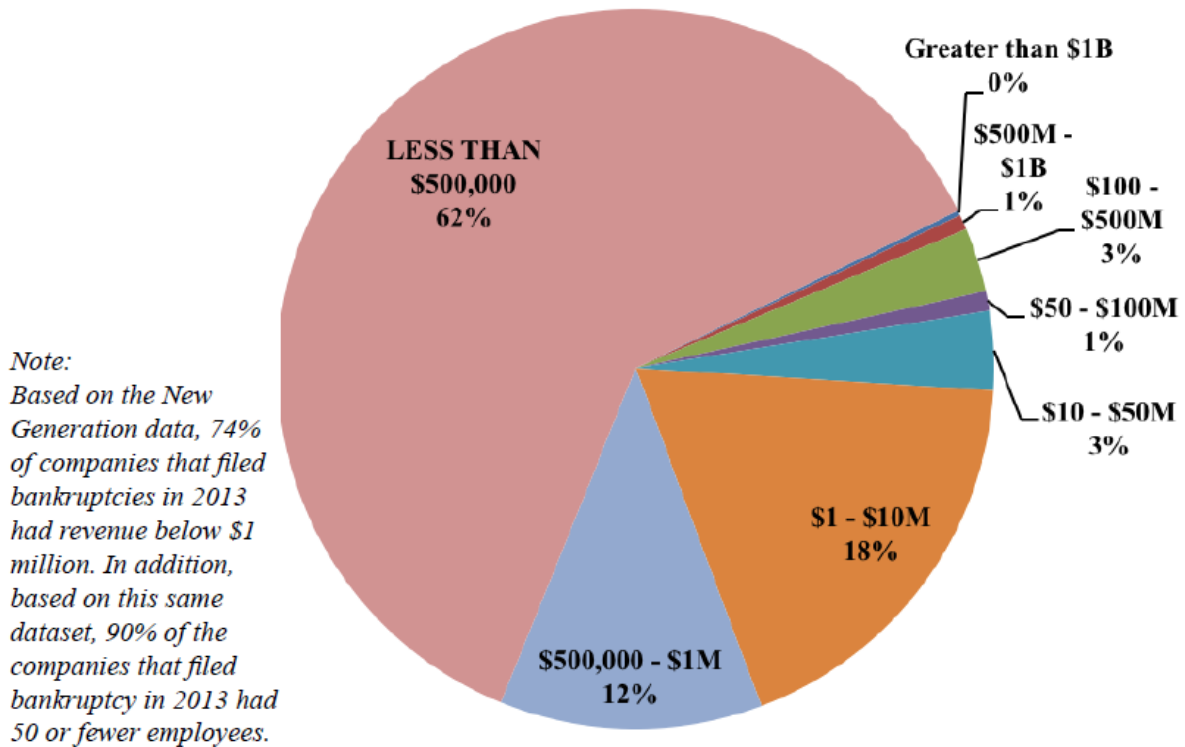
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Appendix 1:

Revenue of Debtors Filing for Bankruptcy in 2013



Source: American Bankruptcy Institute, *Commission to Study the Reform of Chapter 11* (Alexandria, Virginia 2015) at 286.

Appendix 2

Company survival rates

After Examinership Initiated in a particular year

Next Status

	Successful	Unsuccessful			Total	%	Liq initiated		
	Normal	Rec	Rec/Liq	Liq	Year	Success	Mem	Cred	Co
2013	34	0	2	3	38				5
2012	22	2	1	7	32	68.75%			8
2011	21	5	1	3	30	70.00%			4
2010	20	5	4	0	29	68.97%			4
2009	61	5	7	11	84	72.62%		3	1
2008	24	3	0	22	49	48.98%			2
2007	13	1	0	7	21	61.90%			7
2006	3	0	0	0	3	100.00%			0
2005	3	0	0	1	4	75.00%			1
2004	6	0	0	0	6	100.00%			0
2003	6	1	0	4	11	54.55%			4
2002	5	0	0	7	12	41.67%	1		6

Examinerships which started in this particular year.

Current Status

	Normal	% still	Rec	ReLiq	Liq	Disd	Of Companies	
		Normal					Mem	Cred
2013	34	100.00%		2	3			
2012	22	100.00%	2	1	7	0		
2011	21	100.00%	5	1	3	0		
2010	14	70.00%	7	4	3	1	3	
2009	40	65.57%	6	13	21	4	2	1
2008	14	58.33%	3	3	23	6	1	3
2007	7	53.85%	1	0	7	6	1	2
2006	1	33.33%	0	0	1	1		1
2005	3	100.00%	0	0	1	0		
2004	5	83.33%	1	0	0	0		
2003	1	16.67%	0	0	3	7		
2002	2	40.00%	0	0	5	5		

	Examinership	Successfully exited Examinership		Success ratio
2009	84		61	73%
2010	29		21	72%
2011	30		21	70%
2012	32		21	66%
2013	12		11	92%

Source: Companies Registration Office