Comparison of Chapter 11 of the United States Bankruptcy Code and the System of Administration in the United Kingdom

1. BACKGROUND

Administration - Part II Insolvency Act 1986 ("IA")

The concept of administration was conceived by the IA as a method of ensuring the survival of the company as a going concern with the benefit of a moratorium in respect of the administration debts. The aim was to rehabilitate the business of the company and to give it time to reassess its future rather than leaving it to face liquidation or administrative receivership (the process by with the holder of a "floating charge" over the assets of the Company can appoint a receiver to run and ultimately sell the assets).

The administration procedure has recently been reformed by the Enterprise Act 2002 ("EA"). They key reform is that an administrative receiver may only be appointed in respect of certain specified cases.

1. Capital market transactions if debt is, or is expected to exceed £ 50 m;
2. Finance projects if debt is or is expected to exceed £ 50 m and there are step in rights;
3. Utilities projects;
4. Public private partnerships;
5. Financial Markets Transactions;
6. Registered Social Landlords.

Instead, holders of qualifying floating charges will be given the right to obtain an order for the appointment of an administrator on the occurrence of an event of default under the banking facilities - usually a failure to meet a payment deadline but it could be for a breach of another covenant.

The proposals are consistent with the Government's wish to promote a rescue culture in the field of corporate insolvency, and with its preference for insolvency procedures that aim to maximise the benefits for all creditors, rather than for a specific class of interest. The effective abolition of administrative receivership will mean that holders of floating charges will be encouraged to focus less on a disposal of assets as a mean of recouping value (although this option will be open to them under the administration procedure), and more on an approach which achieves an outcome that benefits all stakeholders in the debtor company. One of the Government's particular aims is to help owner-managed companies where for those directors saving the company is much more important than selling the assets to a new company, for example.

Chapter 11 - US Bankruptcy Code ("BC")

Chapter 11 focuses on preserving reorganization or going concern value over liquidation value. As a corollary, Chapter 11 assumes that the most efficacious way to achieve that result is to retain management and enable multiple outcomes either through a plan of reorganization, a series of going concern sales and even a liquidating plan. Chapter 11 enables a wide range of proposals to be put into a reorganization plan, including having the company and its management survive the process. Chapter 11 cases fall into two general categories: the "freefall" case or a prepackaged or pre-negotiated case.

In the former, relief is sought under Chapter 11 of the Bankruptcy Code without having an agreed exit strategy among the company and at least a critical mass or core group of creditors. The latter is characterized by commencing a Chapter 11 case following the development of a consensus on the outcome of the case. Under both scenarios Chapter 11 plans embrace:

1. a "standalone" plan, which essentially connotes that the creditors, secured and unsecured, and , if applicable, the Company and its equity-holders, agree on a reorganisation without the intervention of a third party or a sale of the business, relying instead on what may be termed a "composition" plan under which at least some unsecured creditors agree to accept less than 100% payment or agree to take a combination of debt and equity issued by the reorganised company in return for their claims; or
2. a plan which effects a sale of all or substantially all of the assets as a going concern and distributes the consideration or proceeds of sale to the creditors;
3. a plan which relies upon a capital infusion from an investor;
4. a liquidating plan which sells all of the assets of the company and provides for a distribution of proceeds to creditors;
5. a plan which, in part, contemplates a litigation trust to pursue and prosecute causes of action belonging to the company
6. a combination of the above.

Reforms under the EA

The EA became effective on 15 September 2003 and (amongst other things):

(a) virtually abolishes the concept of administrative receivership by preventing holders of floating charges from blocking the appointment of an administrator; and

(b) allows administrators to be appointed out of court by the holder of a qualifying floating charge or the directors in certain circumstances. In the UK, directors can incur personal liability for trading whilst insolvent ("wrongful trading") and must file for an insolvency process at the time the company cannot avoid insolvency. By filing for administration, this gives the directors 'breathing space' free of creditor pressure to try to put a rescue plan together.

(c) emphasises that the main objective of administration is rescuing the company as a going concern. Only if that primary objective cannot be achieved may the administrator then break up or sell the whole of the business or realise property in order to make a distribution to secured or preferential creditors (see later).

(d) the administrator now owes a duty to protect the interests of all creditors - compared to administrative receivership where the receiver owed a primary duty to the secured lender who appointed him.

COMMENT

The objective of both procedures is the creation of breathing space during which the debtor company is given time to formulate plans for a reorganization. Chapter 11 also has provisions which enable a Company to stabilize its business by, among other things, authorizing the borrowing of loans, the rejection of executory contracts, and the re-negotiation of union and retiree obligations.

2. PROCEDURE

Administration

Administration can be commenced out of court by a secured creditor who holds a "qualifying floating charge" or by the company itself. Otherwise general creditors must apply to court.

Court Procedure

The application must state that:

1 the company is or is likely to become insolvent (on assets/liability test or inability to pay debts grounds); AND

2 it is reasonably likely that the following can be achieved:

- the rescue of the company as a going concern or as much of its business as is "reasonably practicable"; or, if this is not practicable;
- a better result for the company's creditors as a whole than would be likely if the company were to be wound up; or, if this is not practicable;
- the realisation of the company's property on a break-up basis in order to make a distribution to one or more secured or preferential creditors, but "without unnecessarily harming" the interests of unsecured creditors.

The application must be supported by a statement from the proposed administrator confirming that it is reasonably likely that the purpose of the administration will be achieved, providing details of the company's financial position, details of creditors' security and any other relevant matters must be provided.

Out of Court

The holder of a qualifying floating charge may appoint an administrator out of court and the appointment takes effect once the holder of a floating charge has filed the necessary papers at court. As with the court procedure, the proposed administrator must make a statement that the purpose of the administration is reasonably likely to be achieved.

The administrator must satisfy himself that the first two objectives (referred to above) are not practicable, before proceeding with the third objective, namely realising assets for distribution to secured creditors.

The company or its directors may also appoint an administrator out of court.

Chapter 11

A typical Chapter 11 case begins when the debtor company voluntarily files a petition with a bankruptcy court, accompanied by:

1 a list of creditors; and

2 a summary of assets and liabilities.

Technically there is no requirement of 'insolvency'. Companies may have a number of reasons, other than insolvency, to file for bankruptcy relief: the company is faced with massive tort liabilities (e.g. Dow Corning when a global settlement with plaintiffs broke down), an adverse outcome in a litigation (e.g. Texaco when faced with a multi-billion dollar damages award), and anticipated liquidity issues (e.g. a number of U.S. energy companies).

But applications must be in 'good faith' and with the intention of reorganization or to effect a liquidation or sale of the company, and creditors may apply to have petitions dismissed where this is not the case. For example, in the SGL Carbon Corporation case (200 F.3d 154), the court dismissed the company's Chapter 11 case because of bad faith demonstrated by a lack of "reorganizational purpose."

A large company may also be involuntarily pushed into a Chapter 11 case if three creditors holding unsecured non contingent undisputed claims aggregating more than $11,625 file an involuntary petition against the company and if the company is "*generally not paying[its] debts as such debts become due*" The company may contest the petition and if the above standard is not met, may file suit against the filing creditors for costs and /or reasonable attorneys fees or, if filed in bad faith, damages, including punitive damages.

Usually it is the company not the creditors who file for Chapter 11 protection (see Section 6: Control of the Company). However, secured lenders may effectively force a company to file for relief under chapter 11 by threatening to enforce liens.

COMMENT

In the court procedure, the UK court has discretion as to whether to grant the order. Using the out of court route, the holder of a qualifying floating charge is entitled to appoint an administrator as of right, as are the directors and company if there is no holder of a qualifying floating charge or the holder of the qualifying floating charge consents. There are no similar "gating" or entry issues under Chapter 11. The debtor has a legal right to enter the procedure.

3. MORATORIUM

Administration

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 served in the out of court procedure. The moratorium stays all litigation, and prevents the enforcement of judgements and of security without the leave of the court or the consent of administrators. This includes staying the continuation of any pre-existing actions. There are no exceptions to this moratorium.

Chapter 11

Immediately upon the filing of a bankruptcy petition, a moratorium or "automatic stay" stays all litigation and prevents the enforcement of judgements and of security without leave of the court.[1] This includes staying the continuation of any existing actions that were commenced before the filing.

A party who takes any action in violation of the automatic stay risks contempt of court actions and penalties. Also, any act done in contravention of the stay is retroactively made void or voidable by the court.

The stay is effective during the entire time the case is pending but creditors and other parties may make motions to lift or modify the stay.[2]

The BC gives the debtor the exclusive right to formulate a plan of reorganization for 120 days from the date of filing. This "exclusivity period" can be extended if sufficient reasons are established[3]. In most instances the debtor company will first take actions to stabilize its operations and formulate its business plan and thereafter proceed to formulate a plan of reorganization.

COMMENT

The lengthy moratoriums in the UK give the administrators considerable 'breathing' space to enable them to put forward proposals to the creditors.

Given the relative ease with which some Chapter 11 orders can be obtained, some commentators have suggested that there is little to prevent a moratorium of 4 months for a company that is not insolvent and has no need of reorganisation. Such commentators criticise Chapter 11 because, in theory, debtors could use it as a delaying tactic in dealings with actual or potential creditors and opponents in litigation. Yet, that view severely distorts the reality of a large and complex Chapter 11 case. While some coy debtors may issue threats of extending the exclusivity period as leverage during negotiations, speed is an essential element of a successful reorganisation. Delay can have severe negative impacts upon the debtor's business, directors, management, employees, suppliers, customers, and, most importantly, its creditors. Thus, despite the theoretical potential for abuse, the exclusivity issue rarely becomes an obstacle in large U.S. reorganisations.

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1 BC paragraph 362(a)

2 BC paragraph 362(d)

3 BC paragraph 1121

4. LIFTING THE STAY

Administration

A creditor can make an application to the court for the stay on taking legal action or enforcing its security to be lifted. The burden is on the creditor concerned to show that the leave should be given. Where the applicant can show that the giving of leave would not impede the administration then leave will generally be granted. Otherwise it is a balancing exercise to be carried out by the court.

Alternatively, administrators can grant consent to the commencement of proceedings against the company. These are more usually actions by commercial landlords to recover property.

Chapter 11

Generally, an affected party can apply to court at any time after the filing of a bankruptcy petition for relief. Once such a motion is made the stay will expire after 30 days unless within such time a court continues the stay pending a final hearing or the movant consents to such continuation pending a hearing. The court may terminate the stay, modify it or subject it to conditions[4]. The court may lift the stay for cause, but is generally reluctant to do so during the initial stages of a Chapter 11 case because of the general presumption that a debtor should be given a chance to reorganize and prepare a plan.

Motions to lift or modify the stay are based on the following:

1. a court may lift or modify the stay upon a showing of "cause," which includes the lack of adequate protection of an interest in property, or
2. with respect to property securing a lien, (i) the stay will be lifted if the debtor company does not have equity in such property and (ii) such property is not necessary to an effective reorganization.

There are also special rules for single asset real estate cases.

Also, Further, the automatic stay may not stay in effect when applied to certain protected creditors, such as certain aircraft lessors and lenders and vessel lessors and mortgagees. In this context, a lack of adequate protection focuses on whether the creditor is being injured by continuation of the stay due to, among other things, a deterioration in value of its collateral or consumption of collateral by the Company. .

To counter this potentially negative impact of the stay, a debtor company must provide adequate protection, which may take the form of

1. periodic cash payments to cover any depreciation during the stay;
2. additional or replacement liens or substitute security to the extent of any deterioration in value, and other relief that will amount to 'indubitable equivalent', a flexibly interpreted concept[5].

COMMENT

Both jurisdictions show a reluctance to lift the stay unless there are good reasons for doing so.

4 Paragraph 362(d)(2) BC

5 Re Alyulan Interstate Corporation 12 BR 803 at 809.

5. CONTROL

Administration

Control passes to an insolvency practitioner (the administrator) upon the making of the order.

The day to day management of the company is conducted by the administrators who act as agents of the company (and without personal liability). The administrators' powers are set out in the IA. They are also 'officers' of the court and as such must act in good faith. The directors owe statutory duties to assist the administrators.

Chapter 11

In Chapter 11, whether voluntary or involuntary, there is a presumption that control remains with the debtor's management through the concept of 'debtor in possession' ("DIP") (subject to certain safeguards regarding disposal of assets outside the ordinary course of business). To many commentators this smacks of leaving the fox in charge of the hen house. Nevertheless, there are instances where the difficulty is due to exogenous and unexpected events (e.g. Texaco). More importantly, perhaps, is the impression that management provides the most economical and efficient means to reorganize under the oversight of the bankruptcy court, and creditors' committees. Significantly, many companies hire special financial advisors or turnaround management consultants to assist them in their restructuring. Often the creditors, especially the secured creditors, will condition their cooperation. on the hiring of such an expert or chief restructuring officer. Such consultants or specialists nevertheless remains responsible to the board of the company, the bankruptcy court and the creditors. Often they will be in place as part of any out of court restructuring.

Although there is a BC provision to appoint a trustee, such an appointment is rare and only happens where there is some suspicion of misfeasance/fraud/wrongdoing/risk to assets, or because it is the interests of creditors.

When there is a debtor in possession, a party in interest may request the appointment of an Examiner to investigate the debtor's affairs. Although it is mandatory to grant such request where the debtor has unsecured, liquidated debts in excess of $5 million, the bankruptcy court may limit the scope of the Examiner's investigation to guard against a 'fishing expedition.'

As soon as is practicable after the order for relief, the United States Trustee (a government official with a duty to protect all creditors) appoints a creditors' committee, usually made up of the seven largest unsecured creditors willing to serve[6]. The supervisory role and powers of the committee are more extensive than in some jurisdictions, and they can incur the expense of attorneys and other advisors with court approval. Such expenses are funded out of the estate of the debtor[7]. The United States Trustee may also appoint other committees as needed (*e.g.* a Tort Claimants Committee, a Bondholders Committee, etc.).

Although the creditors' committee may employ advisers and may be remunerated from the bankruptcy estate, in smaller cases there may be insufficient financial incentive for there to be a committee formed. This negates the potentially important role the committee has in Chapter 11 proceedings.

6 Paragraph 1102-1103 BC

7 Paragraph 1103(a) BC

COMMENT

Opinion diverges over who is best placed to run the company (presuming there is not mismanagement or dishonesty). It is arguable that many insolvency cases are caused by some weakness in management. Moreover, the historical link between the insolvency to the displacement of management is very strong. This link continues, in part, through the applicability to UK officers and directors of the concept of wrongful trading and civil liability for the debts incurred by the Company in financial distress, such that the UK insists that an insolvency practitioner be in control. Ironically, the UK has not really had experience with substantive stand alone reorganizations and perhaps the new legislation will highlight whether an insolvency practitioner can manage a business back to health and reorganization.

However, the alternative is to identify the management weakness and intervene with expert advisors or help which in many ways mirror the skills of the insolvency practitioner. Perhaps the presumption in favor of a debtor in possession operates as intended only in the context of the intended level of creditor and court oversight in Chapter 11. There is no comparable day to day oversight by the court or creditors in the UK. The insolvency practitioner is the creditors oversight.

In the US, DIP management certainly has considerable incentive to manage the operations and business well. Otherwise creditors will seek to terminate the debtor's exclusive right to file a plan and file their own plan or move to convert the case to a liquidation under chapter 7.

The loss of control by directors in the UK may explain why it is much more common in the US for the directors to file for Chapter 11, where directors will continue to be responsible to all constituents, including equity, and may act to maximize the values for all, including negotiating on behalf of existing equity-holders. US directors know that filing for Chapter 11 will safeguard their position, provide them with the exclusive right to propose a plan or sale of assets, while providing the Company the protection of Chapter 11. It is often critical to the outcome that a company seek Chapter 11 relief early enough to effect a sensible reorganization rather than consume its balance sheet and exhaust the potential for reorganization. In some respects the presumption in favor of a debtor in possession furthers the reorganization objective by not penalizing management for seeking relief under Chapter 11.

The potential for UK directors to be personally liable for losses suffered by creditors as a result of the company continuing to trade while it was insolvent (S214 1A 1986) provides an incentive for directors to petition for an administration order, despite their resulting loss of control, as doing so may relieve them of potential personal liability.

6. CONTRACTS

Administration

There is no power to disclaim onerous contracts for an administrator (unlike a liquidator) in the UK, and the making of an administration order does not, of itself, terminate a contract unless the contract provides.

Chapter 11

The debtor or trustee may assume a contract or lease even it if contains a clause that provides for termination in the event of insolvency , provided the debtor cures any default , and if the debtor had been in default, provides adequate assurance of future performance by itself or its assignee. Alternatively, the debtor may reject any such lease or executory contract, giving rise to breach as of the petition day, leaving the non-debtor party to such lease or contract with a prepetition claim for breach. Certain unsecured claims, such as those of landlords and executives, are limited by the BC.

The trustee or the debtor in possession has the valuable ability to extract value from favorable contracts by assuming and then assigning these contracts regardless of whether the contracts themselves prohibit or condition such assignment.

COMMENT

Chapter 11 provides the debtor with wide-ranging and valuable powers with which it can disclaim, adopt or assign contracts. This power, especially when combined with the ability to sell assets and borrow money, enables the debtor in possession to address its business and operational issues, including its relationship with unions and its pensions. The UK administration procedure has no equivalent.

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8 BC paragraph 1125(a)(1)

9 BR 2002(b)

10 BC paragraph 1126(c)

7. PROPOSALS TO CREDITORS

Administration

Within 8 weeks of the administrator's appointment (or such longer period as the Court or creditors may allow), the administrator must present his proposals for achieving the purposes of the administration order to a meeting of creditors.

The meeting may accept, reject or accept with modifications the proposals. Any modifications must be approved by the administrator.

Acceptance of the proposals requires a simple majority in value of those creditors present and voting, although a resolution will not be passed against the wishes of a majority of non-connected creditors.

If the proposals are accepted, with or without modifications, the administrator must manage the affairs of the company in accordance with those proposals.

If the proposals are rejected, then the court may discharge the administration order, or make such other order as it thinks fit.

An administration will expire after 12 months unless the creditors consent to an extension (up to a maximum of 6 months) or the court makes an order extending the administration.

Chapter 11

For the first 120 days after the order for relief only the debtor (if there is no trustee) may propose reorganization plans. The debtor also has an exclusive right for 180 days from the petition date in which to solicit acceptances from impaired creditors and shareholders. The court may extend or reduce the exclusivity period for cause. After the end of this period the creditors' committee or any individual creditor can propose its own reorganization plan.

Before solicitation of approval for the plan, the debtor or trustee must prepare a disclosure statement and have it approved by the court as containing adequate information[8] to allow a reasonable hypothetical creditor to be able to consider the plan.

At least 25 days notice of the hearing to consider the disclosure statement must be given to creditors[9]. If the court approves the statement it will also fix voting procedures and set a confirmation hearing date on at least 25 days notice to creditors. As a practical matter once a plan is timely filed, exclusivity is likely to be extended. This is more likely if the disclosure statement has been approved and the plan has been sent out for vote.

Chapter 11 requires creditors to be designated into classes and for each class whose rights have been impaired to vote in favor by a majority in number and two-thirds in amount of those actually voting[10]. The minority is bound by the class vote, provided that the plan provided to each creditor at least what it would have received in a liquidation of the debtor. This is the "best interest" test.

The classification of creditors is based upon the premise that claims that are substantially similar should be classified together. It is well established that secured creditors holding liens with different priorities on the same collateral are to be separately classified. As a general rule unsecured creditors are classified in one class. There may, however, be reasons why certain unsecured creditors should be treated differently. Some variation in plan treatment, as among creditors having a *pari passu* right against the debtor, is permitted, provided that such difference does not "unfairly discriminate" against a class of creditors. Generally, the classification scheme is part of the debtor's plan proposal. There has been litigation regarding classification, primarily involving the deficiency claim of a secured creditor.

Confirmation of a Chapter 11 plan requires that there be cash to pay administrative expenses and most priority claims, and to make the cash payments provided for in the plan.

Only those creditors who are going to have their rights impaired (modified) by the plan can vote. Once the voting has taken place the court will consider whether or not to confirm the plan in the light of the votes. If there is a dissenting class of claims and at least one class of impaired claims that has accepted the plan, the plan proponent may nevertheless request confirmation of the plan if the plan conforms to the "absolute priority" rule and is "fair and equitable" with respect to the dissenting class and all junior classes of claims and interests. When the court confirms a plan in such a case it is known as a "cramdown".

With respect to a class of unsecured creditors, a plan is fair and equitable only if (i) such class receives full value for its claims or (ii) no junior class receives or retains any value. Hence, absent full satisfaction of a class of dissenting unsecured claims, there can be no value distributed or retained by any junior claim or interest. A no vote by a class of unsecured creditors usually means wiping out equity.

Once the plan is confirmed it binds all creditors and the property re vests in the debtor company clear of all prepetition claims (and subject to any of the terms of the plan[11]). Where a debtor is unable to confirm a plan, the Chapter 11 case may be dismissed or converted to a chapter 7 case.[12]

COMMENT

In both jurisdictions some level of creditor consent is required to the proposals. The US voting requirements are much more complex, and court approval is required. The scope of the plan however is very broad. and can also address settlements of litigation, asset sales, rejection of contracts, etc. Chapter 11 also has provisions which integrate securities and insolvency laws. This permits debtors to issue public securities under a plan, subject to certain exceptions, that are exempt from the registration process upon issuance and subsequent sale. In the US, tax laws are also integrated with Chapter 11. This provides an ability to monetize tax benefits. In some respects this result can be captured in the UK through an administration followed by a scheme of arrangement.

11 Paragraph 1141 BC

12 Paragraph 1112(b) (c) BC

8. COSTS

Administration

There are greater costs incurred in using an insolvency practitioner (and his/her “team”) (in the UK), rather than the existing management of the company (in the US). The company’s creditors and members will also in effect pay for the ‘learning curve’ of the insolvency practitioner in managing the business.

Chapter 11

The US system requires court involvement and the associated high costs this brings. The creditors’ committee may also appoint advisers that may be remunerated from the estate of the bankruptcy. The expense potential often suggests that constituents try to reach a consensus outside of chapter 11 and commence the case as a pre-negotiated or prepackaged chapter 11 case.

COMMENT

At a time when the company is suffering severe financial problems, the legal and other costs associated with the attempted rescue using the available legal provisions should not suffocate the company further and prevent survival.

In both cases the costs involved mean that small companies may not be able to attempt a rescue.

9. EXIT ROUTES

Administration

Under the EA there are a number of ways in which the administration can cease to have effect:

(a) effluxion of time after one year, unless extended;

(b) on administrator's application where the purpose of the administration has been achieved in which case the administrator will seek to exit the administration through a scheme of arrangement or company voluntary arrangement if there are remaining assets for distribution. If not the administrator will place the company into liquidation or dissolution;

(c) on administrator's application if he considers that the purpose of the administration cannot be achieved in which case the liquidator will place the company directly into liquidation.

Chapter 11

Plan confirmation discharges the debtor's pre-existing obligations to unsecured and secured claimants other than as provided for in the plan, irrespective of whether they actually accepted it themselves.

In cases where a plan is not confirmed it is usual for the court to order conversion to Chapter 7 bankruptcy proceedings.[13] However, as there is no insolvency requirement under Chapter 11, failure to confirm a plan will not necessarily lead to liquidation.

There is no prohibition against re-filing for Chapter 11 This is true even if a case is dismissed, or even if a case ends with a confirmed plan. The second chapter 11 case, or 'chapter 22' as it is sometimes called, is not unusual.

13 Paragraph 1112 BC

10. FINANCES

Administration

The company is more likely to continue to look to its existing lenders or other finance providers for continued support. Whilst an administrator has the power to borrow and encumber assets, no special priority is given to post-administration lenders.

Chapter 11

The BC gives lenders incentives to provide finance to the debtor (called Debtor in Possession or DIP Financing). The lender may be given a lien over assets that are not pledged to other lenders. The court may also authorize liens superior to certain priority claims in the bankruptcy process or even grant new senior liens on collateral already pledged to another party, subject to ensuring that the existing lender has "adequate protection" for the value of its pre-bankruptcy liens.

COMMENT

Chapter 11 funding is more advanced and imaginative than in the UK. Without the introduction of equivalent provisions governing priority lending, it is questionable whether the new reforms will lead to more corporate rescues.

Administration

Chapter 11

In the US there is a robust market for securities issued by troubled companies, as well as for bank debt of troubled companies. There are "distressed investors" active in the debts and securities of financially troubled companies, including companies in Chapter 11. The level and duration of this market confirms that distressed investors provide liquidity and optionality to banks and par buyers of securities, as well as trade creditors. In fact, they create a more efficient marketplace for distressed securities and debt while providing flexibility to debtors and creditors, alike.

Often, distressed investors seek recovery in excess of their investment, usually a fraction of face or par value. Distressed investors have positively influenced the Chapter 11 process. They often bring flexibility and creativity to the process that improves the composition or extension of debts. They also bring time pressure and market sensitivity to the process, thereby creating proper incentives for all parties. However, every constituent has a different concept of "success." For some, the trading value of the reorganized securities is a focus. For others, it is the prospect for continuing business or it is the advent of a healthy borrower or employer.

Empirical evidence based on all Chapter 11 cases filed in the US may be misleading because it includes numerous small, closely-held companies which were essentially in liquidation at the time of filing (so-called 'dead on arrival' companies). Hence, certain statistics that suggest the overwhelming majority of US cases end in a liquidation[14], may not reflect the Chapter 11 experience of the financial institutions overall Their exposure is often concentrated in large companies and the likelihood of a confirmed plan is greater in such cases.

14 1995 statistics

12. SUMMARY

Administration

- Can appoint out of court or through court, in which case it is in the court's discretion to grant order.
- Moratorium triggered on filing of application (court route) or filing of appointment documents (out of court route).
- Insolvency practitioner (usually an accountant) appointed to manage company.
- Loss of control by directors.
- Once in administration the company's business is conducted almost entirely outside court supervision.
- Costs.
- Proposals accepted when majority of creditors vote in favour.
- Administrator manages the company in accordance with the approved proposals.

Chapter 11

- No court discretion over order for relief under Chapter 11 - legal right of the debtor.
- Ease of access to the procedure.
- Technically, although no party has veto powers,. the prohibition on using cash collateral without the consent of the lienholder or court approval gives an undersecured creditor with liens on current assets significant leverage in chapter 11 cases though the negotiation of the "cash collateral" order.
- Imposition of broad automatic stay upon the filing of a Chapter 11 petition, lasting until confirmation of a plan, gives the debtor virtual assurance of a stay for at least the period that the debtor has the exclusive right to file a plan, i.e. 120 days.
- The debtor remains in possession.
- Court approval is required for any action outside the ordinary course of business: sales of assets, assumption or rejection of contracts, borrowing money, etc.
- Debtor given exclusive period of 120 days (as it may be extended for cause) to negotiate plan with creditors.
- Power to 'cherry-pick' contracts and leases.
- Plan accepted by class vote and may be confirmed by the court upon request of a plan proponent provided that (i) at least one class of impaired creditors votes yes; (ii) the plan is "fair and equitable" to any dissenting and junior classes; (iii) provides each creditor at least what it would have received in liquidation; (iv) is feasible; and (v) meets the other requirements of a plan and Chapter 11.
- An approved plan binds all creditors and equity-holders.

CONCLUSION

It is accepted that the Chapter 11 procedural hurdles are lower than those in the UK, where a court must be convinced of the appropriateness of ordering protection to the debtor company. Criticisms of this lower hurdle focuses on how to redirect failed businesses with no prospects for reorganization into a more suitable proceeding (i.e. liquidation under chapter 7) at an early stage without deterring viable cases from being filed. At present, in the US the emphasis is on giving the debtor the benefit of the doubt. There are obvious reasons why the directors of the debtor may be the best persons to continue to run the business, and negotiate with the creditors and equity-holders . However, this does not mean that involvement by an outside professional should not be allowed, and such supervision could be beneficial in many cases.

In the UK it is perceived that bad management is largely responsible in one way or another for most corporate failures. However, recently in the US there is also a growing body of opinion that even under Chapter 11 it is a myth that the original directors retain control of the debtor. The old management is often replaced with new management: the "company doctor" or "crisis manager," either shortly before filing or during the case. New management also may take over upon plan confirmation. Thus, while there may well be valid criticism that Chapter 11, in relying on creditor activism, does not do enough to weed out the dead on arrival Chapter 11 cases, the idea that it maintains poor management in place is suspect. Chapter 11 presumes an active creditors' committee acting on behalf of unsecured creditors and well informed and advised secured creditors acting for themselves, with the fees and expenses of both shifted to the Chapter 11 debtor.

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