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Timothy B. DeSieno
Hebb & Gitlin

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THE DEVELOPMENT OF INSOLVENCY LAW IN THE COMMONWEALTH CARIBBEAN: A BRIEF SURVEY OF POTENTIAL APPROACHES

TIMOTHY B. DESIENO*

I. INTRODUCTION

As the nations of the Commonwealth Caribbean continue their efforts toward the development of insolvency laws, they are considering the advantages and the drawbacks of various other nations' insolvency systems. This article discusses both the goals that are served by any insolvency system, and the policies that guide the individual direction and focus of various insolvency laws.

II. COMMON ASPECTS OF INSOLVENCY LAWS

A. *Goals of Insolvency Laws*

Insolvency laws—laws that govern the substantive and procedural rights of enterprises and their creditors in the event of financial difficulty—are as critical to the success of any market economy as are other laws focusing more directly on the ordinary operation of financial markets (e.g., laws creating and regulating banking, securities and commodities industries). While the various insolvency systems around the world differ markedly from one another, virtually all of them share two primary objectives: (i) to facilitate credit in commercial transactions by providing an orderly system for the liquidation or reorganization of financially-troubled enterprises and (ii) to protect the rights of, and to provide equal treatment to, similarly-situated creditors and employees of insolvent enterprises.

Because all but the most basic market economies are, to some degree, dependent upon credit, virtually every market's operation

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* Mr. DeSieno practices with the firm of Hebb & Gitlin in Hartford, Connecticut. He has advised several developing market economies in the preparation and implementation of insolvency laws.

will be disturbed when credit is not repaid in accordance with the terms of credit contracts. Insolvency laws lend a necessary element of predictability to market economies by establishing a framework for determining and enforcing the consequences that arise when a particular entity cannot repay its debt. It is not that creditors need assurances that their debts will be repaid even in an insolvency; rather, creditors need to be able to predict with some certainty the consequences of an insolvency, whether those consequences are favorable or unfavorable. With an understanding of those consequences, creditors have a framework for assessing the credit terms (such as interest rate, maturity date, requirement of collateral, etc.) they should demand from a particular enterprise. Stated differently, rational insolvency laws create a degree of certainty that allows creditors to make more rational investment decisions than they otherwise could, thus resulting in a greater availability of credit in the market as a whole.

Promoting more efficient investment decisions and, ultimately, a more efficient market is one of the primary goals of an insolvency law. The second primary goal is to ensure that similarly-situated creditors of an insolvent enterprise are treated equitably. As an enterprise begins to encounter financial difficulty, creditors who recognize the trouble often exercise their contractual and legal rights and begin to pursue the assets of the enterprise as a source for repayment of their credit. Stronger or larger creditors, or creditors with easier access to assets of the enterprise, may often be swifter, to the detriment of other creditors. Certain creditors may succeed in preventing the enterprise's use of crucial assets, effectively preventing the enterprise from continuing operations, again to the detriment of other creditors.

In the absence of an insolvency administration, creditors who proceed most swiftly enjoy the greatest likelihood of being repaid. While such a race for the enterprise's assets may benefit individual creditors, it will harm the creditor body as a whole, both by depriving them of access to the assets seized and by accelerating the economic dismemberment of the enterprise. Accordingly, an insolvency law should not reward the swiftest creditors, but should prevent creditor action and thereby afford the enterprise and all of its creditors the ability to resolve financial difficulties more equitably.

In addition to the two universal goals noted above, many insolvency systems (including the systems in the United States and England) also favor a third objective: to afford a "fresh start" to the financially-troubled but honest debtor, particularly in cases of insolvent individuals. This goal is implicit in some insolvency systems, and explicit in the more-debtor oriented systems.

B. Implementation of the Goals

These stated goals of insolvency law are accomplished by various nations in much the same way. Of course, insolvency laws vary widely in their details. As examples, provisions that govern enterprises' eligibility for insolvency proceedings, the scope of the property that constitutes the administered estate, and the method for filing proofs of claim against the estate each tend to vary from country to country. The first goal, however, that of promoting certainty among enterprises and their creditors, is accomplished not by any specific provision of law, but rather by the confidence a nation can instill that its laws are comprehensive, lasting and enforced in a regular way.

Further, in any nation actively engaged in multinational commerce, a comprehensive insolvency law should address the insolvencies of multinational enterprises. A multinational enterprise is likely to have assets located in more than one nation, and such an enterprise may find itself in insolvency proceedings in more than one nation. Because of the differences (large or small) between insolvency laws, multiple proceedings in respect of the same enterprise will inevitably lead to conflicts in the administration of the enterprise's assets. Without established mechanisms for the resolution of such conflicts, the mere fact that an enterprise has assets abroad introduces new uncertainties.

In order to address this issue, many nations have established laws that (i) afford foreign creditors equal status with local creditors and (ii) govern the recognition of, and cooperation with, foreign insolvency proceedings. These laws establish a system that permits enterprises and their creditors to predict with some degree of certainty how a multinational insolvency is likely to be administered.

The second goal, that of providing equitable treatment for similarly situated creditors, is generally accomplished by a number of provisions incorporated into most insolvency laws. For example, most insolvency laws provide that the insolvent entity is protected from hostile actions of at least unsecured creditors upon the commencement of insolvency proceedings. Most insolvency laws also provide a mechanism for the debtor (or its trustee) to recover prepetition transfers of the debtor's assets that were either fraudulent or preferential. Finally, as discussed above, many nations have implemented provisions addressing the insolvencies of multinational enterprises—these provisions often prevent a local creditor from exercising its rights against the local assets of a multinational enterprise and, instead, require the local creditor to participate in the enterprise's foreign insolvency proceeding. Each of these provisions permits an enterprise an opportunity to reorganize in an equitable way and prevents better-situated creditors (either because of their contractual rights or their location) from obtaining an advantage over less fortunate creditors.

The third goal, that of providing a "fresh start", is accomplished by the provisions contained in many insolvency systems granting a discharge to a debtor under certain circumstances.

III. WHERE INSOLVENCY LAWS DIFFER

A. Policies behind Insolvency Laws

Many of the provisions of an insolvency law, however, are formed by the policies that the nation has chosen to emphasize in general. For example, a liberal approach to discharge might further a policy to encourage private individuals and groups of individuals to take the economic risks that will be necessary to start new businesses in an uncertain economic climate. Further, if the preservation of as much job security for employees as possible is an important policy, a nation's insolvency law could be designed to foster reorganizations, either through a continuation of the business of the enterprise, or through a sale of the enterprise's business as a going concern. In either event, creditors may agree to be repaid on terms somewhat different from the terms of their original credit contract.

On the other hand, at least until a market economy is fully established and foreign investors have acquired sufficient familiarity and experience with the way in which businesses will succeed (and fail) under the new insolvency system, liberal approaches to discharge and reorganization may only serve to increase the nervousness of foreign investors and, therefore, increase the cost of their investments. If a nation wishes to encourage the most inexpensive investment (foreign or domestic) as a matter of policy, its law should be designed to foster liquidations for the benefit of creditors (cessation of the operations of the enterprise, liquidation of its assets, and distribution of the proceeds to the creditors), permitting creditors relatively quick access to the assets of the financially-troubled business in order to satisfy their debts. As a very broad generalization, the insolvency laws of a majority of countries are geared primarily toward the liquidation of insolvent businesses, while in a few countries (most notably the United States and France), the laws provide more practical mechanisms for the reorganization of businesses and the preservation of employment.

A nation may wish to have its insolvency law serve any number of other policy objectives beyond the promotion of risk-taking, the preservation of employment and the encouragement of inexpensive investment. Accordingly, insolvency laws often differ from each other markedly as each nation embodies its selected policies (which are not always shared by other nations) in its insolvency law.

B. Implementation of Various Policies

In general, the most significant policies (of those that can be furthered by an insolvency law) are embodied in an insolvency law's provisions that govern (i) an enterprise's ability to seek a reorganization as opposed to liquidation, by secured creditors or otherwise, (ii) the ability of creditors and other constituencies to negotiate debt restructuring and otherwise participate in the insolvency process, and (iii) the priorities assigned to certain claims. Below is a description of some of the most salient policies behind the insolvency laws of France, Germany, England, and the United States and the provisions of their respective insolvency laws that implement those policies.

1. France

In France, the primary objectives of the insolvency system are to preserve the enterprise and to maintain the jobs it provides. It is only a secondary goal to satisfy the claims of creditors. The fact that labor concerns are superior to creditor concerns manifests itself in a number of ways in the French bankruptcy system.

For example, a special committee of employees is formed to advocate the claims of employees and to consult with the debtor at all stages of a case.[1] Further, wage claims for the sixty days preceding the filing are given a "Super Privilege" in the repayment scheme that is senior not only to claims of prepetition unsecured creditors, but is also senior to claims of prepetition secured creditors and to claims of postpetition creditors.[2] Finally, the reorganization process requires that the administrator of a reorganizing entity prepare a report that analyzes the debtor's economic and social position.[3] In ruling on a plan of reorganization, the court considers the social benefits provided by the entity.

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1. In addition to a "Workers' Representation Committee", an Employees' Representative is appointed to represent the interests of the employees. Law 85-98 of January 25, 1985, arts. 44, 123. These employees' representatives cooperate in the preparation of a plan of reorganization. *Id.*, arts. 45, 139(2).

2. *Id.*, art. 40(2).

3. As part of such report, the administrator makes a recommendation as to whether the business should be reorganized or liquidated. *Id.*, art. 18.

Within just two months after the publication of the bankruptcy judgment (30 days in the case of creditors not domiciled in France), creditors are required to file proof of their claims.[4] Creditors of an enterprise in insolvency proceedings in France will have little say, however, in determining the feasibility of a proposed plan of reorganization as the creditors are represented before the court by an official from a designated list, and such official need not seek the creditors' approval of a proposed plan.[5]

2. *Germany*

In Germany, the insolvency processes are perceived to be creditors' remedies. Both liquidation and composition (reorganization) are contemplated by the insolvency laws. A composition, however, requires the debtor to repay at least 35% of its unsecured debts, or 40% if full repayment is delayed beyond one year from the date of confirmation of the composition[6] (secured claims remain unaffected by either liquidation or composition[7]). If the court does not believe that the debtor is capable of paying at least this amount, the debtor is required to liquidate.[8] Further, composition plans can only be implemented if a majority of voting unsecured creditors approve the plan and if that majority holds at least 75% of the amount of the unsecured claims against the debtor (80% if the proposed dividend is less than 50%).[9]

Perhaps most significantly, secured creditors are not stayed by the commencement of insolvency proceedings in Germany, and the secured creditor remains entitled to enforce its security at all times.[10] Given a prevalence of secured credit, this means that compositions are rare in Germany.

As in France, however, claims for wages (for the year preceding the bankruptcy petition) enjoy relatively high priority in liquidation distributions (essentially second only to the administrative costs associated with the proceedings).[11]

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4. If creditors fail to file timely proof of their claims, their claims are extinguished. *Id.*, arts. 53(1), 53(3).
5. *Id.*, art. 46(1).
6. Vergleichsordnung (Composition Law), §§ 7(1), 7(2).
7. Konkursordnung (Bankruptcy Law), §§ 47 *et seq.*; Vergleichsordnung, § 26.
8. Vergleichsordnung, §§ 79, 80.
9. *Id.*, § 74.
10. *See supra* note 7.
11. Konkursordnung, §§ 59, 61.

It should be noted that a new insolvency law is under consideration in Germany.[12] Although much of the proposed law varies from existing law, it does not seem likely that the new law will significantly alter the general approach of German insolvency law.

3. *England*

Like in Germany, English insolvency procedures are perceived to be creditors' remedies. In England, most floating charges provide the chargee with the right to appoint a receiver in the event of a default. Given the prevalence of such secured investment (usually there is little or no unsecured debt), a secured investor will often have a receiver appointed who will carry out the liquidation of a company's assets outside of the bankruptcy courts.

Even if the borrower files a petition for administration (a form of reorganization), the holder of a floating charge is permitted to appoint a receiver for a limited period of time.[13] This effectively supersedes the administration case, and thus administrations are, in practice, relatively rare. Instead, in England, as in Canada and many other Commonwealth jurisdictions, the prevalence of "floating charge" secured debt makes receivership the most common form of insolvency process. Receiverships are commenced simply by the appointment of secured creditors, and no court proceedings are involved (somewhat similar to a UCC public or private sale of collateral in the United States).[14]

4. *The United States*

In the United States, bankruptcy is generally perceived to be a debtor's remedy (as opposed to the creditors' remedy it often is elsewhere). In most cases, there are no stated prerequisites to the filing of a bankruptcy petition (such as a requirement that the filing entity be insolvent).[15] In the vast majority of cases, the debtor voluntarily files the bankruptcy petition. Given the scope of the automatic stay of creditor actions and the cramdown powers (discussed below) that the United States Bankruptcy Code affords to debtors, creditors

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12. For a description of the proposed law, *see* Stefan Reinhart, *Germany's Insolvency Bill*, 2 INT'L INSOL. REV. 29 (1993).

13. The holder of a floating charge remains entitled to appoint an administrative receiver prior to the entry of an administration order approving the relief requested in a petition for administration. Insolvency Act 1986, § 10(2).

14. *See* Insolvency Act 1986, § 33(1).

15. *See* 11 U.S.C. §§ 109, 301, 302, 303, 304.

often wish to avoid having their debtors file bankruptcy petitions.[16] Consequently, debtors often use the "threat" of bankruptcy to help persuade creditors to agree to out-of-court debt restructuring.

The practically unfettered ability to file for protection under an insolvency law is a bargaining chip that debtors do not have in all countries. Further, under the United States Bankruptcy Code, barring rather extreme circumstances, a debtor's management remains in control of a reorganizing debtor (the United States Bankruptcy Code does not provide for the automatic appointment of a trustee to replace a reorganizing debtor's management as in some countries).[17] Accordingly, creditors of United States debtors in bankruptcy often find themselves in the difficult position of being prevented from taking any action to collect debts or proceed against property at the same time that they must discuss a bankruptcy reorganization with the same management that was in place before the bankruptcy—and with whom a consensual out-of-court restructuring was not possible. This possibility also induces creditors to accept something less than full and timely payment in out-of-court restructurings.

Finally, the Bankruptcy Code provides reorganizing debtors with the ability to restructure their debts, even without the approval of creditors, provided certain tests have been satisfied.[18] Although many restructurings are fully consensual, if the debtor cannot obtain the approval of a creditor or class of creditors, it may seek to use its "cramdown" powers and, in essence, force that creditor or class to accept the proposed restructuring. It is the threatened use of this cramdown power that is one of the debtor's most powerful bargaining tools in out-of-court restructurings.

IV. CONCLUSION

In summary, in France and the United States, because of policy choices, the insolvency laws tend to provide a more liberal approach to discharge and reorganization. The French insolvency law is intended in significant part to aid the French social system. The United States system is designed in significant part to promote entrepreneurial risk-taking.

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16. Creditors (both secured and unsecured) are generally prohibited from taking any action to seek payment from the debtor in bankruptcy or its assets. *See* 11 U.S.C. § 362(a).

17. Under the reorganization provisions of the United States Bankruptcy Code, the debtor remains in control of its assets and business. A trustee is only appointed to manage the affairs of the debtor in certain rather unusual circumstances. *See* 11 U.S.C. § 1104(a).

18. This ability is referred to as the "cramdown" power and is described in 11 U.S.C. § 1129(b).

The laws of Germany and England, on the other hand, tend to provide creditors easier access to the assets of the insolvent enterprise. Their insolvency laws are designed, in significant part, to minimize the risk undertaken by an enterprise's creditor body (the vast majority of which holds secured debt in these countries).

While each system operates well, it seems unlikely that the insolvency system of one country could be transferred successfully to another country: the policies served by any given insolvency law would not necessarily coincide exactly with the policies that another country would ask its insolvency laws to serve.

This discussion is a mere overview of the major goals of an insolvency system and the major policies served by various existing insolvency systems. It is not intended to serve as a recommendation to implement any particular policies or systems. Instead, it is designed to suggest that the most logical approach to preparing an insolvency law is to analyze the policies that a nation wishes its law to serve. Only then can a nation select the most appropriate approach to an insolvency law.