Distress dynamics

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Glossary

This glossary is limited to the English version of Dutch legal terms and its corresponding translation.

English	**Dutch**
abuse of power	misbruik van bevoegdheid
Association of supervisory judges in bankruptcies	Recofa
attachment	beslag
bailiff	deurwaarder
Bill Foreclosure Sales	Wetsvoorstel Executieveilingen
Central Insolvency Register	Centraal Insolventieregister
civil law notary	notaris
Code of Commerce	Wetboek van Koophandel
Code of Dutch Civil Procedure	Wetboek van Burgerlijke Rechtsvordering
Collection of State Taxes Act	Invorderingswet
confirmation	homologatie
confirmation hearing	homologatiezitting
Continuity of Enterprises Act 1 (CEA 1)	Wet Continuïteit Ondernemingen I (WCO I)
Continuity of Enterprises Act 2 (CEA 2)	Wet Continuïteit Ondernemingen II (WCO II)
cooling-off period	afkoelingsperiode
costs of bankruptcy	algemene faillissementskosten
Council of State	Raad van State
Court of Appeals	Hof
cram down plan	dwangakkoord buiten faillissement
Debt Restructuring Natural Persons	Wet Schuldsanering Natuurlijke Personen
District Court	Rechtbank
Dutch Bankruptcy Code (DBC)	Faillissementswet (Fw)
Dutch Civil Code (DCC)	Burgerlijk Wetboek (BW)
Dutch Penal Code	Wetboek van Strafrecht
Dutch Supreme Court (HR)	Hoge Raad der Nederlanden (HR)
duty of care	zorgplicht
estate	boedel
estimators	schatters

English	**Dutch**
ex officio	ambtshalve
explanatory memorandum	memorie van toelichting
financial collateral agreement	fiduciary ownership
financiëlezekerheidsovereenkomst	zekerheidseigendom
Inheritance Tax Act	Successiewet
Insolvency Law Committee	Commissie Insolventierecht
intended supervisory judge	beoogd rechter-commissaris
intended trustee	beoogd curator
joint creditors	gezamenlijke schuldeisers
Judge for Preliminary Relief	Voorzieningenrechter
House of Representatives	Tweede Kamer
meeting of creditors	schuldeisersvergadering
Minister of Justice	Minister van Justitie
Minister of Safety and Justice	Minister van Veiligheid en Justitie
ordinary creditor	concurrente schuldeiser
out-of-court reorganization plan	onderhands akkoord
Parliamentary History	Parlementaire Geschiedenis
Parliamentary Papers	Kamerstukken
Predesign Insolvency Law	Voorontwerp Insolventiewet
private sale	onderhandse verkoop
public auction	openbare verkoop
public servant	ambtenaar
Recalibration of Bankruptcy Law	Herijking Faillissementsrecht
reasonable time limit	redelijke termijn
(bankruptcy) reorganization plan	faillissementsakkoord
right of mortgage	hypotheekrecht
right of pledge	pandrecht
right of privilege	voorrecht
right of summary execution	recht van parate executie
secured creditor	zekerheidsgerechtigde
Section	artikel
shareholder	aandeelhouder
Social Insurance Funding Act	Wet Financiering Sociale Verzekeringen
state of insolvency	staat van insolventie
subordinated creditor	achtergestelde schuldeiser
supervisory judge	rechter-commissaris
suspension of payments	surseance van betaling
transition of enterprise	overgang van onderneming

English	**Dutch**
trustee	curator
unsecured creditors	ongezekerde schuldeisers

1 Introduction

1 Introduction of the topic

On September 15, 2008 Lehman Brothers Holdings Inc. (LBHI) filed for Chapter 11 bankruptcy protection in the United States Bankruptcy Court Southern District of New York.[1] This filing sent shockwaves through the global financial system and led to a period of extreme volatility on financial markets. Instead of reorganizing, Lehman Brothers was effectively liquidated on September 20, 2008 with a sale of its core activities to Barclays Capital.[2] A few weeks later, on October 8, 2008, the finance vehicle of the Lehman Brothers Group, the Dutch entity Lehman Brothers Treasury Co. B.V. (LBT) was declared bankrupt.[3] However, instead of selling its main asset – a claim against LBHI – to a third party, a (liquidating) reorganization plan (*faillissementsakkoord*) was adopted in 2013 as to fix the claims of the creditors of LBT.[4]

Changing dynamics in the Netherlands

Both of the bankruptcies set out above illustrate the shift in mindset that is taking shape in both the Netherlands and the United States. In the Netherlands, the opening of a bankruptcy procedure (*faillissement)* traditionally leads to a sale of the assets of the debtor and a distribution of the proceeds among the creditors. Possibilities for the preservation of the business of a debtor in trouble primarily lie in either a going-concern asset sale or a lender-lead informal reorganization process.[5] The other options available to a corporate debtor in trouble that tries to save its business – the reorganization plan and the suspension of payments procedure – are generally perceived as being inadequate. Most notable in this

1 In this dissertation the word 'bankruptcy' is used in the broader, American sense unless stated otherwise. As such, it does not exclusively envelop the Dutch procedure '*faillissement*', which is often translated as 'bankruptcy'. The circumstances that led to the bankruptcy of Lehman Brothers Holdings Inc. can be found in the report by the examiner in this case, Anton Valukas. The report is available at: http://jenner.com/lehman.

2 See: 'Judge approves $ 1.3 bn Lehman deal' via: http://news.bbc.co.uk/2/hi/business/7626624.stm.

3 LBT had been in a suspension of payments procedure since September 17, 2008.

4 For the background to the demise of this entity and the relation to its U.S. parent see: http://www.lehmanbrotherstreasury.com/pdf/english/Annex%20I%20to%20fifteenth%20public%20report.PDF.

5 See about informal reorganizations: F.E.J. Beekhoven van den Boezem, 'De faillissementsprocedure wordt maatschappelijk relevant: hoera?', *Tijdschrift voor Insolventierecht* 2008, 13. See footnote 2 of that publication for an overview of further literature on informal reorganizations. Another possibility to reorganize a Dutch business is via an American bankruptcy procedure. See about this phenomenon: O. Couwenberg and S.J. Lubben, 'Corporate bankruptcy tourists', *Seton Hall Public Law Research Paper* No. 2458044, 2014, available via: http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2458044.

respect is that businesses in the Netherlands are often funded by means of secured debt and that creditors that provide such debt are not affected by a reorganization plan or a suspension of payments procedure.[6]

In recent years, however, there has been increased attention for reform of Dutch bankruptcy law as to enhance its reorganizational possibilities. Most notably, the Dutch legislative program 'Recalibration of Bankruptcy Law' has the possibility of becoming one of the biggest overhauls of bankruptcy law since the enforcement of the Dutch Bankruptcy Code in 1896.[7] It aims *inter alia* to pass legislation regarding the implementation of a legal basis for pre-packaged asset sales, cram down plans outside of bankruptcy and the implementation of other measures to enhance the chances of the successful restructuring of a viable business. Furthermore, the Dutch association of insolvency practitioners, INSOLAD, has launched a proposal for the revision of the suspension of payments procedure, as to give it the character of a reorganization procedure.[8] Finally, the European Commission has published a recommendation largely aimed at enhancing the possibilities for the reorganization of a debtor.[9]

Changing dynamics in the United States

At the other side of the Atlantic Ocean a trend in the opposite direction can be seen. In the United States, bankruptcy law has traditionally been known for its reorganizational possibilities. The fame of Chapter 11 of the U.S. Bankruptcy Code stretches across American borders and it is generally perceived to be the leading system of bankruptcy law regarding reorganizations.[10] Chapter 11 provides the debtor with the possibility to remain in control during a reorganization process that is aimed at the adoption of a reorganization plan. As such, a business can keep functioning in the same legal entity and under debtor-installed management during and after the restructuring process.

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6 See: R.J. van Galen, 'Knelpunten in ons insolventierecht', *Ondernemingsrecht* 2014/81.

7 See: Parliamentary Papers 2012–2013 29 911, no. 74.

8 See: https://static.basenet.nl/cms/105928/website/2015_01_30-Titel-II-Van-surseance-van-betaling.docx and https://static.basenet.nl/cms/105928/website/2015_01_08-Toelichting-op-het-ontwerp-voor-een-nieuwe-surseance.docx.

9 C (2014) 1500 final. Available via: ec.europa.eu/justice/newsroom/civil/news/140312_en.htm.

10 See, for example, the description of De Weijs and Wessels: "*The US chapter 11 procedure is both in practice and conceptually the most important insolvency procedure worldwide.*" B. Wessels and R.J. de Weijs, 'Proposed recommendations for the reform of chapter 11 U.S. Bankruptcy Code', *Ondernemingsrecht* 2015/37. For an interesting – and at times humorous – account of the development of bankruptcy law in the U.S. I refer to the lecture given by the late Harvey Miller at the 38th Alexander L. Paskay Memorial Bankruptcy Seminar. This lectured is available via: http://news.abi.org/podcasts/146-harvey-miller-reflecting-on-impact-of-bankruptcy-law-on-financial-renewal-in-america.

In the early years after its introduction in 1978, Chapter 11 was indeed commonly used for the restructuring of a debtor via a reorganization plan. However, this practice changed over the years, as creditors saw that a debtor was sometimes using Chapter 11 merely to postpone an (inevitable) liquidation.[11] Cases dragged on as creditors stood by and the debtor kept hoping for a turn for the better. In light of these kinds of bankruptcies, creditors started to develop mechanisms to gain more control over the restructuring process and, as a result, changed the dynamics of Chapter 11 cases.[12] Businesses, for example, were being financed more and more by means of secured debt instead of bonds.[13] Sparked by the increased control by creditors, the number of asset sales in Chapter 11 has increased substantially over the last several years.[14] Chapter 11 mega cases from the last few years, such as General Motors and Chrysler, all had a bankruptcy asset sale take place early on in the case.

The changed dynamics have set in motion a discussion about the effectiveness of American bankruptcy law in both literature and bankruptcy practice. This discussion, in turn, led to an extensive review of Chapter 11 by a Commission of the American Bankruptcy Institute (ABI). The result of this review process was the publication of a report in December 2014 containing a number of recommendations regarding Chapter 11.[15] Core recommendations regard restrictions on bankruptcy asset sales, the implementation of a framework to correct the valuation of the debtor for cyclical movements and the introduction of a possibility for small and medium sized entrepreneurs to retain an equity stake in their company despite higher classes not being paid in full. Although it is currently unclear whether or not the report of the ABI will lead to legislative reform of Chapter 11, it is clear that there is a serious debate on Chapter 11 in the United States.

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11 An example that is often mentioned in this respect is the bankruptcy of Eastern Airlines. See about this bankruptcy: Lawrence A. Weiss and Karen H. Wruck, Information problems, conflicts of interest, and asset stripping: Chapter 11's failure in the case of Eastern Airlines, *Journal of Financial Economics* 1998, no. 1. p. 55–97.

12 See, for example, about the changing dynamics of Chapter 11: H.R. Miller, 'Chapter 11 in transition – from boom to bust and into the future', *American Bankruptcy Law Journal* 2007, Fall issue.

13 See: M. Jenkins and D.C. Smith, 'Creditor conflict and the efficiency of corporate reorganization', available via http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2444700. They report that where in 1991 secured debt represented less than 45% of the debt of Moody's-rated firms filing this percentage had risen to 70% in 2012.

14 See: D.A. Skeel, 'From Chrysler and General Motors to Detroit', *Widener Law Journal* 2015, no. 1, p. 127. Section 363 of the U.S. Bankruptcy Code allows the sale of all or substantially all of the assets of the debtor outside the ordinary course of business after notice and a hearing. This Section is also applicable in Chapter 11 procedures.

15 The ABI Report can be found via: http://commission.abi.org.

2 Central research question and scope of research

The handling of the two Lehman Brother bankruptcies mentioned in the preceding paragraph is an example of the changing view on bankruptcy law. In the United States a business is continued by means of a bankruptcy asset sale and in the Netherlands a reorganization plan is used as a way to liquidate a business. As such, bankruptcy practice has stretched up bankruptcy law and changed the dynamics of the bankruptcy process.

While these changed dynamics have lead to a discussion about the reform of bankruptcy law, this discussion – at least in the Netherlands – has not been very structured. The letter, for example, in which the legislative program 'Recalibration of Bankruptcy Law' was announced bore the title 'Combating organized crime' and the discussion is for a large part conducted in the op-ed pages of newspapers. In my view, however, the changed 'distress dynamics' warrant a fundamental discussion about bankruptcy law.

Posing of central research question

Such a discussion should not focus exclusively on altering bankruptcy law as to save as many businesses as possible. Not every business in trouble should be liquidated, but not every business in trouble should be saved either.[16] Rather, the challenge is to ensure that if a business enters bankruptcy, this bankruptcy leads to an efficient outcome by formulating the right rules. This challenge is the one that I humbly take up in this dissertation and the one that leads to my central research question:

> "Is Dutch bankruptcy law regarding asset sales and reorganizations efficient, and, if not, in what way should it be changed?"

By answering this research question more insight can be gained in both the benefits and costs of current Dutch bankruptcy law regarding asset sales and reorganizations. This insight can then be used as the foundation for a broader and more fundamental discussion on the reform of Dutch bankruptcy law. In such a broader discussion other elements – such as political feasibility – may also play a role.

16 Compare: S.M. Franken, 'cross-border insolvency law: a comparative institutional analysis', *Oxford Journal of Legal Studies* 2014, no. 1, p. 106.

Limitations to scope of research

Inevitably, I had to limit the scope of my research. Such limitations were necessary to be able to provide a proper in depth analysis of bankruptcy law regarding asset sales and reorganizations.

A first limitation is that I focused on the bankruptcy of corporate debtors. The reason being, that the situation of natural persons can significantly differ from that of a corporate debtor and, as such, different measures may be more appropriate. As a result, the Debt Restructuring Natural Persons-procedure is not discussed in this dissertation. I have also excluded financial institutions and insurers from my research. Special legislation has been developed for these kinds of debtors, which is so specifically tailored and extensive that these kind of procedures, in my view, justify a discussion of their own.[17] Finally, the suspension of payments procedure and the informal reorganization plan have not been made part of my research. The suspension of payments procedure has not been included, because it is primarily aimed at temporary payments problems and not at reorganizing.[18] The informal reorganization plan is not discussed, because such a plan is simply a multilateral agreement based upon consent of all parties involved. The only aspect of the informal reorganization plan that I do discuss is under which circumstances parties can be bound against their will to such a plan.[19]

3 Overview of research

The central research question is answered in the subsequent six Chapters, which have – with the exception of Chapter 7 – been published before as separate articles.[20]

Assessment framework

The first two Chapters, 2 and 3, are primarily aimed at defining a framework to enable the assessment of bankruptcy law.

17 I note, for example, the Intervention Act in the Netherlands; the Single Supervision Mechanism on an EU level and the Dodd-Frank Act and the proposed Chapter 14 in the United States.

18 See: R.J. van Galen, 'De surseance als echte reorganisatieprocedure', *Tijdschrift voor Insolventierecht* 2015/23.

19 § 4.1 of Chapter 6.

20 I note that Chapter 2 has been changed from UK into US English and that the Chapters 5 and 6 have been translated from Dutch into English. Furthermore, typos that appeared in the published articles have been corrected. Otherwise, the articles have not been altered or updated.

In Chapter 2, I look at the justification for the existence of bankruptcy law and the goal or goals that it should serve.[21] In light of Dutch and U.S. bankruptcy law multiple normative theories regarding bankruptcy law are set out and compared. These theories are: i) the creditors' bargain theory; ii) the risk sharing theory; iii) the rehabilitation view; iv) the feminism/communitarianism view; v) the bankruptcy choice situation; and vi) the team production theory.

In Chapter 3 subsequently, the objective is to answer the question what form bankruptcy law, in particular the law with regard to reorganizations, has to take in order for it to be efficient.[22] To this end the traditional reorganization plan procedure is compared to three alternative kinds of reorganization proceedings. These alternatives are: i) ex ante capital structures; ii) mandatory auctions and iii) options-theory. This comparison provides for conclusions regarding an efficient structure for a reorganization.

With the formulation of a framework in Chapters 2 and 3, it becomes possible to assess different elements of bankruptcy law.

Assessment of bankruptcy law regarding asset sales

The subsequent two Chapters, 4 and 5, focus on bankruptcy law regarding asset sales.

In Chapter 4, the topic is the regular asset sale in bankruptcy.[23] In particular, I assess – in light of the creditors' bargain theory – to what extent the law regarding the sale of assets in Dutch bankruptcies contains obstacles for a trustee to maximize the value of these assets. I devote special attention to the assessment standard for asset sales in view of the goal of bankruptcy law. I also discuss the position of creditors with a right of summary execution in relation to a bankruptcy asset sale and the different sales methods that can be used.

Chapter 5 is devoted to a specific variation of asset sales: the pre-packaged asset sale. In this Chapter the efficiency of the Dutch draft bill Continuity of Enterprises Act 1 (CEA 1) is assessed in relation to the creditors' bargain theory.[24] The CEA 1 introduces the figure of the intended trustee, through which the pre-packaged asset sale is made possible. Particular attention is given to the question how value can be maximized in a pre-packaged

21 This Chapter was published in European Journal of Comparative Law and Governance 2014, issue 2, p. 148–211.
22 This Chapter was published in the Norton Journal of Bankruptcy Law & Practice 2015, issue 1, p. 52–106.
23 This Chapter was published in International Insolvency Law Review 2014, issue 3, p. 271–297.
24 This Chapter was published in Dutch in Tijdschrift voor Insolventierecht 2015, 2, p. 5–16.

asset sale through the correct structuring of the sale process. In this respect, the focus is on the stalking horse sales method that is often used in American pre-packaged asset sales.

Assessment of bankruptcy law regarding reorganizations

Chapters 6 and 7 are devoted to bankruptcy law regarding reorganizations.

In Chapter 6, the subject is the Dutch reorganization plan (*faillissementsakkoord*).[25] There are not many reorganization plans adopted in the Netherlands, while it is currently the only way of reorganizing in a bankruptcy procedure (*faillissement*).[26] This begs the question if, and to what extent, bankruptcy law regarding reorganization plans is efficient. This question is answered in Chapter 6.

Chapter 7, finally, is devoted to the cram down plan outside of the bankruptcy procedure (*dwangakkoord buiten faillissement)*. In particular, in relation to the creditors' bargain theory. The cram down plan procedure is a newly proposed procedure for reorganizing a debtor and is partly based on Chapter 11. It is especially interesting to assess as it provides for an opportunity to reorganize outside the context of a formal bankruptcy procedure. Specific attention is devoted in this Chapter to the justification for a statutory framework for a reorganization procedure outside of bankruptcy in the context of the draft bill Continuity of Enterprises Act 2 (CEA 2). It also provides for an assessment of the position of creditors and shareholders under this draft bill.

Conclusion

Chapter 8 provides for a summary and brings together the conclusions of the preceding Chapters.

25 This Chapter was published in Dutch in Tijdschrift voor Insolventierecht 2010, 26, p. 162–171.

26 I note that the suspension of payments procedure includes provisions regarding a reorganization plan that are nearly identical to the provisions regarding such a plan in bankruptcy. As the suspension of payments procedure is not further discussed in this dissertation, an assessment of the provisions regarding a reorganization plan in a suspension of payments procedure is also not made.

4 Methodology

Methodology I: Law & Economics

I have chosen to use a Law & Economics approach in my research. This is not an often-used research method in the Netherlands.[27] However, in my view it is a useful method for assessing bankruptcy law.

Law & Economics is primarily concerned with incentives and the way these incentives influence behavior.[28] In this respect, law can be seen as a collection of incentives, which leads to certain behavior by people.[29] This also applies to bankruptcy law. In particular, because in bankruptcy there will, generally, not be enough to pay everyone in full. This makes that conflicts of interests and incentives play a large role in bankruptcy.

If law is viewed as a collection of incentives, the challenge becomes to determine if certain laws leads to an increase in social welfare.[30] Such determination can be made by assessing law on its 'efficiency'. What I aim to do in this dissertation is to define 'efficiency' and then assess certain aspects of bankruptcy law in view of this definition. This does not mean that there should be no further room for alternative perspectives in a further discussion regarding bankruptcy law.[31] Justice and ethics, for example, may, and should, also play a role in this discussion.

However, while not providing an all encompassing truth, a Law & Economics analysis of bankruptcy law can provide for an important contribution to a further discussion about the future of bankruptcy law.[32] In particular, such an analysis can provide insight in the consequences of having different rules and the behavior of people under different rules.

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27 Although the importance of viewing bankruptcy as an economic process is more and more acknowledged. See: Van Galen 2014 and § 3.5 of the draft explanatory memorandum of CEA 2.

28 M.G. Faure, 'Law and economics: belang voor het privaatrecht', *WPNR* 2011 (6912), p. 1056.

29 B.C.J. van Velthoven and P.W. van Wijk, *Recht en efficiëntie. Een inleiding in de economische analyse van het recht*, Deventer: Kluwer 2013, p. 1.

30 In this respect, generally, the Pareto criterion or the Kaldor-Hicks criterion is used. Pareto efficiency is achieved if the utility or one or more individuals cannot be increased without a decrease in utility of another individual. Kaldor-Hicks efficiency is achieved if the increase in utility for one or more individuals cannot offset the decrease in utility for one or more other individuals. See: Velthoven and Van Wijk 2013, p. 2.

31 Compare: B.C.J. van Velthoven, 'Rechtseconomie tussen instrumentaliteit en normativiteit', *Rechtsfilosofie & Rechtstheorie* 2008, nr. 1, p. 34–35.

32 Compare: S. Franken, 'Onderzoek naar de effectiviteit van faillissementswetgeving', *Tijdschrift voor Insolventierecht* 2000, p. 175.

This enables legislators and judges to make a better-informed choices.[33] A Law & Economics analysis further provides for an objective framework and outcome. This diminishes the influence of subjective arguments, which can always be added later.[34]

Methodology II: comparative law research

In my research, I have further used a comparative law approach as to provide inspiration for solving inefficiencies.[35] In particular, I have included American bankruptcy law. The question for a comparison with (only) American law begs the question why I specifically chose the United States. As described in § 1 above, American and Dutch bankruptcy law have displayed a converging trend over the last years. As such, it is interesting to include American bankruptcy law, as to be able to further study this convergence in the context of an efficiency assessment. Furthermore, American bankruptcy law has since long been a source of inspiration for foreign jurisdictions. As such, I think that it can also serve this function in an assessment of Dutch bankruptcy law. Although, during my research I have always been aware of the fact that the United States and the Netherlands are very different countries and that I could not simply copy solutions that worked in the United States into Dutch law.

The research for this dissertation was concluded on May 19, 2015. In particular, this concerns the Chapters 1 and 8. Research for the other Chapters was concluded at the time the articles were submitted.

33 See: W.C.T. Weterings, 'De economische analyse van het recht', in: W.C.T. Weterings (eds.), *De economische analyse van het recht*, Den Haag: Boom Juridische uitgevers 2007, p. 13.

34 Weterings 2007, p. 13.

35 See for example: Th. M. de Boer, 'Vergelijkenderwijs: de inspiratie van buitenlands recht', *WPNR* 1992 (6033), p. 42 and 45.

2 Efficient bankruptcy law in the U.S. and the Netherlands. Establishing an assessment framework*

Introduction

There are many different systems of bankruptcy law in the world. A researcher can, in principle, test these legal systems to find out whether they are efficient. However, before anyone can undertake such research, one first has to establish a normative assessment framework to determine what constitutes efficient bankruptcy law. Therefore, the question is posed: Which conditions should be met by bankruptcy law in order for reorganizations to be efficient?[1]

Efficiency means maximizing economic value for society as a whole. In the end this comes down to a cost-benefit analysis. It can be argued that it is efficient to prohibit substantive policies – which redistribute value – when a corporation goes bankrupt. Prohibiting substantive policies may externalize some costs onto parties without a defined legal entitlement against the bankrupt corporation, but this can still be efficient if the economic value for society is maximized. It can also be argued that it is inefficient to prohibit substantive policies in bankruptcy. Substantive policies may give some parties an incentive to forum shop, which can also result in costs. But if these costs are lower than the total benefit of the parties that are advantaged, introducing substantive policies is still efficient. In this article several law and economics theories that claim to provide an assessment of efficiency are compared and assessed. At the end I will conclude that the costs of introducing substantive policies in bankruptcy exceed the benefits and that a bankruptcy procedure should only revolve around economic value maximization.

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* This chapter was published as an article in UK English in the European Journal of Comparative Law and Governance 2014, issue 2, p. 148–211.

1 This article aims to answer the question which goal or goals bankruptcy should serve. It does not provide for an answer to the question how this goal can be achieved in an efficient way. See, for this discussion, e.g. M. Bradley and M. Rosenzweig, 'The untenable case for Chapter 11', *The Yale Law Journal* 101(5) (1992) 1043–1089; B.E. Adler, 'Financial and political theories of American corporate bankruptcy', *Stanford Law Review* 45(2) (1993) 311–346; L.A. Bebchuk, 'Using options to divide value in corporate bankruptcy', *European Economic Review* 44(4–6) (2000) 829–843; and p. Aghion, O. Hart and J. Moore, 'Improving bankruptcy procedure', *Washington University Law Review* 72(3) (1994) 849–872. Furthermore, no attention will be given to tax aspects of bankruptcy.

The structure of this article is as follows. After a general overview of Dutch and US bankruptcy law is given in Part A, the creditors' bargain theory is introduced in Part B. The creditors' bargain theory gives a justification for the existence of bankruptcy law. In this respect, I supplement the creditors' bargain theory by assessing that bankruptcy law exists to overcome both a commons and an anticommons problem. I further set out the three principles that are to be used in drafting bankruptcy law in accordance with the creditors' bargain theory. This theory promotes that only the interests of property right holders should be taken into account and that there is no room for value redistribution in bankruptcy.[2] In Part B some attention will also be devoted to absolute priority of creditors to show the implications of accepting the creditors' bargain theory as a normative framework.

In Part C the creditors' bargain theory will be compared with theories that state that bankruptcy is a place for changing substantive rights and the redistribution of value. These theories are the risk sharing theory, the value view and the team production theory. These three theories all have a different view on bankruptcy and incorporate substantive policies in bankruptcy law. But they all have in common that they are critical of the creditors' bargain theory. I review and assess their criticism. At the end of this Article the scales are weighed and the creditors' bargain theory is chosen as the theory that is best able to form a normative framework for bankruptcy law.

Part A: The playing field

Before the question what bankruptcy law *should* look like is answered, it is important to devote some attention to what bankruptcy law *does* look like. In this article US and Dutch bankruptcy law are described, so as to provide some reference for discussing normative theories. The reason for choosing US bankruptcy law is that the theories discussed in this article have been developed by American authors and are geared towards American law. So US bankruptcy law seems to be a good starting point for the comparison of normative and positive bankruptcy law. The reason for choosing Dutch law is that the current Dutch Bankruptcy Code (*Faillissementswet*) is over 115 years old and there is ample discussion about replacing or, at least reforming, it.[3]

2 The term 'property right holder' is defined in Part B.

3 In 2007 the Insolvency Law Committee (*Commissie Insolventierecht)* launched the Predesign Insolvency Law (*Voorontwerp Insolventiewet*). This predesign offered a complete draft for a bill. The Minister of Justice has stated that the Dutch government has no plans to submit a bill for a completely new bankruptcy code in the near future based on this predesign. By letter of November 26, 2012 the Minister did, however, announce a legislative program announcing a recalibration of the Dutch Bankruptcy Code. The 6 bills that are to be submitted to parliament will likely not alter the conclusion of this article. See for the proposed bills:

The American Chapter 11 and the Dutch provisions for a plan of reorganization (*faillissementsakkoord*) differ in character. Where Chapter 11 is a full-swing reorganization proceeding, Dutch law only offers a rudimentary reorganization proceeding that is enveloped in the liquidation procedure. The differences between these 2 legal systems should be taken into account when comparing these systems. However, from a normative point of view both the US and Dutch bankruptcy process should serve the same goal or goals, and therefore the two systems are comparable.

1 Bankruptcy procedure in the US

The current US Bankruptcy Code entered into force in 1978.[4] It is laid down in Title 11 of the US Code.[5] For corporate debtors the most important parts of the Bankruptcy Code are Chapter 7 and Chapter 11.

Chapter 7 provides for a court supervised liquidation of a debtor. A Chapter 7 case begins with the filing of a petition with the bankruptcy court.[6] After filing a petition the US Trustee appoints a trustee to administer the case and liquidate the assets of a debtor.[7] These assets can be sold either piecemeal or jointly. In case of a corporate debtor the last kind of sale is called a 'going-concern sale'.

After the sale of the assets of a debtor the proceeds are distributed among the creditors. The order of payment is laid down in the Bankruptcy Code and the trustee cannot deviate from this order.[8] This means that there is a rule of absolute priority. There are basically three kinds of claimants: i) holders of a lien, ii) priority claim creditors and iii) ordinary creditors.

First in rank are the holders of a lien. Within this category of claimants several types of liens, with differing priority, can be distinguished. The starting point is that holders of a

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Kamerstukken 2012–2013, 33695, no. 1. Available at https://zoek.officielebekendmakingen.nl/dossier/33695/kst-33695-1?resultIndex=2&sorttype=1&sortorder=4, retrieved 08/01/2014.

4 Its last major modification took place in 2005 with the enactment of the Bankruptcy Abuse Prevention and Consumer Protection Act.

5 The current Bankruptcy Code was preceded by the Bankruptcy Act of 1898. This Act was also called the 'Nelson Act' and was the first modern federal bankruptcy law of the United States. It was significantly amended in 1938 by the Chandler Act.

6 This petition may be either voluntary or involuntary. See: 11 U.S.C. § 301(a) and 303(b).

7 11 U.S.C. § 701 and 704. In Alabama and North Carolina the trustee is appointed by the bankruptcy court. The US Trustee is part of the Department of Justice of the United States. If there are no assets or all assets of the debtor are exempted from liquidation a 'no asset' report is filed with the court and no distribution to the creditor takes place. See Federal Rule of Bankruptcy Procedure 5009 for the no asset report.

8 11 U.S.C. § 726(a) (1).

secured claim have the highest ranking lien.[9] It is, however, possible that the court authorizes the trustee to incur debt secured by a priming lien.[10] This kind of debt is often described as 'debtor-in possession financing'. The 'priming' of the lien is only possible with the consent of the holder of the secured creditor, or if 'adequate protection' is offered to the secured creditor.[11] Next are the holders of a subordinated lien.[12] This kind of lien is vested for loans that do not require a priming lien, but for which the lender demands a higher status than a loan that qualifies as an administrative expense.[13]

Second in rank are the holders of an (unsecured) priority claim.[14] Within this category there are also differing priorities.[15] According to 11 U.S.C. § 507 (b) the highest ranking claims are those from secured creditors that have been confronted with a priming lien without receiving sufficient protection to cover their claim.[16] A list of other priority claims and their order is given in 11 U.S.C. § 507(a). This order is roughly: administrative expenses, claims that have arisen between the filing and the order for relief, wage claims, employee benefit claims, tax claims.[17]

The third ranking creditors are the ordinary creditors.[18] Within this class, ordinary claimants that have timely-filed claims or claims tardily filed by a creditor that did not know of the bankruptcy, have priority over tardily filed creditors who were given notice or had knowledge of the bankruptcy.[19] Those creditors rank higher than those with claims arising from fines or punitive damages.

Fourth and last in rank are the shareholders. They will only receive payment if a surplus remains after all the higher ranking creditors have been fully paid. Full payment includes payment of interest obligations.

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9 § 9 UCC.

10 11 U.S.C. § 364(d)(1).

11 11 U.S.C. § 364(d)(1)(A). The other requirement is that the trustee is unable to obtain credit in another manner. Secured creditors cannot execute their rights during bankruptcy, because the order of relief triggers an automatic stay. See: 11 U.S.C. § 362.

12 11 U.S.C. § 364(c).

13 11 U.S.C. § 364(b).

14 11 U.S.C. § 726(a)(1).

15 11 U.S.C. § 507(a).

16 This form of priority is commonly called a 'superpriority claim'. There are some special kinds of claims that trump claims of holders of a priming lien with insufficient adequate protection. See e.g. 11 U.S.C. § 506(c).

17 See 11 U.S.C. § 503 for a list of claims that qualify as administrative expenses.

18 11 U.S.C. § 726.

19 In a Chapter 7 procedure, claims have to be filed within 90 days after the first date set for the meeting of creditors: 11 U.S.C. § 341 and Federal Rule of Bankruptcy Procedure 3002.

A debtor can also file for a Chapter 11 bankruptcy.[20] Chapter 11 of the Bankruptcy Code provides for the reorganization of a debtor.[21] In Chapter 11 cases, however, generally no bankruptcy trustee is appointed, but the debtor himself stays in control of the operation of the business as 'debtor in possession'.[22] During the bankruptcy the debtor in possession may use, sell or lease property of the estate in the ordinary course of business.[23] The US Trustee monitors the debtor in possession and the operating of its business. Furthermore, the US Trustee appoints the members of the creditor committee and organizes a creditor meeting.[24]

After a bankruptcy petition is filed a debtor has the exclusive right to propose a reorganization plan during the first 120 days.[25] This 'exclusivity period' may be extended up to a maximum of 18 months.[26] After the exclusivity period has expired any party in interest may propose a plan.[27] The Bankruptcy Code states that the proposed plan has to designate classes of claims and interests for treatment.[28] The proponent of a plan is free in the classification of the claimants in the different classes, but within a class each claimant has to be treated equally.[29] If the proposed plan is accepted it binds all creditors as well as the shareholders.[30]

The starting point for acceptance of a plan is that all classes have to consent to a plan in order for it to be eligible for confirmation.[31] If not all impaired classes have voted in favor

20 This petition may also be either voluntary or involuntary. A Chapter 11 case may be qualified as a 'small business case' in the case of a small business debtor (11 U.S.C. § 101(51C)), or a 'single asset real estate' case in case the debtor conducts no other substantial business than the operation of a single real estate property or project (11 U.S.C. § 101 (51B). In this article no further attention will be devoted to the distinction between these cases.

21 i.e. The restructuring of the liabilities of a debtor. A liquidating plan is also permissible under Chapter 11.

22 11 U.S.C. § 1107(a). The bankruptcy court can appoint a trustee. It can also appoint an examiner. The role of the examiner is usually investigatory, but the court may grant the examiner broader powers. 11 U.S.C. § 1106.

23 11 U.S.C. § 363(c). Prior approval by a court is unnecessary, unless ordered otherwise.

24 11 U.S.C. § 341 and 1102. The creditor committee ordinarily consists of the unsecured creditors who hold the seven largest claims.

25 11 U.S.C. § 1121(b). 11 U.S.C. 1123(a) and (b) list the mandatory and discretionary provisions of a reorganization plan.

26 11 U.S.C. § 1121(d). The exclusivity period may also be curtailed by the court.

27 If a trustee is appointed he may file a plan. The US Trustee may not file a plan (11 U.S.C. § 307).

28 11 U.S.C. § 1123(a)(1).

29 There are some limits to the classification of creditors. According to the Fifth Circuit "*[a] fair reading of [11 U.S.C. § 1122] suggests that ordinarily 'substantially similar claims', those which share common priority and rights against the debtor's estate should be placed in the same class.*" See: *Phoenix Mutual Life Insurance Company* v. *Greystone III Joint Venture*, 995 F.2d 1274 (5th. Cir. 1991).

30 11 U.S.C. § 1141.

31 11 U.S.C. §1129(a)(8). A class is deemed to have consented to the proposed plan if an amount of creditors representing two thirds of the amount impaired and half of the number of claims within the class has voted

of a proposed reorganization plan the court can still confirm the plan on the basis of a 'cram down'. A cram down is possible if at least one class of claimants votes in favor of the reorganization plan, and with regard to the opposing classes the proposed plan does not discriminate unfairly and is fair and equitable.[32]

In order for a plan to be 'fair and equitable' it will have to meet the requirement of 11 U.S.C. § 1129 (b). With regard to secured creditors this section holds that a plan may only be confirmed if a fully secured creditor opposing the plan retains its lien on the collateral to the extent of the value of the collateral, and the creditor is paid, with interest, over the life of the plan, the amount of the allowed secured claim.[33] With regard to unsecured creditors and shareholders the section provides that a plan may only be confirmed if a shareholder receives nothing or retains an interest until the unsecured creditors are paid in full.[34] This last rule is called the 'absolute priority rule' and ensures that shareholders do not receive payment before the unsecured creditors are paid in full. This rule is not applicable if all impaired classes consent to the proposed plan.

There has been ample discussion whether an exception on this rule can be made for the situation that existing equity pays an amount equal to the going-concern value of the corporation in return for an equity stake in the reorganized corporation. This is the so-called 'new value exception'. Such new value is often necessary to raise the working capital necessary to successfully reorganize. In practice the former shareholders are often the most willing to provide the necessary capital.

In *Case* v. *Los Angeles Lumber Products* the existence of a new value exception was acknowledged by the Supreme Court.[35] This judgment, however, dates back to 1939 and commentators have debated whether *Case* still applies under the Bankruptcy Code of 1978. The lower courts are divided on this question. Courts, however, that do accept a new value exception usually require that the 'new value' is i) new, ii) substantial, iii) money or money's worth, iv) necessary for a successful reorganization and v) a reasonable equivalent to the value of the property that the equity class is to retain or receive.[36] Until now the Supreme

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in favor of the proposed plan. 11 U.S.C. § 1126(c). In case of equity it is sufficient if the consenting shareholders represent two thirds of the amount of impaired equity capital. 11 U.S.C. § 1126(g).

32 11 U.S.C. § 1129(a)(10), 1129 (b)(1). The requirements of 11 U.S.C. § 1129(a) should be met whether all classes have accepted the plan or not.

33 11 U.S.C. § 1129(b)(2)(A)(i)(I). 11 U.S.C. § 1129 (b)(2)(A)(ii) states that a secured creditor has a right to an asset sale. A plan can also be confirmed if the secured creditor receives the 'indubitable equivalent' of his claim. 11 U.S.C. § 1129(b)(2)(A)(iii).

34 11 U.S.C. § 1129 (b)(2)(B)(ii).

35 *Case et al.* v. *Los Angeles Lumber Products Co.*, 308 US106, 60 S.Ct. 1 (1939).

36 In *re Coltex Loop Central Three Partners*, 138 F.3d 39, 41 (2nd Cir. 1998).

Court has refused to answer the question whether a new value exception exists. It refused to do so in both *Ahlers* and *203 North La Salle Street*.[37] In *203 North LaSalle* it did, however, state that the fact that Congress did not codify the new value exception when the Bankruptcy Code was enacted did not preclude the existence of a new value exception. It also stated that, *assuming* that a new value exception exists, in order for a plan that includes a new value exception to be eligible for confirmation, the plan should provide for any kind of market valuation or competition to ensure that the proposed contribution by the shareholders is the best obtainable result. Finally, the Supreme Court stated that a plan that includes a new value exception cannot be confirmed if the plan is filed during the exclusivity period of the debtor.

It therefore remains to be seen if the new value exception really exists. In the meantime empirical research has shown that deviations from the absolute priority rule, in the sense that equity was benefited at the expense of unsecured creditors, occurred in 23% of the cases in the period 1993–2004. This percentage was 16% for the relation between secured and unsecured creditors.[38] Prior research reported deviations from the absolute priority rule in 77% of the cases.[39] This research also showed that, on average, equity got 7.6% of the paid out value, while they had a right to 0%. LoPucki and Whitford, in their study, found a deviation of far less than 10% in almost all cases.[40]

2 Bankruptcy procedure in the Netherlands

The Dutch Bankruptcy Code (DBC) entered into force in 1896 and replaced the provision regarding bankruptcy in the Code of Commerce of 1838 (*Wetboek van Koophandel*). Under the Dutch Bankruptcy Code corporate debtors have the possibility to either file for bankruptcy (*faillissement*) or suspension of payments (*surseance van betaling*).[41]

37 *Norwest Bank Worthington v. Ahlers* 479 US1081 (1988) and *Bank of America National Trust and Savings Association* v. *203 North La Salle Street Partnership*, 526 US 434, 199 S. Ct. 1411 (1999).

38 V. Capkun & L.A. Weiss, 'Bankruptcy resolution and the restoration of priority of claims', *American Law & Economics Association Annual Meetings Working Paper* 2008-43. They report that, in their research, equity received a 100% pay out in 2% of the cases, but that in the vast majority of the cases they received little or no distribution.

39 A.C. Eberhart, W.T. Moore & R.L. Roenfeldt, 'Security pricing and deviations from the absolute priority rule in bankruptcy proceedings', *The Journal of Finance* 45(5) (1990) 1457–1469.

40 L.M. LoPucki and W.C. Whitford, 'Bargaining over equity's share in the bankruptcy reorganization of large, publicly held companies', *University of Pennsylvania Law Review* 139(1) (1990)125–196 at 142 and 166. This research only involved large, publicly held companies.

41 Bankruptcy is laid down in Sections 1–213kk DBC; suspension of payments in Sections 214–283 DBC. Suspension of payments is meant as a temporary solution for an acute liquidity problem. It provides, as the name implies, for a suspension of payments. There is also a procedure for the reorganization of debts of a natural person (Sections 329–340 DBC). These last two procedures will not be further discussed in this

The bankruptcy of a debtor in the Netherlands starts with the filing of a petition with the court.[42] After the debtor has been declared bankrupt by the court, a trustee (*curator*) is appointed.[43] This trustee employs the assets of the debtor to generate value for the joint creditors ('*gezamenlijke schuldeisers*').[44] Once value is realized, the proceeds have to be distributed among the creditors. The leading principle for the distribution of proceeds among creditors in bankruptcy is the *paritas creditorum* principle. *Paritas creditorum* roughly translates to 'equality of creditors' and holds that every creditor has an equal right to proportional payment. It is laid down in sections 3:276 and 3:277 Dutch Civil Code (DCC).[45]

The principle of equality of creditors, however, is the exception rather than the rule. Dutch law includes a number of statutes that provide for preference for a certain creditor over another.[46] These statutes provide for the following scheme of relative priority. First in rank are the administrative expenses made by the estate. However, the holders of a right of pledge (*pandrecht*) or a right of mortgage (*hypotheekrecht*) trump administrative expenses in priority, as the first two kinds of creditors can still seek individual recourse and exercise their rights as if there was no bankruptcy.[47] The creditor second in rank is the fisc. He has a right of privilege to all goods of the debtor.[48] His claim, however, outranks the holder of

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article. However, some cases that are discussed hereinafter have been ruled under these procedures. Since the procedure for a reorganization plan under a suspension of payments procedure and a debt reorganization of natural people are (almost) equal to the procedure for a reorganization plan in a bankruptcy these judgments can also be applied in a bankruptcy situation.

42 This petition can be filed either voluntarily or involuntarily. Section 1 DBC.

43 Section 68 DBC.

44 G.W. van der Feltz, *Geschiedenis van de Wet op het faillissement en de surseance van betaling, bewerkt door G.W. baron van der Feltz I*, Zwolle: W.E.J. Tjeenk Willink 1897 at 339 and 371. The Supreme Court has ruled in three different cases that 'societal interests' are also interests that should be taken into account by the trustee. See: Supreme Court 24 February 1995, *NJ 1996, 472* (*Sigmacon II*); Supreme Court 19 April 1996, *NJ 1996, 727* (*Maclou*) and Supreme Court 19 December 2003, *NJ 2004, 293* (*Mobell*). There is discussion in the literature whether these judgments hold that societal interests can prevail over the interests of the joint creditors or only over the interests of an individual creditor. For a discussion about the goal of Dutch bankruptcy law and the creditors' bargain theory see: G.D. Hoekstra, *De positie van de pandhouder in het faillissementsrecht. Een rechtseconomisch en rechtsvergelijkend onderzoek* (Den Haag: Boom Juridische uitgevers, 2007) at55–78.

45 In Supreme Court 3 November 2006, *NJ 2007, 155* (*Nebula*) the Supreme Court ruled that a trustee can ignore an obligation to permit if this obligation otherwise resulted in the possibility for a certain creditor to use a good (a claim to use), while being able to ignore other creditors. Thus, preventing an infraction of the *paritas creditorum* that was not provided for by the law.

46 Section 3:277 (1) DCC states that preference of a creditor can only follow from the law.

47 Section 3:279 DCC and Section 57 DBC. Under certain circumstances the holder of a right of retention has the same right. Section 60(3) DBC. A secured creditor cannot seek individual recourse if the judge-commissioner orders a cooling-off period (*afkoelingsperiode*). This cooling-off period has a maximum of four months. Section 63a DBC.

48 Section 21 Invorderingswet 1990 (Collection of State Taxes Act). There are a limited number of rights of privilege that outrank the fisc. See: Section 3:284, 3:287 and 3:288 (a) DCC. The priority for the fisc also

a right of pledge on property found on the premises of the debtor (*bodemzaken*).[49] For these claims the fisc has a superpriority. Third in rank are the holders of a right of privilege on certain goods. Holders of legal privilege on all goods of the debtor are fourth in rank. Both the specific and the general rights of privilege are scattered throughout the Dutch Civil Code and specific statutes.[50] Only then, fifth in rank, is it the turn of the ordinary creditors. Sixth and seventh are the holders of subordinated claims and the shareholders, respectively.

Unlike in the United States, Dutch bankruptcy law has no separate reorganization procedure for which a debtor can file. It is possible for the debtor, however, to propose a reorganization plan (*faillissementsakkoord*) to the creditors during the bankruptcy procedure. This possibility is reserved exclusively for the debtor.[51] A proposal for a reorganization plan by the trustee or a creditor is not possible. Furthermore, shareholders and creditors with a right of preference are not bound to a reorganization plan.[52] Another distinct difference with the American reorganization plan is that voting does not take place in classes. A proposed reorganization plan is accepted if approved by more than half of the acknowledged and conditionally acknowledged ordinary creditors that are present at the meeting of creditors, representing at least half of the total amount of ordinary claims.[53] If the previously mentioned requirements are not met, the supervisory judge can still cram down the proposed plan if three quarters of the acknowledged and conditionally acknowledged creditors present at the meeting of creditors have approved of the proposed plan and the rejection of the plan is the consequence of unreasonable voting behavior.[54]

If the proposed plan is approved by the creditors or crammed down, the court holds a confirmation meeting (*homologatiezitting*). The Dutch Bankruptcy Code contains four provisions that provide for an imperative ground for refusal of confirmation and one discretionary ground.[55] If no reorganization plan is passed the trustee sells all assets of the debtor, either piecemeal or going-concern, and the proceeds are distributed among the creditors according to their relative priority.

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extends to claims for social security contributions. Section 60 Wet financiering sociale verzekeringen (*Social Insurance (Funding) Act*).

49 Section 21 (2) Invorderingswet 1990 (Collection of State Taxes Act).

50 For an overview of all rights of privileges see: SDU Commentaar Insolventierecht, Section 180 DBC, C 2.2.3.

51 Section 138 DBC.

52 Section 157 DBC.

53 Section 145 DBC.

54 Section 146 DBC.

55 Section 153 DBC.

The provisions regarding the reorganization plan do not contain an explicit rule requiring absolute priority. This is not strange because there is only one class of creditors that is bound to the reorganization plan: creditors without preference.[56] However, secured creditors and creditors with a right of privilege on a certain good retain their right of preference and their right to get paid in full before any other creditor receives any payment under a reorganization plan.[57] Moreover, secured creditors have a right to execute their rights as if there were no bankruptcy.[58] With regard to other preferential claims section 163 DBC states that the debtor has to provide security for payment or deposit the amount due to these creditors with the trustee.

But what about the lower ranking class of shareholders? Shareholders are the residual claimants of a corporation. In a liquidation they receive everything that remains after all the fixed obligations of a corporation have been fulfilled. On the other hand, if nothing remains they receive nothing. They rank last in the priority order of payment of a corporation. Under an absolute priority rule in a reorganizational procedure this priority order would be respected and shareholders would receive nothing until all higher ranking classes would have been paid in full.

It is questionable, however, whether an absolute priority rule regarding shareholders under a reorganization plan exists. Neither the Dutch Civil Code nor the Dutch Bankruptcy Code explicitly provide for such a rule. There are, however, two provisions that at first glance seem to imply absolute priority with regard to shareholders.

Section 2:23b (1) DCC states that

> "After satisfaction of the claims of the creditors the liquidator shall transfer any surplus assets of the legal person subject to the liquidation to the parties entitled thereto in proportion to their respective rights under the articles or otherwise to the members or shareholders. (…)."[59]

It is clear that according to section 2:23b (1) DCC the shareholders are last in rank and should only receive payment after all creditors have been satisfied. This would therefore imply absolute priority. This provision, however, only applies in case of the dissolution of

56 Section 157 DBC.

57 Insofar as the object which is encumbered does not have enough value to satisfy the claim of the preferred creditor, the remaining part of the claim becomes an ordinary claim. Section 132 DBC.

58 § 57 DBC. Unless an automatic stay has been promulgated. Section 63a DBC.

59 Original text: "*De vereffenaar draagt hetgeen na de voldoening der schuldeisers van het vermogen van de ontbonden rechtspersoon is overgebleven, in verhouding tot ieders recht over aan hen die krachtens de statuten daartoe zijn gerechtigd, of anders aan de leden of aandeelhouders. (…)*."

a corporation. Its applicability in a bankruptcy procedure is explicitly precluded in section 2:23a (5) DCC. Absolute priority for shareholders under a reorganization plan can therefore not be derived from this rule.

Another provision that seems to be relevant is section 153 (2) (1) DBC.[60] This provision forbids confirmation of a plan if the assets (*baten*) exceed the proposed payment under the proposed plan substantially.[61] The provision seems to imply that if a shareholder receives any payment or retains an interest in the corporation under the reorganization plan the judge should refuse confirmation of the proposed plan.[62] To which requirement I would add: 'unless the ordinary creditors receive full payment'.

There is, however, one catch to section 153 (2) (1) DBC. That is the word 'substantially'. This word seems to leave room for deviation from the absolute priority that Section 153 DBC would otherwise entail. It can be derived from the parliamentary history of the Dutch Bankruptcy Code that the word 'substantially' was already included in the relevant provision of the Code of Commerce of 1838.[63] In the parliamentary history of 1896, however, the lawgiver does not elaborate on the word, but simply copied it into the Bankruptcy Code. Surprisingly the word 'substantially' cannot be found in section 272 DBC, the equivalent of section 153 DBC for the suspension of payments procedure. The parliamentary history, however, seems to indicate that this omission was simply an accident and that the word should also have been included in section 272 DBC.[64]

It is therefore likely that the word 'substantially' was included in section 153 DBC on purpose and has a material meaning. However, according to case law, 'substantially' should not be interpreted as giving the judge room to balance the interests of the different parties

60 The equivalent of this provision under a suspension of payments procedure is Section 272 DBC. Section 338 (2) states that Section 153 (2) DBC is applicable in a reorganization of the debts of a natural person.

61 "*Zij zal de homologatie weigeren: 1) indien de baten des boedels, de som, bij het akkoord bedongen, aanmerkelijk te boven gaan*." With regard to the *baten*, the assets that can be expected to be received by the debtor are also relevant. See: Supreme Court 14 December 2001, *NJ 2002, 39*. This was a procedure for the reorganization of the debt of a natural person. Furthermore, it seems justified to take the going-concern value of the assets into account and not just the liquidation value. For otherwise a reorganization plan would be confirmed that yields a suboptimal value for the assets. The Leeuwarden Court of Appeal seems to concur with this opinion. See: Court of Appeal Leeuwarden, 21 July 2006, *LJN AY 4796*. This was a suspension of payments procedure.

62 See also: A.D.W. Soedira, *Het akkoord* (Deventer: Kluwer, 2011) 200.

63 G.W. van der Feltz, *Geschiedenis van de Wet op het faillissement en de surseance van betaling, bewerkt door G.W. baron van der Feltz II*, Zwolle: W.E.J. Tjeenk Willink 1897 at 176.

64 Parliamentary Papers 1980–1981, 16 593, no. 3, at 158 and 160. The lawgiver did not make any comments regarding the word 'substantially' in its amendments on Section 153 DBC and referred to this provision when writing about Section 272 DBC. That the omission of the word 'substantially' in Section 272 was an accident is also the opinion of the Court of Appeal of Amsterdam. See: Court of Appeal Amsterdam, 5 November 2005, *JOR 2007, 51*.

involved. It merely gives the judge some leeway in making the mathematical comparison between the assets and the proposed payment under the proposed plan, under which comparison the assets can exceed the proposed payment.[65] This is not a very strict requirement for a judge.[66] Therefore deviations from absolute priority can and do occur. For example, the District Court of Utrecht has ruled that if shareholders retain an interest of 3% in the reorganized corporation, while not all creditors have been satisfied, "*[t]his treatment is not such a preferential treatment in respect to one of them [the shareholders] as 'post-ordinary creditors', that confirmation of the reorganization plan should be withheld on this ground.*"[67] So, there does seem to be a certain boundary on how big an interest a shareholder can retain before a judge will deny confirmation, but it is unclear when this boundary is reached.

There is, to my knowledge, no empirical research regarding the deviation of absolute priority under Dutch reorganization plans. It is to be expected, however, that deviations of absolute priority with regard to shareholders will regularly occur.[68] To respect absolute priority, shareholders should lose their interest in the corporation insofar as the value of the corporation is lower than the amount of outstanding debt and this interest should be transferred onto the creditors.[69] This can be done by means of a 'debt-for-equity-swap'. Under such a swap, debt holders can receive an equity stake in the corporation without the consent of the old shareholders. Dutch law, however, does not know this figure. This means that shareholders have to consent voluntarily to emit new shares and reduce the nominal value of their own shares.[70] Since they have nothing to lose – shareholders would also receive nothing in a liquidation – they have no incentive to do so. For this reason shareholders regularly retain an interest in the reorganized corporation, despite the fact that not all creditors have been fully satisfied.

65 Supreme Court 24 November 2006, *NJ 2007, 239*. This was a procedure for the reorganization of the debts of a natural person.

66 Compare: A.L. Leuftink, *Surséance van betaling* (Deventer: Kluwer, 1995) at 313.

67 District Court Utrecht, 9 August 1989, *NJ 1990, 399* (*Bredero*). Original text: "*Daarin is niet een zodanige bevoordeling van hen [de aandeelhouders] als 'post-concurrente crediteuren' te zien, dat goedkeuring aan het akkoord op die grond zou moeten worden onthouden.*"

68 This is not a new phenomenon. See: A.L Leuftink (n66) at 307.

69 This underlines the importance of correct valuation of the corporation. A subject that, while very interesting, will not be discussed any further in this Article.

70 Often a qualified majority is necessary to approve proposals to emit new shares or reduce the nominal value of outstanding shares.

Part B: The creditors' bargain theory

In Part A, a general overview of US and Dutch bankruptcy law was given. In this Part some attention will be devoted to normative theories of bankruptcy law, starting with the creditors' bargain theory. The creditors' bargain theory provides a justification for the existence of bankruptcy law and an assessment framework to determine if a specific legal rule is efficient or not.[71] According to this theory the goal of bankruptcy law is to maximize the value of the pool of assets for the investors as a group.[72] It is explicitly not to keep a certain corporation in business or to pursue substantive goals of its own.[73]

1 Why does bankruptcy law exist?

1.1 The common pool problem

A creditor can, theoretically, pursue two ways to seek recourse for his claim: individually or collectively. Individual debt collection law can be found in non-bankruptcy law. Every creditor can go to the debtor at any given time and request that his claim is paid. If this system would have no shortcomings – at the time a debtor is unable to pay his debts – bankruptcy law would be redundant and no creditor would prefer a collective method of debt collection.

However, according to the creditors' bargain theory a creditor will choose a collective method of debt collection if this leads to a higher value of the pool of assets for the investors as a group. The value surplus in comparison to the individual method of debt collection can then be divided amongst the different creditors.[74] The extra yield for the creditor comes

71 The creditors' bargain theory was developed in the 1980's by D.G. Baird and T.H. Jackson. See: T.H. Jackson, 'Bankruptcy, non-bankruptcy entitlements and the creditors' bargain', *Yale Law Journal* 91(5) (1982) 857–907; D.G. Baird and T.H. Jackson, 'Corporate reorganizations and the treatment of diverse ownership interests: a comment on adequate protection of secured creditors in bankruptcy', *The University of Chicago Law Review* 51(1) (1984) 97–130; T. H. Jackson, 'Of liquidation, continuation and delay: an analysis of bankruptcy policy and nonbankruptcy rules', *The American Bankruptcy Law Journal* 60 (1986) 399–428; and T.H. Jackson, *Logic and limits of bankruptcy law* (Cambridge: Harvard University Press, 1986).

72 T.H. Jackson, *Logic and limits of bankruptcy law, ibid.* at 5. The notion 'investors as a group' includes everyone with a 'right' to the debtor's assets under nonbankruptcy law. This includes employees of the debtor and shareholders, but not – for example – the power of management to control day-to-day operations. See: Jackson *ibid.* at 33. 'Right' is defined as the right to the income stream generated by the firm's assets, the right to receive payment out of the assets, or the rights to the assets upon dissolution. See: D.G. Baird and T.H Jackson, (n71) at 100. An asset is something that makes the estate more valuable with the item than without it. T.H Jackson, *Logic and limits of bankruptcy law* (n71)at 89.

73 T.H Jackson, *idem* at 1–2.

74 T.H Jackson, 'Bankruptcy, non-bankruptcy entitlements and the creditors' bargain' (n71) at 860–865.

from three things: 1) reduction of strategic costs, 2) increased aggregate pool of assets, and 3) administrative efficiencies.[75]

The reduction of strategic costs and the aggregate pool of assets stem from the elimination of costs that would be made by individual creditors with regard to the 'race to the court-house'[76] If there was only an individual system of debt collection when a debtor was insolvent, debts would be paid on a 'first come, first serve' base. Therefore, if there is not enough to repay every creditor, only the creditors who come early are repaid.[77] This leads to a situation in which creditors will try to be the first to seek recourse, because only then they will have a chance of being repaid in full.[78] In other words, a common pool problem arises.[79] A collective system of debt collection prevents the arising of the common pool problem and the associated costs.[80] This system is named bankruptcy.

To illustrate the common pool problem the example of an oil well is often used. Without restraint each person involved in drilling for oil has an incentive to extract as much oil as possible as soon as possible even if the value of the pool of oil would be maximized by coordinated extraction.[81] The reason for this is that the oil is being distributed according to the 'first-come, first-serve' principle.

Because of the common pool problem an incentive for creditors is created to engage in (costly) monitoring behavior of the debtor and each other to find out when they should seek recourse. This will probably lead to a higher cost of credit for the debtor, because the

75 *Idem* at 861.

76 *Idem* at 862.

77 This is also known as the rule of *iura vigilantibus.*

78 It is assumed that creditors will only act in their own interests.

79 T.H. Jackson, 'Bankruptcy, non-bankruptcy entitlements and the creditors' bargain' (n71) at 864, T.H. Jackson, 'Of liquidation, continuation and delay: an analysis of bankruptcy policy and nonbankruptcy rules (n71) at 402–403; T.H. Jackson, *Logic and limits of bankruptcy law* at 10 and D.G. Baird, 'The uneasy case for corporate reorganizations', *The Journal of Legal Studies* 15(1) (1986) 132–133.

80 The United Nations Commission on Trade Law (UNCITRAL) recognizes overcoming the common pool problem as a goal of bankruptcy law. See: UNCITRAL Legislate Guide on Insolvency Law at 136. Easterbrook also sees solving the common pool problem as the reason bankruptcy law exists, but writes that delivering penalty for failure, by forcing a 'wrapping up' when a business cannot pay its debts, is also a reason for the existence of bankruptcy law. See: F.H. Easterbrook, 'Is corporate bankruptcy efficient?', *Journal of Financial Economics* 27(2) (1990) at 411. I note that it is not only the applicability of bankruptcy that prevents a common pool problem, but also the tools that are given by bankruptcy law, such as preference law. See: R.J. de Weijs, 'Harmonisation of European insolvency law and the need to tackle two common problems: common pool and anticommons', *International Insolvency Review* 21(2) (2012) 67–83 at 71–72. A discussion of preference law falls outside the scope of this article.

81 For example because coordinated extraction would have kept the natural pressure in the well higher, which in turn would have led to the ability to extract more oil in total. So – in economic terms – there is a situation of overuse.

creditor would want to divert the costs of monitoring on to the debtor. A collective system of debt collection makes this monitoring and the related strategic costs unnecessary, because the race to the courthouse is prevented.

The increased aggregate pool of assets is realized by the possibility in a collective system of debt collection to keep assets together.[82] In an individual system creditors will race to the courthouse, because otherwise there may be nothing left for them. The consequence of this race is that the assets are sold piecemeal. In a collective system such a race is prevented and the assets can be kept together.[83] These assets, in turn, can then be sold collectively if this results in a higher value.

Administrative efficiencies will be realized because the creditors can act collectively in determining the amount of assets and claims against the debtor.[84] In an individual system every creditor will have to make costs for collecting their debts. Furthermore, an individual system means that, when claims are contested by the debtor, the debtor (i.e. the estate) has to defend himself in numerous procedures. The above probably leads to higher costs for the creditor and the debtor.

1.2 The balance-sheet insolvent debtor

At first glance it may seem that the creditors' bargain theory proposes that every debtor who has more liabilities than assets – and is balance-sheet insolvent – knows a common pool problem and, as a consequence, bankruptcy law should apply. Jackson, however, has acknowledged that not every debtor who is balance-sheet insolvent should be declared bankrupt, but he is unclear as to what additional circumstances are necessary to constitute a common pool problem.[85]

That mere balance-sheet insolvency does not constitute a common pool problem is also asserted by Block-Lieb. In an article in the American University Law Review she states that a mere potential for prejudice among creditors does not create a common pool problem.[86] This seems to make sense. If every debtor who is balance-sheet insolvent were

82 T.H. Jackson, 'Bankruptcy, non-bankruptcy entitlements and the creditors' bargain' (n71) at 864–865.

83 Of course the assets should only be kept together if that adds to maximizing the value of the pool of assets for the investors as a group.

84 T.H Jackson, 'Bankruptcy, non-bankruptcy entitlements and the creditors' bargain' (n71) at 866.

85 That Jackson acknowledges that not every balance-sheet insolvent debtor should be declared bankrupt follows from: T.H. Jackson, *Logic and limits of bankruptcy law* (n71) at 199.

86 S. Block-Lieb, 'Fishing in the muddy waters: clarifying the common pool analogy as applied to the standard for commencement of a bankruptcy case', *The American University Law Review* 42 (1993) 337–431 at 374.

declared bankrupt, every company that is leveraged for more than 50% should be declared bankrupt regardless of whether they are paying their debts as they fall due. As a result many profitable companies would have to close their doors, even though creditors have no incentive to collect their claims as soon as possible.

Such a train of thought, however, fails to take the earnings of a debtor into account.[87] If a debtor is insolvent, but can pay his creditors out of current earnings, there is no incentive for creditors to engage in a race to the courthouse and no common pool problem exists. A creditor can, however, of course exhibit strategic behaviour and, even though a debtor can pay his debts as they fall due, still try to 'jump the gun'.[88] As a result other creditors may become nervous, also trying to collect their debt as soon as possible, and a common pool problem arises.[89]

1.3 The cash-flow insolvent debtor

Furthermore, the common pool analogy used by the creditors' bargain theory seems to be geared only towards a balance-sheet insolvent debtor.[90] A debtor, however, can also be cash flow insolvent.[91] The question is whether this solvent, but illiquid debtor constitutes a common pool problem that justifies the application of bankruptcy law. This is because although the debtor cannot pay his debts immediately, he has enough assets to pay all creditors in the end. So why would a collective system of debt collection be necessary?

A cash-flow insolvent debtor, however, can also warrant the applicability of bankruptcy law. In this respect it is good to note that if earnings of a debtor accrue more slowly than debt obligations, the earnings of the debtor can be qualified as a scarce resource.[92] The debtor's inability to pay debts as they fall due will therefore cause a common pool situation that prejudices creditors.[93]

Creditors are also prejudiced by a cash-flow insolvent debtor, because collection efforts by creditors can negatively affect the debtor's ability to continue operations. This reduces

87 *Idem* at 375.
88 *Idem* at 376.
89 *Idem* at 376–378. The common pool problem will arise when collection efforts occur more rapidly than the earnings of the debtor accrue. See: *Idem* at 383.
90 See: T.H. Jackson, *Logic and limits of bankruptcy law* (n71) at 10–19.
91 This means that a debtor is not able to pay debts as they fall due.
92 S. Block-Lieb, (n86) at 379. A debtor's earnings are exhaustible, because he can only earn a certain maximum over a certain period.
93 *Ibid.* at 379.

a debtor's earning potential.[94] Furthermore, individual methods of debt collection result in the piecemeal sale of assets. This means that value is lost in comparison to a going-concern sale of the assets, since assets generally yield a higher value when sold going-concern.[95] Finally, the debtor himself can also cause a common pool problem. The debtor can do this by repaying creditors in a suboptimal way. For example, by selling a valuable machine piecemeal and then distributing the proceeds among certain creditors. Such a way of acting by the debtor can influence the debtors' ability to repay other creditors, causing a common pool problem.[96] In these cases the applicability of bankruptcy law is also justified.

1.4 Commons and anticommons

With regard to reorganization law overcoming the common pool problem is not the only possible justification for its existence, although it is the only justification given by the creditors' bargain theory. Bankruptcy law as a means of solving the common pool problem is directed at preventing overuse. With regard to reorganization, however, there is also the risk of underuse because of creditors who hold out on an efficient reorganization plan. There can be, in other words, an anticommons problem.[97]

The anticommons problem has been defined as follows: "*In an anticommons, multiple owners are each endowed with the right to exclude others from a scare resource, and no one has an effective privilege of use.*"[98] In a reorganization this is exactly what happens. Reorganizing a firm may be more efficient than liquidation, but creditors can vote against a proposed reorganization plan and prevent an efficient solution of a bankruptcy.[99] The risk of this kind of 'hold-out' behavior by creditors is especially prevalent if a reorganization plan provides for the possibility to deviate from absolute priority.[100] In such event a creditor

94 *Idem* at 384.
95 *Idem* at 386.
96 *Idem* at 385.
97 The term 'anticommons' was coined by Michelman. See: F.I. Michelman, 'Ethics, economics and the law of property', in: R.J. Pennock and J.W. Chapman (eds.), *Nomos XIV: Ethics, economics and the law*, (New York: New York University Press, 1982) at 3–40. It was first applied to bankruptcy by Baird and Rasmussen in D.G. Baird and R.K. Rasmussen, 'Anti-bankruptcy', *Yale Law Journal* 119 (2010) 648–699. The first application of anticommons to bankruptcy by a European scholar can be found in R.J. de Weijs (n80).
98 M.A. Heller, 'The tragedy of the anticommons: property in the transition from Marx to markets', *Harvard Law Review* 111(3) (1998) 621–688 at 622.
99 The anticommons problem is relevant when as few as two creditors are required to consent to a reorganization plan. It is, however, required that each one should have the right to exclude the other. See: J.M. Buchanan and Y.J. Yoon, 'Symmetric tragedies: commons and anticommons', *Journal of Law and Economics* 43(1) (2000) 1–13 at 5.
100 See: de Weijs (n80) at 10–11.

can hold or threaten to hold out in an attempt to get a larger share than he is legally entitled to.

It should be noted that an anticommons problem need not arise.[101] In many cases parties can negotiate with each other and reach consent on the most efficient solution.[102] There is, however, always a risk that the anticommons problem does arise in a reorganization procedure.[103] For these cases a solution is necessary to provide for the most efficient way of handling a bankruptcy.

A simple solution to an anticommons problem is bringing decision power in one hand.[104] Reorganizational bankruptcy law can provide for this. The law can, for example, hold the possibility of a plan cram-down by a judge or provide for exclusivity with regard to the filing of a reorganization plan. Provisions of this nature are currently included in both US and Dutch bankruptcy law.[105] Whatever solution is chosen, it should provide for a way to prevent wrongful hold-out behavior and underuse of a debtor's assets.

2 The (hypothetical) creditors' bargain

Once it is recognized that a collective system of debt can overcome a common pool problem (and an anticommons problem) and maximize the value of the pool of assets, it is not a big step to assume that creditors will likely agree to a collective system of debt collection. However, if a collective system is not imposed on all the investors by the government it can be presumed that such a system will not be realized by the creditors themselves.

Ex ante the creditors will not reach a collective agreement because of the costs involved and the uncertainty with regard to the question of who the creditors of the debtor are.[106] These costs and uncertainty are the consequence of the fact that a debtor generally has a large and constantly changing pool of creditors. This is especially true for large corporations.

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101 A.J. Levitin, 'Bankruptcy markets: making sense of claims trading', *The Brooklyn Journal of Corporate, Financial and Commercial Law* 4 (2009) 67–112 at 102.

102 M.A. Heller (n98) at 673–674.

103 Baird and Rasmussen contend that the anticommons problem has become more prevalent in the last decade, because of the rise of syndicated lending, claims trading and credit default swaps. See: D.G. Baird and R.K. Rasmussen (n97). Levitin disputes the claims of Baird or Rasmussen with regard to claims trading. Stating that their conclusions are based on a factual situation that has 'limited anecdotal evidentiary basis'. See: A.J. Levitin (n101) at 101.

104 See: de Weijs (n80) at 7.

105 E.g. Section 138, 146 DBC and 11 U.S.C. § 1121(b), 1129.

106 T.H. Jackson, 'Bankruptcy, non-bankruptcy entitlements and the creditors' bargain' (n71) at 865–866. In this situation the free rider problem can occur. Creditors can join the agreement reached by others, without contributing to the costs that were involved in realizing the agreement.

This makes it very hard, if not impossible, to contract with all the creditors of a debtor on how to handle a possible bankruptcy of a debtor.

Ex post the creditors will, as explained above, engage in a race to the courthouse and no creditor will wait to see if there is a possibility for reaching a collective agreement. They will want to beat the other creditors in seeking resource and not stand idly by while others see their claims getting paid in the hope that an agreement can be reached. Hence, a collective system has to be imposed on the creditors. Such a system is the solution to minimize perverse incentives for creditors.

The compulsory collective system would take the form of the agreement the creditors would have reached prior to bankruptcy if they had been able to reach such an agreement. Bankruptcy law – in the view of the creditors' bargain theory – can therefore be seen as a hypothetical bargain.[107] This hypothetical agreement has to meet three principles:[108]

1. [B]ankruptcy law at its core should be designed to keep individual actions against assets, taken to preserve the position of one investor or another, from interfering with the use of those assets favored by the investors as a group.
2. Bankruptcy law should change a substantive nonbankruptcy rule only when doing so preserves the value of assets from the group of investors holding rights in them.
3. [B]ankruptcy (…) should be (…) concerned with the interests of those (…) who have property rights in the assets of the firm (…).

Principle 1

The first principle implies that the goal of bankruptcy law is to let the investors as a group act collectively and prevent individual recourse that is not in the interest of the investors as a group.[109] This principle concerns only the question how the assets should be deployed to realize a maximum value for the investors as a group (the deployment question). This question differs from the question how the proceeds of the assets should be divided (the distribution question).[110]

To answer the question how the pool of assets can best be deployed to maximize the value for the investors as a group, the deployment question should be answered the way a sole owner of the assets would.[111] For, if a business only has one owner, he will deploy the assets

107 *Idem* at 860.

108 D.G. Baird and T.H. Jackson (n71) at, 100 and 103. With regard to principle 2, I interpret 'nonbankruptcy rules' as being those rules that are not exclusively applicable in bankruptcy.

109 *Idem* at 106.

110 T.H. Jackson, 'Of liquidation, continuation and delay' (n71) at 404.

111 D.G. Baird and T.H. Jackson (n71) at 104. Sole owner means that only one person has the right to use an asset and no one else can assert any claim against the asset. This situation will not occur very often in reality.

in a way that would advance maximization of the value of the pool of assets. This is so, because he is the only one who will incur both the costs and the benefits through his decisions with regard to the asset. By pretending that there is a sole owner when decisions have to be made in bankruptcy, assets are deployed in a way that means maximization of the value of the pool of assets for the investors.[112] If you let the deployment question be answered by different creditors, the situation can occur that they answer the question differently. This results in a situation where creditors put their individual interest first and 'grab' the assets for their own benefit. As a result of this value maximization would be prevented.

Principle 2

The second principle is related to the changing of substantive rights by bankruptcy law. A justification for changing a substantive right in bankruptcy only exists if this results in enlarging the value of the pool of assets for the investors as a group. This is so because the change of a substantive right in bankruptcy can result in an advantage for a creditor (for example a preferential status) that he does not have outside of bankruptcy. This advantage gives an incentive to the creditor to pick his own interest over the interest of the investors as a group.[113] Which in turn leads to the situation that a creditor will try to have a debtor declared bankrupt, if that is more beneficial for the position of the creditor.[114] Because of this, preferably, substantive rights should not change in bankruptcy, but a situation should be created that resembles non-bankruptcy law as closely as possible.[115]

Several authors have criticized this principle. They state that the creditors' bargain theory cannot just assume non-bankruptcy entitlements as a given and then say that, as a consequence, bankruptcy entitlements should be the same. According to these authors the creditors' bargain theory should prove that the non-bankruptcy law distribution scheme is the right scheme.[116]

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112 There is only one amount that equals the maximum value of the pool of assets. The fact that this amount is not divided equally between the creditors does not matter for the optimal deployment of the assets.

113 D.G. Baird and T.H. Jackson (n71) at 104.

114 This is called forum shopping. The creditor 'shops' for a forum where he is most likely to have his claim paid.

115 T.H. Jackson, *Logic and limits of bankruptcy law* (n71) at 22 and T.H. Jackson, 'Of liquidation, continuation and delay' (n71) at 399. As a result the justification for (for example) secured credit and its preferred status are not relevant for bankruptcy law. This matter (as well as the efficiency of secured credit) is to be dealt with in non-bankruptcy law. D.G. Baird and T.H. Jackson (n71) at 110–111.

116 R.C. Picker, 'Security interests. misbehavior, and common pools', *The University of Chicago Law Review* 59 (1992) 646–680 at 647, footnote 6; and E. Warren, 'Bankruptcy policy', *The University of Chicago Law Review* 3 (1987) 755–814 at 799–800.

However, the matter of the efficiency of non-bankruptcy entitlements is not a question of bankruptcy law.[117] The creditors' bargain theory only argues that, to prevent forum shopping, non-bankruptcy and bankruptcy entitlements should be changed as little as possible.[118] The creditors' bargain theory does not purport that all non-bankruptcy entitlements are 'right' by definition.[119] It can very well be that another distribution scheme is better. This, however, is a question of non-bankruptcy law and not of bankruptcy law.

LoPucki has expressed the view that this explanation takes away the normativity of the creditors' bargain.[120] However, there is still normatively right bankruptcy law. That is to say, efficient bankruptcy law in light of non-bankruptcy law as it exists. There is also normatively right non-bankruptcy law. Which is to say, efficient non-bankruptcy law. These two bodies of law combined will result in normative right (i.e. efficient) law as a whole. In a situation where non-bankruptcy law is not normatively right, bankruptcy law will not be equal to normatively right law as a whole. It will, however, be normatively right bankruptcy law. That is to say, the most efficient bankruptcy law while (non-efficient) non-bankruptcy law is observed.

That it is preferable not to change substantive entitlements in bankruptcy does not mean that the rights of creditors can always be respected in full.[121] This follows from the simple fact that if a debtor were able to respect all his creditors' rights in full there would be no need for bankruptcy. However, the fact that the absolute rights of creditors are not respected does not mean that the *value* of his right relative to other creditor's rights should not be respected.[122]

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117 See: D.G. Baird, 'Loss Distribution, forum shopping, and bankruptcy: a reply to Warren', *The University of Chicago Law Review* 54 (3)(1987) 815–834 at 823.

118 *Idem* at 822–823. See also: *Idem* 826: "*The reason for having the two avenues of enforcement (the cost of travel to the courthouse) does not justify any difference in the way courts do business.*"

119 *Idem* at 827.

120 See: L.M. LoPucki, 'A team production theory of bankruptcy reorganization', *Vanderbilt Law Review* 57(3) (2004)742–780 at 747–748.

121 T.H. Jackson, *Logic and limits of bankruptcy law* (n71) at 28–29. An example of a right that cannot be respected is the right of unsecured creditors to seek individual recourse. Respecting this right would effectively reinstate the common pool problem.

122 *Idem* at 59. As stated above, what this position of one creditor in relation to another is, is a question of non-bankruptcy law. This value (who gets what in what order) is the 'relative value' of a right. This value is different from the 'nominal value' of the creditor's right. This is the value of right if a creditor were not insolvent. See: *Idem* at33–34.

Principle 3
The third principle means that bankruptcy law should only be involved in the interests of the holders of a property right.[123] Other interests such as the public interest or preserving employment have no place in bankruptcy law and should be dealt with in non-bankruptcy law.[124] For example, a special status for employees should be provided for in labor law. Bankruptcy law should then respect this special position.[125] In the words of Jackson: "*Bankruptcy law exists to solve the common pool problem, not to solve social issues.*"[126]

3 The creditors' bargain theory and absolute priority

One of the central elements of the creditors' bargain theory is that bankruptcy law should change a substantive non-bankruptcy rule only when doing so preserves the value of assets from the group of investors holding rights in them.[127] Re-distribution of wealth should be prevented if possible. This entails that the order of priority is respected in bankruptcy.[128] Or, in other words, that there should be absolute priority.

Does a requirement of absolute priority exist under American and Dutch law with regard to reorganizations? With regard to secured creditors it is clear under both American and Dutch law that secured creditors have a right of priority over other claimants. In the US section 1129 (b)(2)(A)(i)(II) requires that secured creditors receive full payment under the proposed reorganization plan, before the plan can be confirmed. In the Netherlands such a rule does not seem to exist.[129] Secured creditors can, however, generally ensure that they receive full payment of their claim by making use of their right of summary execution (*recht van parate executie*).[130]

From the perspective of the creditors' bargain theory the preceding account of Dutch bankruptcy law is problematic. Secured creditors will want to minimize the risk that they do not receive full payment of their claim, while lower ranking claimants receive payment. They have no incentive to consent to a reorganization if the claims of the secured creditor are lower than the liquidation value of the debtor. The secured creditors will therefore exercise their rights as soon as possible if they are sure this will provide them with full

123 See above for the definition of 'right'. The creditor can only claim his right if he were also able to claim it outside of bankruptcy. See: *Idem* at 34–35.
124 D.G. Baird and T.H. Jackson (n71) at 103.
125 T.H. Jackson, *Logic and limits of bankruptcy law* (n71) at 31–32.
126 *Idem* at 25.
127 D.G Baird and T.H. Jackson (n71) at 100.
128 T.H. Jackson, 'Of liquidation, continuation and delay' (n71) at 406.
129 See § 2 above.
130 Section 57 DBC.

payment of their claim. Waiting with enforcement of their claims only results in an increased risk of non-payment and time value costs.[131] If the going-concern value of the corporation is higher than the liquidation value, the value of the corporation will not be maximized and inefficiencies arise.

The solution is two-fold. First, after a debtor has entered bankruptcy a secured creditor – in line with the first principle of the creditors' bargain theory – should be prevented from taking individual actions that prevent value maximization. This can be done by limiting the right of summary execution to situations in which its use does not destroy value. Second, and also in line with the first principle of the creditors' bargain theory, the secured creditors should be bound to a reorganization plan and lose their right to individually enforce their claims.[132] Otherwise, the secured creditor can still prevent value maximization of the debtor by executing his rights after the confirmation of the reorganization plan.

In return, secured creditors should be awarded an explicit right to receive full payment before any lower ranking class of claimants can receive any kind of payment under a reorganization plan. This ensures enforcement of absolute priority. Furthermore, the claim of a secured creditor should be fully respected. The creditors' bargain theory states that bankruptcy law is the hypothetical agreement between creditors. Secured creditors, however, have no incentive to participate in this agreement, unless their rights are fully respected.[133] Respecting the rights of the secured creditors means that they should receive a compensation for incurred risks and time value costs. Risks are incurred, for example, because the value of the collateral can depreciate in value. The time value of costs follows from the fact that a secured creditor has to wait a certain time before he can invest his money elsewhere. Another cause of time value costs is the fact that a nominal amount of money is not worth the same in a year as it is now.[134]

A secured creditor does not have a right to risk and time value compensation under current US or Dutch law. In the United States a secured creditor is only entitled to interest on

131 Time value costs are the costs that are incurred, because a nominal amount of money is not worth the same in a year as it is now.

132 As mentioned above (n3) the Dutch Minister of Justice has a announced a recalibration of the Dutch Bankruptcy Code. Kamerstukken 2012–2013, 33695, no. 1 (n3) seems to indicate that in one of the bills that will be submitted it will be made possible to bind secured creditors to an informal reorganization plan. Possibly this bill will also include a proposal to make it possible to bind secured creditors to a formal reorganization plan.

133 Without participation they can simply execute their rights.

134 An accounting firm may be hired by the trustee to calculate the amount of compensation. See for an example of how this compensation should be calculated: T.H. Jackson, 'Of liquidation, continuation and delay' (n71) at 188 *et seq*.

claims that are over-secured.[135] He is not entitled to interest on under-secured claims or any compensation for incurred risk.[136] Under Dutch law the same rule applies. The secured creditor is only entitled to interest for over-secured claims.[137] A compensation for incurred risks can be prevented if a secured creditor has no risk. This can be done by enforcing a rule that requires the trustee to provide the secured creditor with sufficient protection for the amount of his claim. The problem of delayed payment can be solved by giving the secured creditor – whether under-secured or over-secured – a right to interest on his claims insofar as it is secured. This only leaves the point of value of time for money. A solution to this problem could be to give the secured creditor an entitlement to compensation equal to a discounted cash flow valuation with a future income stream based on a percentage fixed by statute.

With regard to shareholders, US bankruptcy law has an explicit rule that states that shareholders cannot receive or retain any interest in the debtor under a proposed reorganization plan, until all higher ranking classes have been paid in full.[138] This is in line with the creditors' bargain theory, which requires absolute priority. Under Dutch law an absolute priority rule with regard to shareholders does not seem to exist.[139] Shareholders can retain an interest in the reorganized corporation, unless retaining their interests provides ordinary creditors with a substantial disadvantage. Because shareholders can retain an interest they have an incentive to reorganize, even if a liquidation were to be efficient, it also means that, assuming not all higher ranking creditors have been fully paid, wealth is re-distributed to the shareholders.

To solve the inefficiency in Dutch law described in the preceding paragraph a 'debt-for-equity-swap' and an absolute priority rule with regard to shareholders should be introduced. A debt-for-equity-swap means that it is possible to strip shareholders of their interests against their will and transfer these shares to the creditors.[140] Introducing a strict absolute priority rule would mean that a debt-for-equity-swap is a condition for confirmation of a reorganization plan, if the value of the corporation is lower than the amount of outstanding debt. It also means eliminating the word 'substantially' from section 153 (2) (1) DBC.[141]

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135 11 U.S.C. § 506 (b).

136 United States Supreme Court, 484 US 377, 108 S. Ct. 626 (1988) (*Timbers of Inwood*).

137 Section 128 DBC.

138 11 U.S.C. Section 1129 (b)(2)(B)(ii).

139 See § 2 of Part A.

140 Shareholders can already voluntarily consent to a debt-for-equity-swap under Dutch law. This is allowed as long as it can be expected that the shares do not depreciate in value after the bankruptcy. District Court Utrecht, (n67).

141 This could induce valuation problems. See: A.L. Leuftink (n66) at 288. These can be reduced by requiring that the debtor has to give the judge and the creditors sufficient insight in his financial position. This is already a requirement under Dutch law. See: Court of Appeal Leeuwarden, 5 November 2004, *LJN AR 5308*.

Introducing these two rules would bring the position of shareholders in a bankruptcy in line with the creditors' bargain theory.

4 The creditors' bargain theory and the new value exception

As described above the creditors' bargain theory promotes absolute priority. Does this also mean that there is no room for a new value exception? Can a shareholder retain an interest in the debtor, thus redistributing wealth away from creditors, in return for a monetary contribution to the corporation? The creditors' bargain theory has a negative attitude against redistribution of wealth in bankruptcy. It does, however, make an exception for rules that change the scheme of distribution, but which provide for value maximization of the pool of assets. Sometimes this value maximization can be realized by a reorganization, while the debtor lacks the necessary working capital to realize the reorganization successfully. The old shareholders can provide this working capital and enhance the value of the estate.[142] In this sense a new value exception therefore seems to be acceptable from the view of the creditors' bargain theory, but only if this maximizes the value of the pool of assets.

Maximizing the value of the pool of assets does mean, however, that a shareholder should not receive or retain a bigger interest in the debtor than his contribution is worth. This means that both the contribution of the shareholder and the equity stake given in return should be valued. This can be quite hard.[143] In this light the requirement made by American courts that the new value is money or money's worth is understandable. This makes the valuation of the contribution easier. Furthermore, it should be ensured that the amount the shareholders pay for the equity interest is the amount that the interest is worth. This also requires valuation. It is therefore recommendable that multiple parties can bid for the equity interest. This can be accomplished by allowing not only the debtor, but also the creditor to propose a reorganization plan. In a competitive market this will result in maximization of the price of the equity interest. In this respect the *203 North LaSalle Street* judgment of the US Supreme Court is an understandable judgment.[144]

142 E. Warren, 'A theory of absolute priority', *Annual Survey of American Law* (1) (1991) 9–48 at 32; and D.A. Skeel, 'The uncertain state of an unstated rule: bankruptcy's contribution rule doctrine after Ahlers', *The American Bankruptcy Law Journal* 63(1989) 221–247 at 229.

143 B.E. Adler, 'Bankruptcy and risk allocation', *Cornell Law Review* 77(3) (1992) 439–489 at 447; D.G. Baird and D.S. Bernstein, 'Absolute priority, valuation uncertainty, and the reorganization bargain', *Yale Law Journal* 105(2006) 1930–1971 at 1935; D.J. Meyer, 'Redefining the new value exception to the absolute priority rule in light of the creditors' bargain model', *Indiana Law Review* 24(2) (1991) 417–438 at 433 and D.A. Skeel (n142) at 238 signal the same problem.

144 In this judgment the Supreme Court required a market valuation or competition to ensure that the proposed contribution was the best obtainable result. See § 1 of Part A.

In the Netherlands in at least one case a shareholder was allowed to retain an equity interest in the debtor, while not all higher ranking creditors were paid in full.[145] In this judgment the court did not lay down rules for when a new value exception was admissible. The judge merely gave vague guidelines.[146] Furthermore, section 138 DBC gives the debtor an unlimited right of exclusivity. In light of the creditors' bargain it is advisable that a provision is introduced in the Dutch Bankruptcy Code that stipulates that a new value exception is only admissible if this maximizes the value of the pool of assets. It is also advisable that a new value exception cannot be made if there is plan exclusivity for the debtor. It should therefore be allowed for the debtor to give up his right of plan exclusivity and allow creditors to propose a reorganization plan. This means that section 138 DBC should be repealed.

Part C: Criticism on the creditors' bargain theory

Over the years there has been a debate about the validity of the creditors' bargain theory. A lot of the criticism has been directed at the fact that for the creditors' bargain theory the economic value is the only important value in bankruptcy. In this Part the 3 most prominent theories that criticize the creditors' bargain theory are discussed and their merits evaluated. These theories are: i) the risk sharing theory, ii) the value view and iii) the team production theory.

1 Risk sharing as a goal of bankruptcy

The risk sharing theory agrees with the creditors' bargain theory that the justification for bankruptcy law can be found in the common pool problem and that bankruptcy law can be seen as a hypothetical bargain, but explicitly disagrees on what the goals of bankruptcy law are.[147]

145 District Court Utrecht (n67).

146 "*[t]his treatment is not such a preferential treatment in respect of one of them [the shareholders] as 'post-ordinary creditors', that confirmation of the reorganization plan should be withheld on this ground.*" Original text: "*Daarin is niet een zodanige bevoordeling van hen [de zekerheidshouders] als 'post-concurrente crediteuren' te zien, dat goedkeuring aan het akkoord op die grond zou moeten worden onthouden.*" District Court Utrecht (n67).

147 The risk sharing theory was developed in the late 1980's by T.H. Jackson and R.E. Scott. See: R.E. Scott, 'Through bankruptcy with the creditors' bargain heuristic', *The University of Chicago Law Review* 53(2) (1986) 690–708; T.H. Jackson and R.E. Scott, 'On the nature of bankruptcy: an essay on bankruptcy sharing and the creditors' bargain', *Virginia Law Review* 75(2) (1989) 155–204; and R.E. Scott, 'Sharing the risks of bankruptcy: Timbers, Ahlers, and beyond', *Columbia Business Law Review* 1 (1989)183–194.

According to the creditors' bargain theory the only goal of bankruptcy law is to maximize the value of the pool of assets. Redistribution is not desirable and should be avoided.[148] Thus, pre-bankruptcy rights should be respected. Jackson and Scott, however, state that the true test for any model is the ability to explain why the American Bankruptcy Code still holds many re-distributional impulses. According to Jackson and Scott the creditors' bargain theory is unable to do this.[149] The reason for this is, according to the risk sharing theory, that the goal of bankruptcy is not only value maximization, but also to share certain risks.[150] Jackson and Scott put forward four examples that, according to them, show that risk sharing is relevant and right. These four examples are: i) diversification of common risks, ii) minimization of perverse incentives on the eve of bankruptcy, iii) protection of idiosyncratic value, and iv) protection of non-consensual claimants.

1.1 Diversification of common risks

Jackson and Scott state that bankruptcy is meant to make claimants share in the "common risks of business failure."[151] 'Common risks' can be defined as "*those contingencies whose probabilities or effect cannot be influenced by the actions of individual parties, contingencies that are, in consequence, common to the affected group of claimants.*"[152]

The argument for distinguishing between common risks and non-common risks is made on the assumption that parties can handle non-common risks efficiently, but are not able to do this with regard to common risks. For non-common risks a creditor can choose to adopt a strategy of risk control and let a certain risk be borne entirely by the party best able to influence the risk. The creditor can also choose to adopt a strategy of risk transfer and transfer risks to a party who is able to handle these risks better.[153] However, some risks, the common risks, are not best borne by one party, because such a party cannot influence

148 This stems from the fact that the creditors' bargain theory sees bankruptcy as a foreseeable risk. Thus, the risks of failure of a business will not be shared among claimants. See: T.H. Jackson and R.E. Scott, (n147) at 164.

149 T.H. Jackson and R.E. Scott (147) at179 and R.E. Scott, 'Through bankruptcy with the creditors' bargain heuristic' (n147) at 699–700. Why a theory is normatively right only if it explains positive law is not explained by Jackson and Scott. What an amendment of the law, for example the abolishment of reorganizational procedures, would mean for the normativity of their theory is not explained. Furthermore, the question remains whether the theory of Jackson and Scott actually does explain positive (American) bankruptcy law. See: M.J. Roe, 'Commentary on "on the nature of bankruptcy": bankruptcy, priority, and economics', *Virginia Law Review* 75(2) (1989) 219–240 at 229–240.

150 In the words of Jackson and Scott: "*Our model suggests that various distributional objectives shape the bankruptcy process (..).*" T.H. Jackson and R.E. Scott (n147) at 202.

151 R.E. Scott, 'Through bankruptcy with the creditors' bargain heuristic' (n147) at 699.

152 Ibid.. That is to say, the bankruptcy should be caused by exogenous factors beyond influence of the parties involved.

153 T.H. Jackson and R.E. Scott (n147) at 164–165.

its relation to the debtor in relation to the risk. That is why parties would share these risks. If these (common) risks were shared the costs of these risks would be reduced for the parties involved, because, although the probability that a party thus has to contribute in a bankruptcy is increased, the amount of money lost is smaller.

Another reason, Jackson and Scott predict, that parties would only include risk sharing in their hypothetical bargain for common risks is that it is very costly to determine how a risk should be shared.[154] It is likely that negotiations over these questions will be difficult. Furthermore, because the division of the yield of the pool of assets is more complex, the costs of the actual division will be higher. For these reasons risk sharing will only be efficient for common risks.

However, even if parties agree to share only common risks there are two serious problems with regard to the implementation of such a system. The first one is that deciding whether a risk is a common or a non-common risk, whether it is on a case-by-case or overall basis, is very difficult.[155] The second is that whether or not a risk qualifies as a common risk can only be determined with hindsight. This means uncertainty for parties with regard to distribution of the assets. Parties thus have an incentive to engage in unnecessary precautionary behavior.[156]

1.2 Minimizing perverse incentives on the eve of bankruptcy

Another reason why, according to the risk sharing theory, risk sharing can be seen as an objective of bankruptcy is that it reduces eve-of-bankruptcy-conflicts. The creditors' bargain theory states that the value of pre-bankruptcy entitlements should be preserved to prevent perverse incentives that lead to forum shopping. When a difference exists between pre-bankruptcy and bankruptcy entitlements creditors will seek the situation that is most profitable to them. According to the creditors' bargain theory the preservation of pre-bankruptcy entitlements averts this problem.

Jackson and Scott, however, contend that it is impossible not to alter pre-bankruptcy entitlements of individual claimants in bankruptcy. As a consequence perverse incentives are inevitable. These incentives are stronger just before bankruptcy occurs. A creditor knows that, if enough pressure is exercized, a debtor will be prone to pay more than that a creditor would receive in bankruptcy. This problem is especially true for creditors who

154 *Idem* at 167.
155 This is acknowledged by Jackson and Scott. See: T.H. Jackson and R.E. Scott (n147) at 168 and 199 *et seq*.
156 *Idem* at 199.

have control over the decisions a debtor makes.[157] These creditors will of course try to move the debtor to a decision that favors them.[158] A rule of risk sharing would minimize these perverse incentives. Why this is so, is shown by making an analogy with the maritime rule of general average.

When a ship is in danger at sea a captain would want to save the ship he controls.[159] To this end he can jettison some of the cargo aboard; the ship is then saved, but the cargo owner whose cargo is jettisoned would have to bear the damage by himself. The captain can also – for example – cut off the mast; the ship is then also saved, while the owner of the ship would incur all the damage. Without the rule of general average the captain has an incentive to jettison random cargo of the cargo owners, without taking the interests of the cargo owners as a group into consideration.[160]

The rule of general average states that the captain – as an agent of all the participants involved – is allowed to make certain decisions to save the ship. However, the owners of the jettisoned cargo owners or the damaged ship will be reimbursed and all others – including the captain – have to share equally in the damage. This way the conflict of interest for the captain is dissipated. He will jettison whatever cargo or part of the ship that is sufficient to save the ship, but – because he has to pay himself for part of the damage – that is also the least valuable.

This rule of general average can be translated to the situation just before bankruptcy. The ship – the corporation – has entered rough weather. The captain – a dominant secured creditor – would want to save the ship and the cargo owners – the creditors – would want their cargo to arrive safely.[161] To let the ship arrive safely certain assets and liabilities or part of the equity value should be jettisoned, preferably in an efficient way. When risk

157 Examples are management and equity who will try to delay filing for bankruptcy, because their rights and power have no value in bankruptcy.

158 T.H. Jackson and R.E. Scott (n147) at 169–170. The laws of preference avoidance are designed to prevent this problem. However, according to Jackson and Scott this is not enough to prevent perverse incentives on the eve of bankruptcy.

159 The captain can be seen as the agent of the owner of the ship. This is an example of agency theory. Agency theory is relevant in the situation that a hierarchic structure exists. In this situation the agent is under contract by the principal to perform certain services. However, the interests of the agent and principal do not always align. The agent can have an incentive to act in his self-interest, even when this is not in the interest of the principal. To counterbalance these incentives the principal will have to incur certain (agency) costs. The seminal piece on agency theory is written by M.C. Jensen and W.H. Meckling. See: M.C. Jensen and W.H. Meckling, 'Theory of the firm: managerial behavior, agency costs, and ownership structure', *Journal of Financial Economics* 3(4) (1976) 305–360.

160 This follows from the fact that the captain is the agent of the owners of the ship.

161 T.H. Jackson and R.E. Scott (n147) at 172.

sharing is introduced this would be achieved.[162] This way eve of bankruptcy conflicts can be minimized and the corporation can be saved efficiently.

It is noted that Jackson and Scott state that the captain of the ship is a dominant creditor. However, it seems plausible that the management of the corporation should also be considered the captain. Just before bankruptcy it is not only the dominant secured creditor, but also management who should be moved to take efficient decisions.[163]

1.3 Protection of idiosyncratic value

Risk sharing can also play a role when idiosyncratic, or particular personal value, is involved. As stated above, the assumption of the creditors' bargain theory is that all claimants are only interested in maximizing the value of the pool of assets. The risk sharing theory, however, argues that in firms where idiosyncratic values are involved, such as a small, closely held business, the equity class does not pursue only profit maximization, but also has other goals. Such goals include the continued existence of their business.[164] This is especially relevant in relation to the fact that firm-specific investment brings about risks that cannot be diversified.[165]

The more firm-specific investments the equity class makes, the more likely it is that they would like to receive an extended possibility for 'their' corporation to reorganize. This extended possibility could consist of, for example, reduced payments to a secured creditor or a restraint on the possibility to foreclose on property of the debtor.[166] It could best be incorporated in bankruptcy law and can be seen as a form of risk sharing.[167]

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162 The jettison would – ideally – take place before bankruptcy. According to Jackson and Scott, however, the jettison can also take place after bankruptcy (and most of the times it will), because bankruptcy and business failure are not linked. *Idem* at 173. It should be noted that the jettisoning means that not only the right of a creditor is violated, but also the value of the right.

163 See: G.D. Hoekstra (n44) at 24.

164 T.H. Jackson and R.E. Scott (n147) at 174.

165 For the investment is firm-specific.

166 T.H. Jackson and R.E. Scott (n147) at 175. Monetary payments would hold the risk of false claim. Because the possibility to reorganize does not consist of money it is hard to incorporate it in the *ex ante* bargain. What the larger possibility to reorganize should hold exactly is a question that can only be answered after bankruptcy. The extended possibility to reorganize would not be the prevention of liquidation under all circumstances. Jackson and Scott present the idea of making extra firm-specific investments in return for an extended possibility to reorganize as a form of insurance. It is noted that their theory does not take the private benefits of control into account.

167 *Ibid.*

Jackson and Scott acknowledge, however, that it would be difficult to separate the 'deserving' equity claimants from the 'undeserving'.[168] Contractual provisions are no solution to this problem, because no individual investor would agree to give the equity class leniency if it was not completely sure that all other investors would also agree to the provisions.[169] Furthermore, Jackson and Scott are aware of the fact that, if idiosyncratic value would be protected via bankruptcy law, costs would be incurred because of forum shopping, implementation and transition costs.[170]

1.4 Protecting non-consensual claims

The problem of non-consensual claimants is not presented as an example of why risk sharing is normatively right, but it is shown to prove that these claimants have rights that do not come from consensual agreement of an *ex ante* bargain. Non-consensual claimants are claimants that have not had the possibility to negotiate with the debtor (or the other creditors) before bankruptcy, such as tort claimants.[171]

Jackson and Scott state that these claimants can be compared to victims of a disaster.[172] They consider these claimants people who have no choice. Because of this they should receive a part of the assets. However, if assets are redistributed they cannot go to other claimants. These assets can thus be considered costs of bankruptcy.

2 Why risk sharing is not a goal of bankruptcy

Jackson and Scott recognize that changing relative entitlements in bankruptcy creates a forum shopping problem and brings along other costs. However, at the same time they defend risk sharing and the change of relative entitlements by pointing out their benefits. They assert that whether or not the benefits outweigh the costs is an empirical question and that there is at least a trade-off.[173]

The theory posed by Jackson and Scott has never been empirically tested, but criticism is possible. The criticism can be directed at the fact that high costs, higher than the costs presented by Jackson and Scott, are incurred with regard to the position of the secured

168 The undeserving equity claimants are those that are fully diversified or those that have caused the bankruptcy themselves by means of incompetence or mismanagement. See: *Ibid.*
169 In other words: a collective action problem arises. See: *Idem* at 176.
170 *Ibid.*
171 *Idem* at 177–178.
172 *Idem* at 177.
173 *Idem* at 174.

creditor, while at the same time risk sharing provides little benefit. The same is true with regard to risk sharing as a means to avert perverse eve-of-bankruptcy incentives for manager-shareholders. Furthermore, the question can be posed whether contracts are not better suited to achieve risk sharing. I will now look at these points more closely.

2.1 Limited class of beneficiaries

The class of beneficiaries of risk sharing is limited to a small class: those that have an undiversified portfolio. Most of the times it is likely that this is only the manager-shareholder. Other creditors can invest in a number of firms and even out the risk with regard to a particular firm.[174] Because their risk is so small, they do not have much to expect from risk sharing.

Jackson and Scott do state that risk sharing should only apply when 'common risks' occur. This would mean that an industry-diversified investor would benefit from risk sharing, since diversification could not prevent his higher chances of losing on his investment. The reason for this is that common risks will generally affect not only a single corporation, but the entire industry in which a corporation is active. But a creditor is not bound to industry-diversification and could fully diversify.[175] In that case risk sharing still only awards benefits to a very limited class of investors.

2.2 Higher costs because of behavior by secured creditor

As stated above, risk sharing is most likely to benefit the manager-shareholder. It is also most likely that the risks that have been taken away from the manager-shareholder now lie with the secured creditors. These creditors have knowledge of the fact that their priority status is reduced in the case of bankruptcy, because then they will have to contribute to the risk sharing by giving some part of their claim away. Because their investment is riskier, they will correspondingly increase their interest rates. The unsecured creditors will lower their interest rates, because risk sharing provides them with a lower risk.[176]

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174 B.E. Adler, 'Bankruptcy and risk allocation' (n143) at 480–484. Adler illustrates this by showing that risk sharing is net valueless for a diversified creditor. Consider that an investor who might benefit from risk sharing is more likely to get a return from each of its investment. It must however pay an *ex ante* price for this increased probability. This price should offset the present value of *ex post* increased expected returns.

175 However, in the case of a national or worldwide economic downturn even full diversification would not work and a creditor may benefit from risk sharing, but this depends on his creditor status in his different investments. Risk sharing would therefore be only beneficial by chance. *Idem* at 483.

176 *Idem* at 464 and 476–477. Carlson questions whether this assumed risk pattern corresponds with the intuitive risk pattern. The theory of Jackson and Scott means that secured creditors must be prone to risk will they 'consent' to the risk sharing. It is generally assumed, however, that secured creditors take security *precisely*

One could state that the increase in interest rates by the secured creditors and the decrease in interest rates by the unsecured creditor would counterbalance each other. However, it is more likely that the decrease in value of the security interest is greater than the lowering in interest rates and that risk sharing thus has bigger inefficiency costs than expected. This follows from the fact that, because of its loss in priority, the secured creditor has a greater incentive to monitor the debtor. However, it is likely that the secured creditor took a security interest because it is not best suited to monitor. This will result in higher monitoring costs than the unsecured creditor incurred when he had to monitor.[177] As a result the net costs of monitoring are therefore likely to rise, because of the shift in risks.[178]

Furthermore, since a secured creditor knows that he will probably receive less in bankruptcy than before he is likely to seek recourse before bankruptcy. This way he can avoid the risk sharing regime which is costly for him.[179] In this sense the analogy with general average is questionable.[180]

2.3 Higher costs because of behavior by manager-shareholder

According to Jackson and Scott risk sharing minimizes perverse incentives on the eve of bankruptcy. However, manager-shareholders are also aware of the risk sharing regime when a business is solvent. This creates two perverse incentives. The first one is that management is more inclined to take risks, because they will still receive a pay-out after bankruptcy in the event of a common risk. Although Jackson and Scott exclude mismanagement from risk sharing, it can be highly debatable whether a bankruptcy is caused by a common risk or mismanagement.[181] This way management can receive an unjustified pay-out.[182] The second one is that management lacks an incentive to work diligently, because they know that if bankruptcy occurs assets will be reallocated. Thus, they will not

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because they are risk averse. D.G. Carlson, 'Bankruptcy theory and the creditors' bargain', *University of Cincinnati Law Review* 61(2) (1992) 453–510 at 486.

177 The assumption being that the unsecured creditors remained unsecured because they are relatively good monitors. See: B.E. Adler, 'Bankruptcy and risk allocation' (n143) at 477.

178 *Idem* at 476–478. Carlson is also critical of the shift of risks to a secured creditor. D.G. Carlson, (n176) at 492.

179 See: G.D. Hoekstra (n44) at 52.

180 When a secured creditors' claim is fully secured he has no reason to wait for bankruptcy to seek recourse. Unless he has unsecured claims against the debtor, there is no special reason why he would want to save 'the ship'. In the analogy to the general average situation the secured creditor would call a helicopter and be lifted of the ship. See for further criticism with regard to the analogy of general average: D.G. Carlson (n176) at 506–507.

181 Jackson and Scott are also unclear about what to do when bankruptcy is caused by a common risk in relation to mismanagement. In case a director is personally liable for company debts there will have been mismanagement.

182 An unjustified payout can also be caused because of the nuisance value of an illegitimate claim.

fully experience the consequences of their lack of diligence.[183] The result is inefficient behavior.

2.4 *Contractual risk sharing as an alternative for mandated risk sharing*

Furthermore, it is questionable whether it is not more efficient to provide for risk sharing in a contractual way. And if it is, why it is not being done. One could for example give debt obligations as compensation to the manager-shareholder of the firm. This would counterbalance perverse eve-of-bankruptcy-interests. By giving debt obligations risk sharing is reached in a less costly and more efficient way.[184] There is no reason why special bankruptcy law is needed to reach the same results.[185]

But, if risk sharing by contract is possible, then why is it never done? Roe states that there can be two reasons: i) the negotiation process is transactionally (too) costly, or ii) sharing is unimportant or costly for creditors.[186] He does note that the first hypothesis is weakened by the fact that agreements that contain a negative pledge clause are widely used, but this does not invalidate his hypothesis.[187] Thus, maybe risk sharing is just not what creditors want. That would mean that creditors would not incorporate risk sharing in their hypothetical bargain.

3 Rehabilitation and the interests of non-property right holders as a goal of bankruptcy

There are also other authors who differ with the proponents of the creditors' bargain theory in assessing whether economic value maximization is the only goal of bankruptcy. In their view, bankruptcy law embodies substantive policies of its own. They state that the goal of bankruptcy law is not so much economic value maximization, but a weighing of different values that play a role in bankruptcy to determine if a business should be rehabilitated. These theories, which I jointly call the 'value view', state that in this weighing not only the

183 B.E. Adler, 'Bankruptcy and risk allocation' (n143) at 473–476.

184 *Idem*, at 484–486. It is true that it is hard to distinguish between common risks and other risks in the contract *ex ante*, but *ex post* it is similarly difficult to distinguish these 2. See also: D.G Carlson (n176) at 509 and M.J. Roe (n149) at 223. This difficulty to distinguish is the only reason that Jackson and Scott give for defending mandated risk sharing via bankruptcy law over contractual risk sharing. Carlson explicitly renders this reasoning insufficient. Something I agree with. D.G Carlson (n176) at 497.

185 B.E. Adler, 'Bankruptcy and risk allocation' (n143) at 487–489.

186 M.J. Roe (n149) at 224.

187 Negative pledges make sure that no other creditor uses security instruments. These clauses therefore prevent a shifting of risk from taking place. It should be noted, however, that it is likely that negative pledge clauses are less costly to transact than contracting on common risks.

interests of property right holders should be considered, but the interests of a broader group of people. This group includes, for example, employees, managers and the community in which the business functions. Thus, in contrast to the creditors' bargain theory, the value view states that the pie should be redistributed in bankruptcy, and that it has to be shared with more people.

The most prominent defenders of the value view are Warren, Gross and Korobkin.[188] Warren bases her theory on the difference between the situations in which debt is collected under non-bankruptcy collection law in comparison to debt collection under bankruptcy law. Gross justifies her views on the function of bankruptcy law by using communitarianism and feminism. Korobkin uses a contractarian approach and draws his inspiration from the principles of justice as laid out by John Rawls to defend his view of bankruptcy.

3.1 The justification for including non-economic values in the goals of bankruptcy law: the rehabilitation view

According to Warren bankruptcy is a combination of values in play. Because the function of non-bankruptcy law and bankruptcy law differs, the values that play a role in these systems also differ.[189] For this reason, economic maximization should not be seen as the only relevant goal of bankruptcy, and redistribution is justified.[190]

188 The value view was developed at the end of the 1980's and in the 1990's. See: E. Warren, 'Bankruptcy policy' (n116) E. Warren, 'Bankruptcy policymaking in an imperfect world', *Michigan Law Review* 92(2) (1993) 336–387; K. Gross, 'Taking community interests into account in bankruptcy: an essay', *Washington University Law Review* 72(3) (1994) 1031–1048; D.R. Korobkin, 'Rehabilitating values: a jurisprudence of bankruptcy', *Columbia Law Review* 91(4) (1991) 717–789; D.R. Korobkin, 'Value and rationality in bankruptcy decision-making', *William and Mary Law Review* 33(2) (1992) 333–366 and D.R. Korobkin, 'Contractarianism and the normative foundations of bankruptcy law', *Texas Law Review* 71(3) (1993) 541–631. Other defenders of the value view are J.A. Veach, N.D. Martin, S.L. Bufford and H.R. Miller. See: J.A. Veach, 'On considering the public interest in bankruptcy: looking to the railroads for answers', *Indiana Law Journal* 72(4) (1997) 1211–1230; N.D. Martin, 'Noneconomics interests in bankruptcy: standing on the outside looking in', *Ohio State Law Journal* 59 (1998) 429–505; S.L. Bufford, 'What is right about bankruptcy law and wrong about its critics', *Washington University Law Review* 72(3) (1994) 829–848 and H.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', *American Bankruptcy Law Journal* 69 (1995) 431–465. Defenders of incorporating values in the goals of bankruptcy law are sometimes also referred to as 'traditionalists'. The defenders of economic value maximization theories, in turn, are referred to as 'proceduralists'. See about this difference: D.G. Baird, 'Bankruptcy's uncontested axioms', *The Yale Law Journal* 108(3) (1998) 573–599.

189 E. Warren, 'Bankruptcy policy' (n116) at 777–779.

190 Warren acknowledges that (at least) enhancing the value of a bankrupt firm is a goal of bankruptcy law, besides promoting non-economic values. See: E. Warren, 'Bankruptcy policymaking in an imperfect world' (n188) at 343–353.

Non-bankruptcy collection law and bankruptcy law are both systems to collect debts from a debtor who fails to pay. But, Warren argues, there is a difference between the situations in which both systems are used. Non-bankruptcy collection law is meant to enforce payment of a single debt. The focus is on the debtor/creditor relationship. Bankruptcy law, on the other hand, concentrates on default on multiple obligations, to the extent that the debtor is unable to pay all creditors. Here the focus is on the relationship among the creditors themselves, who are battling for payment of their claim.[191] In other words, the distribution question becomes more relevant.

If one acknowledges this difference, then an opportunity is created to answer the distribution question in another way than outside of bankruptcy. Other values than value maximization can be introduced and the losses involved can be spread among more people.[192] So, bankruptcy law can redistribute some of the losses by giving a business an opportunity to reorganize and interests of non-property right holders can and, according to Warren, should be accounted for.[193] Otherwise it is possible that a business is liquidated because it is in the best interest of the property rights holders, while 'rehabilitation' provides for a better result for all those involved in the bankruptcy.

Warren states that the re-distributional rationale described above, as far as US bankruptcy law goes, also follows from the Bankruptcy Code and Congressional comments.[194] However, when one establishes that the justification for bankruptcy is also re-distributional, the next question is automatically which values deserve protection.[195] Or, put in another way, how should the costs of bankruptcy be divided? In this respect, Warren does not offer a normative framework of what bankruptcy law should look like; she merely gives her general view of bankruptcy law as a whole. She does, however, offer some principles that, according to her, determine how costs are to be distributed. She names, among other things: i) the relative ability to bear costs (e.g. preference for salary payments), ii) dealing with incentive effects on pre-bankruptcy transactions (e.g. fraudulent preference), iii) similarities among creditors (e.g. the inability to end executory contracts), iv) who bears the losses when a business fails and v) benefit to the bankruptcy estate (e.g. refusal to recognize *ipso facto* clauses).[196] She immediately recognizes that she does not provide an answer to the question

191 E. Warren, 'Bankruptcy policy' (n116) at 782–785.
192 *Idem*, at 777.
193 *Idem*, at 788.
194 *Idem*, at 787–788; and E. Warren, 'Bankruptcy policymaking in an imperfect world' at 354–355. The Supreme Court of the United States, however, has ruled that the goal of bankruptcy is not to create new substantive rights. See: *Butner* v. *United States* 440 US 48 (1979).
195 E. Warren, 'Bankruptcy policy' (n116) at 796.
196 E. Warren, 'Bankruptcy policy' (n116) at 790–793 and E. Warren, 'Bankruptcy policymaking in an imperfect world' (n188) at 353–361. Warren clearly states that this list is not exhaustive.

how far to pursue a given goal or to the question what to do when certain goals conflict.[197] This makes it hard to assess whether the rehabilitation view provides for more efficient bankruptcy law than the creditors' bargain theory.

3.2 *The justification for including non-economic values in the goals of bankruptcy law: feminism and communitarianism*

Another proponent of the value view is Gross. She also holds the opinion that a broader range of interests should be included in bankruptcy law.[198] Like Warren she only has a general view of what bankruptcy should look like and does not offer an alternative for the creditors' bargain theory. Gross, unlike Warren, bases her theory on feminism and communitarianism.[199] The latter theories have been developed to provide a general view on how to analyze a specific subject.[200]

According to Gross the defenders of a purely economic account of bankruptcy law base their arguments on two premises: i) community interests are extremely difficult to quantify, and ii) this difficulty justifies their absence from an economic model of bankruptcy.[201] These premises, in turn, rely on three underlying premises that Gross tries to refute. They are: i) individuals are selfish (and hence disinterested in community concerns), ii) choices are easily addressed through *ex ante* decision making, because they are unchanging and exogenous, and iii) interpersonal utility comparisons are impossible.[202]

Gross continues her defence of the value view by refuting these premises. With regard to the first underlying premise she states that the goodness of human nature leads to the conclusion that we should not only care about debtor and creditor interests.[203] In other words, she defends the concept of altruism. The fact that there are some people who display

197 E. Warren, 'Bankruptcy policymaking in an imperfect world' (n188) at 360. Another relevant question, raised by Martin, is how the interests of non-property right holders should be taken into account. N.D. Martin (n188) at 481. Martin answers these questions by stating that non-property right holders should have a right to be heard in major events cases, if their interests are substantial enough. See: N.D. Martin (n188) at 502.

198 K. Gross (n188) at 1031–1032. Gross explicitly states that protecting a broader array of interests does not mean that value maximization for property righ holders is not important. *Idem*, at 1039.

199 Feminism is a theory that sees the world as an interrelated place with focus on day-to-day-life. Communitarianism is a theory in which people are responsible for the well-being of their community.

200 Gross realizes that the usage of the terms may be off-putting, but does not see this as a convincing reason to use other terms. K. Gross (n188) at 1036.

201 K. Gross (n188) at 1035. With regard to her observations of the economic account, Gross mainly refers to M. Bradley and M. Rosenzweig (n1), footnotes 44 and 108.

202 K. Gross (n188) at 1038–1039.

203 *Idem* at 1041.

selfish behavior in bankruptcy situations, should not lead to the conclusion that all individuals are selfish.[204] Furthermore, both feminism and communitarianism see people as interrelated and interdependent and for this reason we should not only look after ourselves.[205] The creditors' bargain theory, however, does not assume that all actors are rational profit maximizers. Rather, the creditors' bargain theory advances that the participants in a bankruptcy are sensitive to the costs and benefits of their actions. Those parties who enjoy the benefits should incur the costs.[206]

The second underlying assumption of the creditors' bargain, according to Gross, holds that individuals can always be bound by default rules based on the conclusion once reached in the past about how people will act in a hypothetical situation. Gross argues that this assumption is incorrect, because both people and their lives change. As a consequence we cannot establish *ex ante* how a bankruptcy would be approached in the event that it really occurs.[207] However, in the creditors' bargain theory parties involved in the bargain know their legal status relative to a corporation when they hypothetically negotiate over the bankruptcy contract.[208] So, the parties involved know that they are property rights holders and what their relative priority to other property rights holders is. This makes the *ex ante* decision making less uncertain.

The third underlying assumption that Gross refutes is that personal utility comparisons are unquantifiable and should therefore not be taken into account. Gross refutes this and states that it should be possible in some way to take altruism and community interests into account. Gross, however, provides no lead as to how this should be done.[209] But, according to Gross, even if it is not possible to measure altruism and community interests, their non-quantification does not make them unimportant.[210]

The arguments described above lead Gross to the conclusion that the premises (and conclusions) of the economic account are flawed. Because of this, value maximization cannot be seen as the only goal of bankruptcy; the inclusion of other values would provide for more efficient bankruptcy law.

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204 *Idem* at 1040.
205 K. Gross (n188) at 1041.
206 D.G. Baird and T.H. Jackson (n71) at 118, footnote 68.
207 K. Gross (n188) at 1043–1044. Gross also criticizes the theory of Korobkin – which will be discussed in the next paragraph – on this point. See: K. Gross (n188) at 1044.
208 T.H. Jackson (n71) at 860–861.
209 Gross writes that 'we need accounting and business types for this'. See: K. Gross (n188) at 1045.
210 *Idem* at, 1045–1046.

3.3 *The justification for including non-economic values in the goal of bankruptcy law: the bankruptcy choice situation*

A third defender of the value view is Korobkin. In two subsequent articles Korobkin tries to draft a framework for normative bankruptcy law.[211] He starts by defining bankruptcy as a response to financial distress, in which values play a role. With this in mind, Korobkin formulates the 'bankruptcy choice situation'. In this situation he places participants behind a Rawlsian veil of ignorance and then tries to establish which bankruptcy law they would adopt.

3.3.1 Bankruptcy as a response to financial distress

According to Korobkin the bankruptcy process is not only about money, but a broad array of values play a role. Bankruptcy is a response to financial distress and not merely a means to solve the problem of collecting debt.[212] To this end he defines financial distress as: "*[A] moral, political, personal, and social problem that affects its participants.*"[213]

That bankruptcy does not involve only property, but also values is, according to Korobkin, true for both the debtor as well as the other participants in the bankruptcy process – which group is not confined to merely those with an economic interest, but all those who are affected by the distress.[214] Bankruptcy means that the interests of those affected will conflict. According to Korobkin, to those affected the money means more to them than just the money itself. The money stands for success, moral dismissal or another subjective value.[215]

The same goes for the business itself and the estate, which are not the same thing according to Korobkin. A business is more than its property. It has personality and potential.[216] This is also true for the estate. Korobkin states that this insight leads to the conclusion that bankruptcy is not merely about the deployment and division of assets, but about a kind of existential enquiry into what the role of the estate should be.[217]

Because bankruptcy is a response to financial distress, bankruptcy law sometimes has to recognize different substantive rights than those under non-bankruptcy law.[218] This way

211 D.R Korobkin, 'Rehabilitating values: a jurisprudence of bankruptcy' (n188); and D.R. Korobkin, 'Contractarianism and the normative foundations of bankruptcy law' (n188).
212 D.R. Korobkin, 'Rehabilitating values: a jurisprudence of bankruptcy' (n188) at 762.
213 *Ibid.*
214 *Ibid.*
215 Korobkin talks about 'the expression of their more fundamental moral, political, personal, and social values.' *Idem* at 765.
216 *Idem* at 745.
217 *Idem* at 771.
218 *Idem* at 768.

the different values in play can be sufficiently taken into account and the proper role for the estate can be established. Whether it is liquidation or rehabilitation. Even though the latter is not value maximizing.

3.3.2 The bankruptcy choice model

How would bankruptcy law be shaped if bankruptcy is a response to financial distress and values play a role in the decisions regarding bankruptcy? Korobkin tries to answer this question by formulating a (hypothetical) bankruptcy choice situation. This framework is based on the theory of John Rawls about justice.[219]

Korobkin starts by making several assumptions about the conditions under which the hypothetical choice for the establishment of the principles of bankruptcy is made. The first assumption he makes is that all people in society who are affected by the bankruptcy should be included in the formulation of the framework for bankruptcy law.[220] The reason being that, according to Korobkin, bankruptcy is not about the problem of collecting debt, but about financial distress; a situation in which not only the creditors are involved. Another reason for Korobkin to include non-property right holders is that he does not want to impose controversial exclusions of people.[221]

In this respect he criticizes the creditors' bargain theory. In this theory bargaining only takes place between property right holders.[222] According to Korobkin this automatically leads to a situation in which only those interests are represented. He dismisses the proposition that the people who are not included in the (hypothetical) creditors' bargain have consented to doing this by not bargaining for a property right.[223] No justification can therefore be found for excluding non-property right holders.

The second assumption regards the knowledge of the participants involved in the bankruptcy choice situation. It is assumed that all participants are placed behind a 'veil of ignorance'. Every human can be seen as an (almost) blank sheet with no knowledge of his

219 See: J. Rawls, *A theory of justice*, (Cambridge: Belknap, 1999) (revised edition). Interestingly enough Rasmussen has argued that from a Rawlsian point of view a bankruptcy regime designed to promote efficiency would promote social justice. See: R.K. Rasmussen, 'An essay on optimal bankruptcy rules and social justice', 1 *University of Illinois Law Review* (1994) 1–43.

220 D.R. Korobkin, 'Contractarianism and the normative foundations of bankruptcy law' (n188) at 554.

221 *Idem* at 553–554.

222 T.H. Jackson, 'Bankruptcy, non-bankruptcy entitlements and the creditors' bargain' (n71) at 858–860

223 D.R Korobkin, 'Contractarianism and the normative foundations of bankruptcy law' (n188) at 557–558. Korobkin argues that consent to be excluded in a single case does not mean that a person consents never to be included in the bargain. Another problem, according to Korobkin, is that some people (such as tort victims) cannot be construed to have consented at all.

class, status or legal position in a bankruptcy.[224] This ensures that the participants will not make their decisions on the basis of self-interest.

The bankruptcy choice differs from the creditors' bargain theory on this point. In the latter theory the participants in the bargaining process know their legal position. Korobkin sees this as a serious problem for reaching agreement on a hypothetical bargain in bankruptcy. He doubts whether fully secured creditors would join in the bargaining process if they knew their status in bankruptcy. The reason for this is that they have nothing to win and can only lose.[225] The creditors' bargain theory tries to obviate this objection by ensuring that secured creditors are left as well off as when they would not participate in the bargain.[226] For this reason the secured creditor should be compensated for the risk and monetary inflation loss he incurs by delayed payment.[227]

The third assumption is that the participants in the bargain have a limited knowledge of the circumstances of bankruptcy.[228] However, the participants do know about the applicable law in a non-bankruptcy situation. And it is assumed that this law is just. Furthermore, they know that there are different aims being pursued by different participants and that there is a difference in their motivation. And although they do not know what their aims are, the participants will want to be in the best position possible.

On the basis of the above mentioned principles Korobkin formulates two principles that would be used by the participants in the bargaining process to formulate bankruptcy law. These principles are i) the principle of inclusion, and ii) the principle of rational planning.

The principle of inclusion holds that the participants in the bargaining process would choose to include all those affected by the bankruptcy of the business and not only the property right holders. The reason for this is that the participants do not know their own goals, but still want to be in the best position to pursue them. So they would not want to exclude themselves from the possibility that they can fulfil these.[229]

The principle of rational planning regards the influence that participants can have on the outcomes of the bankruptcy process. For example, their practical leverage or their possibilities to enforce their legal rights. The principle means that a) bankruptcy law should try

224 *Idem* at 559–560. Of course the participants have to know they have been assigned the task of establishing bankruptcy principles. For Rawls about the veil of ignorance see: J. Rawls (n219) at 136–142.
225 D.R. Korobkin, 'Contractarianism and the normative foundations of bankruptcy law' (n188) at 562.
226 T.H. Jackson, 'Bankruptcy, non-bankruptcy entitlements and the creditors' bargain' (n71) at 870.
227 T.H. Jackson, 'Of liquidation, continuation and delay' (n71) at 188 *et seq*.
228 D.R. Korobkin, 'Contractarianism and the normative foundations of bankruptcy law' (n188) at 565–571.
229 *Idem* at 572–575.

to meet as many goals of the participants as possible, and b) if meeting all goals is impossible, bankruptcy law should meet the goals that are the most important. This means, protecting the people in the most vulnerable position, because they are the ones that have the most to lose.[230]

Thus, where Warren and Gross merely give a general view of what bankruptcy law should look like Korobkin provides actual principles that would be used by participants to formulate bankruptcy law. He does not, however, give a complete normative framework for bankruptcy. But all three authors have in common that they hold the opinion that the creditors' bargain theory is not right in not recognizing any other 'value' than the economic one.

4 The case against introducing substantive policies in bankruptcy

It can easily be admitted that non-property right holders have an interest when a business fails. This does not mean, however, that bankruptcy is the place to redistribute wealth, just because a business goes bankrupt.[231] Three reasons underpin this conclusion: i) the internalization of costs provides for bigger social costs than benefits, ii) re-distribution of wealth can be efficiently done in other ways than the internalization of costs, and iii) there is no proper framework for bankruptcy law that includes interests of non-property right holders.[232] For these reasons the externalization of costs can be considered justifiable and economic value maximization provides for efficient bankruptcy law.[233]

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230 In this respect Korobkin makes a comparison to medical triage. In medical triage it is not the patient that is the most seriously injured that is helped first, but the patient that has most to lose. *Idem* at 586.

231 Proponents of economic value maximization have stated in their work that there are certain non-pecuniary interests that deserve protection. They do, however, refute the view that these interests should be protected via bankruptcy law. See: D.G. Baird, 'Loss Distribution, forum shopping, and bankruptcy' (n117) at 815 and A. Schwartz, 'A contract theory approach to business bankruptcy', *Yale Law Journal* 107(6) (1998) 1807–1852 at 1810 (footnote 15). Furthermore, it is noted that redistribution is not prohibited by definition in the creditors' bargain theory. However, redistribution should be restricted to cases that provide for overall value maximization.

232 It is important to note that some proponents of the value view have resorted to positive US bankruptcy law to defend their views. See for example: E. Warren, 'Bankruptcy policy' (n116) at 788–789. However, normative theory cannot be derived from positive law. In this respect, this category of arguments cannot be accounted for as justifying redistributional objectives in bankruptcy. See also: D.G. Baird, 'Loss Distribution, forum shopping, and bankruptcy' (n117) at 817 and A. Schwartz, (n231) at 1814–1815.

233 Besides the authors who are mentioned hereafter, the following authors can also be seen as proponents of economic value maximization: R.E. Scott, M. Bradley, M.I. Rosenzweig, P. Aghion, O. Hart, J. Moore, F.H. Easterbrook, G.G. Triantis, M.J. White and C.W. Mooney. See: R.E. Scott 1986; M. Bradley and M.I. Rosenzweig 1992A; p. Aghion, O. Hart and J. Moore 1994; F.H. Easterbrook 1990; G.G. Triantis, 'A theory of the regulation of debtor-in-possession financing', *Vanderbilt Law Review* 1993 901–934; M.J. White, 'The corporate bankruptcy decision', *Journal of Economic Perspectives* 3(2) (1989)- 129–151; M.J. White, 'Corporate bankruptcy as filtering device: Chapter 11 reorganizations and out-of-court debt restructurings', *Journal of*

4.1 The social costs of internalization

The proponents of the value view argue that a broad array of interests should be protected and that the creditors should therefore internalize the costs of bankruptcy. According to them this would be socially efficient. It is, however, unclear whether it really is socially efficient to internalize the costs of bankruptcy. There are at least three objections that can be made against this argument: i) the increase in the cost of credit, ii) the costs of forum shopping, and iii) the misconstruction of equity.

4.1.1 Re-distributional objectives increase the cost of credit

One of the consequences of including re-distributional objectives in bankruptcy law is that the cost of credit for companies increases. The reason is that the amount lenders charge for their loan is linked to the risk these lenders incur. If a lender estimates that there is high risk that he will not be repaid, he will charge a higher interest rate. If he estimates a low risk of non-repayment, he will charge a lower interest rate.[234]

When re-distributional objectives are included in bankruptcy law, lenders are less certain about their expected returns. It is not clear beforehand what their exact priority position will be since non-property right holders can claim a part of the pie, the size of which is uncertain before bankruptcy.[235] Because re-distribution in bankruptcy would lead to a higher chance of equity retaining an interest in a firm, management – as an agent of shareholders – of a solvent firm would have an incentive to invest in risky projects;[236] a strategy that increases the risk of a lender even further.

The risks described would lead lenders to try to offset the increased amount of risk. The way to do this is increase the interest rate for credit.[237] Furthermore, lenders could deem

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Law, Economics & Organization 10(2) (1994) 268–295; and C.W. Mooney, 'A normative theory of bankruptcy law: bankruptcy as (is) civil procedure', *Washington and Lee Law Review* 61(3) (2004) at 931–1061. Mooney does hold the opinion that bankruptcy law serves to maximize the value of a bankrupt corporation, but he justifies this goal by means of a non-economic explanation. He bases his explanation for bankruptcy law on moral principles and conflict of redistributional objectives with US case law and the background of the US legal system.

234 See: R.K. Rasmussen, 'An essay on optimal bankruptcy rules and social justice' (n219) at 19. This is the reason that a borrower of secured credit pays a lower risk than a borrower of unsecured credit. See about risk and secured credit: A. Schwartz (n231) at 1984.

235 See: C.W. Frost, 'Bankruptcy redistributive policies and the limits of the judicial process', *The North Carolina Law Review* 74(1) (1995) 75–139; A. Schwartz (n231) at 1807–1851; and A. Schwartz, 'A normative theory of business bankruptcy', *Yale Law School Legal Scholarship Repository* Paper 305 (2005)- 1199–1265.

236 B.E. Adler, 'Bankruptcy and risk allocation' (n143) at 473. The incentive to take higher risks exists, because equity has less to lose in a bankruptcy.

237 See: R.K. Rasmussen, 'Debtor's Choice: A Menu Approach to Corporate Bankruptcy' *Texas Law Review* 71(1992)51–121 at 82–83.

it necessary to spend money on monitoring or to extend extra credit to prevent bankruptcy, because a bankruptcy would lead to a diminished return. This also adds extra costs to the extension of credit for lenders.[238]

In the end, non-property right holders may even be worse off compared to the situation that economic value maximization is the only goal of bankruptcy. Because corporations would probably try to prevent the extra costs of credit by changing the labor/capital mix. This mix will be changed so as to lower the 'labor' side of the equation. If fewer employees are hired, the employees receive less in bankruptcy and the increase in the cost of credit can be limited.[239]

4.1.2 The forum shopping problem

Another problem with the value view is that it leads to forum shopping.[240] This is the situation in which certain participants would strategically attempt to get a corporation to either file for bankruptcy or not to file for bankruptcy, because they would gain from one of these actions. Property right holders would try to get a corporation to not file for bankruptcy, because then they would have to pay for the benefits that the non-property right holders would enjoy that are a consequence of the wealth redistribution in bankruptcy. For non-property right holders it is the other way around.

The result of forum shopping is costs.[241] These costs result from opportunistic behavior by individual parties to maximize their own gain, while possibly preventing value maximization of a corporation. There may also be costs incurred by the attempt to either get the firm to file for bankruptcy or prevent bankruptcy.[242]

The creditors' bargain theory contends that the costs related to forum shopping are socially inefficient. They would exceed the benefits of redistribution of rights.[243] For this reason

238 B.E. Adler, 'Financial and political theories of American corporate bankruptcy' (n1) at 317.

239 See: C.W. Frost (n235) at. 118–119.

240 A prime example of forum shopping is Center of Main Interest-migration in the context of the European Insolvency Regulation. See about this subject in the context of the creditors' bargain theory: R.J. de Weijs and M. Breeman, 'Comi-migration: use or abuse of European insolvency law?', SSRN Working Paper, available at: http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2291405, retrieved 15/01/2014.

241 D.G. Baird, 'Loss Distribution, forum shopping, and bankruptcy' (n71) at 825–826.

242 D.G. Baird, 'Bankruptcy's uncontested axioms' (n187) at 592, footnote 58.

243 See: R.V. Butler and S.M. Gilpatric, 'A re-examination of the purposes and goals of bankruptcy', *American Bankruptcy Institute Law Review* 2 (1994) at 286. The argument that minimizing the costs of forum shopping is preferable is a choice. Whether this is truly so is a question of empirical research. Baird admits as much in his criticism on Warren's theory. D.G. Baird, 'Loss Distribution, forum shopping, and bankruptcy' (n71) at 828–831.

there should be as few ways as possible to enforce payment of a debt and the different ways of collecting debts should be as similar as possible.

Related to the forum shopping problem are Baird's remarks about the fact that Warren nowhere justifies the fact that certain rights are awarded to groups of people that do not have those rights outside of bankruptcy. Why should these people not have these rights in a situation where a debtor is not bankrupt?[244] This is especially so when a firm closes outside of bankruptcy.[245] Warren nowhere explains why employees or the community should not receive the protection they would receive if the firm closed after being declared bankrupt.

4.1.3 Equity reasons

Furthermore, at first sight it may seem that the value view is the more equitable way to handle a bankruptcy. Appearances, however, are deceiving. It may well be that a purely economic approach in the end is more equitable for society as a whole. Because, while the employees of a certain corporation may benefit from the redistribution of wealth, others may stand to lose from it. When a certain corporation is 'subsidized' by redistribution of wealth from the lenders to others, it results in unfair competition. A non-efficient corporation is kept running, while its competitors – outside of bankruptcy – have to compete without any subsidies. A possible negative effect of redistribution, for example, may be that management of the bankrupt corporation engages in risky pricing strategies. This has a high payoff, but a low success rate.[246] Other companies may suffer from these strategies, and in the end it is likely that the employees and community of those other companies suffer as well. In the end the 'equitable' solution of redistribution can therefore turn out not to be so equitable after all.

Besides, one can also simply view employees – insofar as they do not have a claim against the debtor – and the community as participants in the bankruptcy situation that chose not to 'buy' a claim against the debtor. They could have become a creditor and would have had a claim in bankruptcy. If the participants choose not to become creditors in the bankruptcy, there is no reason to give them extra protection.[247]

244 D.G. Baird, 'Loss Distribution, forum shopping, and bankruptcy (n71) at 829–830 and D.G. Baird, 'Loss Distribution, forum shopping, and bankruptcy' (n71) at 185.

245 For example, when a firm is moved to a third world country or closed down by management because of the lack of profitability.

246 C.W. Frost (n235) at 121.

247 An answer to this question may be that these participants do not possess the ability of real choice, because of their lack of wealth. See: *Idem*, at 109–110.

4.2 Redistribution of wealth by other means than internalization

Another problem with the value view is that its proponents fail to explain why, if redistribution is in order, the bankruptcy forum is the correct place to redistribute value by means of providing for biased legislation in favor of reorganization. It could well be that redistribution in another way than via bankruptcy is more efficient.

Redistribution would be unnecessary if either the non-property right holder found an immediate replacement for the interests it had in the bankrupt firm or if there were some kind of safety net that would be just as good as the immediate replacement. In the case of an employee this means that there would be no need for redistribution if he found a job immediately after he was fired. Alternatively, he would enjoy social benefits during the time he does not have a job. For the employees that immediately find a job after bankruptcy, no redistribution of wealth is necessary. Since markets are not perfect, however, the chances are that not every employee will find a job immediately after he is fired. This inefficiency, however, can be solved by government imposed taxation and a social welfare system.[248] The government could tax the corporation *ex ante* and spend these taxes directly on the community affected by the corporation. The social welfare system ensures that employees do not have to switch jobs immediately after they lost their jobs because of a bankruptcy, but that they can wait and get a job that puts their abilities to the best use.[249]

The advantage of taxation and a social welfare system is that both the taxation and the spending can be specifically targeted.[250] Furthermore, taxation and spending at the level of central government can be done in a co-ordinated fashion with a good overview of aggregate economic effects.[251] In this respect redistribution via the government provides for a major advantage over redistribution via the bankruptcy forum.

4.3 The lack of a clear and consistent value view-framework

The final argument against the value view is one that has been acknowledged by Warren and Gross themselves.[252] Even if it is accepted that there should be redistribution of wealth in bankruptcy, the fact is that the value view does not provide an actual framework for bankruptcy law that provides for this redistribution. It does not state how values should

248 *Idem* at 136.
249 A. Schwartz (n235) at 1818.
250 C.W. Frost (n235) at 136.
251 *Ibid.* The government could also use taxation and spending to spread risks.
252 E. Warren (n188) at 360; and K. Gross (n188) at 1045.

be defined or measured, what the relative weights of the different values are or how these values should be taken into account in the bankruptcy process.[253]

Perhaps the bankruptcy court could be appointed as the body to decide how the available wealth should be redistributed in bankruptcy. But, even if it were clear to judges how they should rule and how far wealth creation can be exchanged for other interests, it is questionable if the bankruptcy court is the apt body to weigh all objectives against each other and decide.[254]

In order for judges to be considered suitable for deciding on redistributional issues in bankruptcy, the proponents of the value view should demonstrate that a judge knows and can control the extent of the consequences of his decisions.

First, he should be able to determine the relevant community. In order to this, the judge has to distinguish all relevant community interests. However, these interests are infinite and their boundaries limitless. A decision to redistribute value in the bankruptcy of firm A in country X may negatively affect the unemployment rate in country Y or the revenues of firm B.[255] It will therefore be hard for a judge to assert which interests should play a role.

Second, the judge should be able to oversee the consequences of not only his decision, but of all the decisions of bankruptcy judges combined. Since there is no objective standard when redistributional values are included in bankruptcy, judges will act on an unco-ordinated basis. This means that a chance exists that contradictory judgments will be given or that the combined judgments have an unforeseen effect on the economy of a certain country.[256] The lack of an objective standard also means that a judge is more at risk to be influenced and it is possible that the decisions in a bankruptcy case are politicized.[257] In

253 See about the first point: C.W. Frost (n235) at 75. And about the second point: N.D. Martin (n188) at 481.

254 See: D.G. Baird, 'Loss Distribution, forum shopping, and bankruptcy' (n71) at 820–821. Schwartz poses the first two questions in his article. See: A. Schwartz (n231) at1816. Another question that is unresolved is the question how a judge should rule in the case of competing interests.

255 B.S. Schermer, 'Response to professor Gross: taking the interests of the community into account in bankruptcy – a modern-day tale of belling the cat', *Washington University Law Review* 72(3) (1994) at 1052 at 1050–1051; and C.W. Frost (n235) at 113–114.

256 *Idem* at 132. Korobkin has tried to show, by using the theories of John Rawls, that decisionmaking in bankruptcy does not have to be uncoordinated when values are included in the decision making process. See: D.R. Korobkin 'Value and rationality in bankruptcy decisionmaking' (n188). However, he develops his theory in a situation of individual and personal decisionmaking and then transposes this into a bankruptcy situation.

257 C.W. Frost (n235) at 123; and B.S. Schermer, (n255). Also, it will be more difficult to shut the corporation down on a later point.

other words, a risk of unpredictable and inconsistent decisions arises when values are introduced.[258]

Finally, it should be noted that judicial decision making is very costly.[259] The more a judge is needed in bankruptcy, the more costs are imposed on society. These costs have a negative effect on societal wealth and should be included in answering the question whether including non-economic values are a goal of bankruptcy law.

Why not simply eliminate as many perverse incentives as possible? All theories discussed in this article acknowledge that the economic value is the most decisive value in a corporation;[260] an objective and measurable standard. Why should a corporation suddenly, just because it has gone bankrupt, become 'huggable' and start protecting all kinds of interests it was not interested in before bankruptcy?[261] Using economic value as the relevant standard obviates all these problems eliminates the need for a judge to make decisions, the consequences of which are hard, if not impossible, to oversee.

5 Team production theory as an explanation for bankruptcy law

After the preceding paragraphs it appears that the creditors' bargain theory provides the most efficient theory for bankruptcy law. However, another theory should also be taken into account in determining what the normative assessment framework for bankruptcy law should be. This is the 'team production theory'. The (general) team production theory is the outcome of a debate in the literature trying to solve the problem of team effort and the division of the result of this effort.[262] LoPucki, in turn, has used the general team production theory to offer an explanation for the existence of bankruptcy law.[263] This general team production theory, the team production theory as applied by LoPucki to bankruptcy, and the question whether this theory presents a better explanation for the existence of

258 Y.G Ren, *A comparative study of the corporate bankruptcy reorganization law of the U.S. and China*, (Den Haag: Eleven International Publishing, 2011) at 40. Furthermore, the subjective values of the judge could also play a role.

259 See: R.V. Butler and S.M. Gilpatric (n243) at 286.

260 Y.G. Ren (n258) at 37.

261 Once again, the creditors' bargain theory does not state that community interests under no circumstances should be taken into account. It merely states that they should only be taken into account in bankruptcy if they are taken into account outside of bankruptcy and are embodied in a property right.

262 See: A.A. Alchian and H. Demsetz, 'Production, information costs, and economic organization', *The American Economic Review* 62(5) (1972) 777–795; M.M. Blair and L.A. Stout, 'A team production theory of corporate law', *Virginia Law Review* 85(2) (1999) 247–328; and M.M. Blair and L.A. Stout, 'Director accountability and the mediating role of the corporate board', *Washington University Law Review* 79(2) (2001) 403–447.

263 L.M. LoPucki (n120).

bankruptcy than the creditors' bargain theory will be examined below from the point of view of efficiency.

5.1 The team production problem

Before elaborating on LoPucki's proposal, some attention has to be given to the team production theory he uses. The team production theory finds its roots in the work of Alchian and Demsetz.[264] It is the precursor of the agency theory and can be described as aiming to form an elaboration on the work of Coase on the theory of the firm.[265]

A central element in the theory of Alchian and Demsetz is 'team production'. Team production is the production in which: "*1) several types of resources are used and 2) the product is not a sum of separable outputs of each cooperating resource. (…) [And] 3) not all resources used in team production belong to one person.*"[266]

The advantage of team production is that it can provide for extra output over individual production.[267] For this reason firms will be formed. The difficulty, however, is that the output of a certain team member cannot be determined by solely looking at the output or the input. Since the reason for team production is the advantage of synergy, the input cannot be described as the sum of the separable outputs of the team members.[268] Because it is difficult to determine each individual team member's contribution, it will also be difficult to determine how the result of the production should be divided among team members.[269] The difficulty to determine the input of each of the individual team members means that individual team members have an incentive to engage in either shirking or rent seeking.[270] To 'solve' this problem, Alchian and Demsetz present their theory of team production.

264 A.A. Alchian and H. Demsetz (n262).
265 See: R.H. Coase, 'The nature of the firm', *Economica* 4(15) (1937) 386–405.
266 A.A. Alchian and H. Demsetz (n262) at 779.
267 *Ibid.* Alchian and Demsetz admit that team production will not be used in every case. The cases in which it will be used are those in which the output of team production is larger than the sum of the individual production with regard to some end product.
268 *Ibid.*
269 M.M. Blair and L.A. Stout, 'A team production theory of corporate law' (n262) at 249.
270 *Ibid.* Rent seeking refers to the situation that individuals try to attain the biggest part of a fixed amount of wealth. The actions undertaken by individuals are costly and result in diminishing the amount of wealth available.

5.2 Team production theory

The solution proposed by Alchian and Demsetz is to appoint a specialized monitor that checks the input performance of the team members.[271] In the theory of Alchian and Demsetz the shareholders are the monitor, although they admit that the shareholders will probably delegate this task to the managers.[272] The task of the monitor is to determine the reward the individual team members should receive. To this end the monitor must have the power to discipline team members on an individual basis.[273]

Monitoring, however, is costly. When the costs of monitoring exceed the synergy results realized by team production, the justification for forming a firm is no longer present.[274] One should therefore try to keep the costs of monitoring as low as possible. Solely appointing a monitor would not help towards this end, since the monitor itself will have an incentive to shirk.[275]

To solve this problem Alchian and Demsetz propose that the monitor – the shareholders – receive the residual value that is left after all the team members are rewarded in accordance with their individual input.[276] The monitor is rewarded by receiving the reduction in shirking he brings about.[277] This 'residual claim' of the shareholders to all the profits left after the contractual obligations by the corporation are met, is also the reason, so it is argued, that a corporation exists for the sole benefit of creating wealth for them.[278] In the solution proposed by Alchian and Demsetz the monitor will have an incentive to monitor efficiently, while team members do not engage in rent seeking, because of their fixed reward.[279]

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271 A.A. Alchian and H. Demsetz (n262) at 781.

272 *Idem* at 788. Although the shareholders and the other team members are all members of the team, there is still an agency relationship.

273 *Idem* at 782.

274 See the example described by Alchian and Demsetz, *idem* at780–781.

275 *Idem* at 782. "*Who will monitor the monitor?*"

276 I.e. receive a fixed wage.

277 *Idem* at 782.

278 M.M. Blair and L.A. Stout, 'A team production theory of corporate law' (n262) at 264.

279 The team members could also receive an input related reward, in which case the monitoring would prevent shirking.

5.3 Team production theory: maximizing stakeholder value and the mediating hierarch

Blair and Stout have also written extensively about team production.[280] For the most part they agree with the analysis given by Alchian and Demsetz, but their work differs in two important aspects: the question for whom a corporation should create value and the question how people should be monitored efficiently.

With regard to the question whose interests should be furthered by a corporation, Blair and Stout state that it is stakeholder value – and not shareholder value – that should be maximized.[281] The reason for this is that Blair and Stout contend that the members of the team are not merely 'interchangeable units', but provide the firm with certain firm-specific investments.[282] Because of these firm-specific investments the value surplus of team production can actually be realized.[283] This means that team members cannot simply be given a fixed reward that is laid down in a contract, but expect a part of the residual of the surplus realized by team production. Failure to provide for this reward would lead to suboptimal effort by the team members and destruction of (potential) value.[284]

Members of a team, however, will be reluctant to make firm-specific investments if it is another member of the team who has control over the division of the surplus. The reason for this is that making firm-specific investments means a team member cannot walk away from the team without losing a certain amount of value.[285] If another team member has control over the division of the surplus (and can allocate all the value surplus of the team

280 *Ibid*,; and M.M. Blair and L.A. Stout, 'Director accountability and the mediating role of the corporate board' (n262).

281 M.M. Blair and L.A. Stout, 'A team production theory of corporate law' (n262) at 251, 266–267 and 288–289; and M.M. Blair and L.A. Stout, 'Director accountability and the mediating role of the corporate board' (n262) at 212–214. With stakeholders I refer to "any group or individual who can affect or is affected by the achievement of an organization's purpose." This definition is from Freeman. See: R.E. Freeman, *Strategic management: a stakeholder approach*, Pitman Series in Business and Public Policy, (London: HarperCollins, 1984) at 53. According to Freeman this means that some organization should count a terrorist group as a stakeholder. The definition given above includes shareholders. I will call these stakeholders 'shareholder-stakeholder'.

282 M.M. Blair and L.A. Stout, 'A team production theory of corporate law' (n262) at 266–267. For the reasoning of Alchian and Demsetz about team members as 'interchangeable units' see: A.A. Alchian and H. Demsetz (n262) at 777.

283 M.M. Blair and L.A. Stout 'A team production theory of corporate law' (n262) at 270.

284 *Idem* at 282. M.M. Blair and L.A. Stout, 'Director accountability and the mediating role of the corporate board' (n262) at 418. Examples of the way in which this surplus can be doled out are memberships of a gym or corporate jets. The 'rights' to these rewards are non-enforceable and non-legal. The reason for this is that team members are unable to contract directly for a share in the value. Team members, however, would consider these rewards an entitlement. See also: L.M. LoPucki (n120) at 749.

285 I.e. the value of the firm-specific investments, which cannot be realized elsewhere. See: M.M. Blair and L.A. Stout, 'A team production theory of corporate law' (n262) at 272.

production to himself) the first team member will therefore have reason to fear that he will not receive any amount of the value surplus, despite the firm-specific investments he has made.[286]

Blair and Stout solve this monitoring problem by introducing the 'mediating hierarch'.[287] The concept of the mediating hierarch holds that all team members give up their rights to control division of the value surplus to an independent outsider, who makes no firm-specific investments. In return for his monitoring efforts the mediating hierarch will receive a fixed reward.[288] This way the mediating hierarch can divide the value surplus created by all team members who make firm specific investments – the stakeholders – between them in an efficient manner. Because none of the team members can control the division of the value surplus, team members will not have an incentive not to make a firm-specific investment and the value of synergy created by team production can be realized.

Blair and Stout contend that when a corporation is formed, team members hand over their control rights over the division of the value surplus.[289] These rights will then be executed by the board of directors, as a mediating hierarch which has the power to allocate output and fire team members. That the board of directors has the power to allocate output does not mean that it will maximize the output. If the directors on the board are to receive a fixed reward, why would the board not shirk itself? Blair and Stout recognise this problem.[290] They state that there are at least three reasons why a board of directors has an incentive to maximize team output.[291] First of all, Blair and Stout contend that directors will want to keep their job and thus have an incentive to show a certain degree of result of their efforts. Otherwise team members will leave or the board will be replaced.[292] Secondly, corporate law limits directors in exercising their tasks in a form that results in too much self-interested behavior.[293] Finally, Blair and Stout have a great amount in faith in the concept of cultural norms of fairness and trust. They state that, while acknowledging that

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286 *Ibid.*

287 *Idem* at 274. The concept of the 'mediating hierarch' was developed by R.J. Raghuram and L. Zingales. See: G.R. Raghuram and Luigi Zingales, 'Power in a theory of the firm', *Quarterly Journal of Economics* 113(2) (1998) at 387–432.

288 M.M. Blair and L.A. Stout, 'A team production theory of corporate law' (n262) at 274.

289 *Idem* at 277.

290 *Idem* at 315.

291 *Idem* at 315–316.

292 Another reason this incentive exists, according to Blair and Stout, is that directors would like to be perceived as 'good', so they can serve on other boards. See *Idem* at 315.

293 The team production theory does not require directors to be altruistic. However, it does contend that certain constraints on the behavior of directors can be necessary. *Idem* at 283. Blair and Stout use examples from American corporate law to explain this constraint on behavior of directors. However, as far as I know, all developed countries impose some form of fiduciary duty on directors.

this clashes with the concept of the rational self-interested individual, team members should simply trust directors to engage in their best efforts to maximize team output.[294]

5.4 The team production theory in bankruptcy

According to LoPucki, if the team production theory – as developed by Blair and Stout – is applied to bankruptcy it is normatively as well as descriptively superior to the creditors' bargain in explaining bankruptcy law.[295] His theory, however, is limited to a situation in which a corporation reorganizes. The reason for this is that the team (and the team production agreement that is formed between the team members) ceases to exist when a corporation is liquidated.

The team production theory as developed by LoPucki is a contractarian theory. In it bankruptcy law is not a hypothetical bargain, but an actual contract as agreed on by the team members. This team production agreement, which – as agreed on prior to the bankruptcy of the corporation – holds that should a corporation go bankrupt the legal rights of certain team members (e.g. creditors and shareholders) are to be subordinated to the 'rights' of other team members (e.g. society and employees).[296] Accordingly, bankruptcy law is applicable.[297]

The reason why the team members have agreed on the fact that the team production stays in force during bankruptcy is twofold. First of all, if the team production ended in bankruptcy, the going-concern value of the corporation would be lost. The reason for this is that the performance of production in a team provides for a value surplus. Honoring the team production as agreed on by the team members prevents this loss.[298] The second reason is that, by means of the team production agreement, team members have mandated the board of directors to honor the original team production agreement in bankruptcy. This way, directors can choose to give priority to the non-enforceable entitlements of team

294 *Idem* at 316. See extensively about trust and corporate law: M.M. Blair and L.A. Stout, 'Trust, trustworthiness, and the behavorial foundations of corporate law', *University of Pennsylvania Law Review* 149(6) (2001) 1735–1810.

295 L.M. LoPucki (n120) at 765. It should be noted with regard to the descriptive superiority that LoPucki only writes about American bankruptcy law.

296 *Idem* at 743. I write 'rights' because they are non-enforceable, non-legal agreements, but nevertheless regarded as entitlements by the team members. See: *Idem* at 751.

297 *Idem at* 754. Certain team members, i.e. creditors, can 'opt out' of bankruptcy by using certain financial instruments. E.g. sale-and-lease-back.

298 *Idem* at 754–755.

members over the legal claims of creditors and shareholders.[299] As a result, according to LoPucki, the value of the firm is *ex ante* maximized.[300]

I have written above that the team members have mandated the board of directors to execute the team production agreement in bankruptcy as a 'mediating hierarch'.[301] This is, according to LoPucki, the explanation for the figure of the 'debtor in possession'.[302] With respect to US bankruptcy law this would qualify team production theory as descriptively correct. However, team production does not offer an adequate description of systems of law, such as Dutch law, that do not provide for the debtor in possession, but only provide for the figure of the trustee, who replaces the board of directors as the possessor of power after a corporation is declared bankrupt.[303] In this way team production theory has limited descriptive power.

With regard to normative superiority LoPucki contends that the team production prevails over the creditors' bargain in two aspects. Firstly, the assets should be deployed in a manner consistent with the original team production agreement by using assets to create value for all stakeholders in the corporation. Since this agreement was deemed efficient, or so LoPucki following Blair and Stout argues, the deployment of resources is also efficient.[304] Secondly, unlike the team production theory, the creditors' bargain theory would let many of the social costs be borne by non-creditors. The team production theory, on the other hand, would minimize the externalization of costs.[305]

6 Why the team production theory is inadequate

This paragraph provides for a further analysis of the team production theory. The conclusion of this analysis is that the team production theory as proposed by Blair and Stout and applied to bankruptcy by LoPucki is deemed inadequate. It is questionable whether it is normatively right to promote stakeholder value. Furthermore, the workability of the mediating hierarch model in practice can be doubted. The arguments for using team production theory in relation to bankruptcy are not convincing and do not offer a normative

299 *Idem* at 763.
300 *Idem* at 758 and 761. That is to say, the value of the firm is maximized, while the interests of all team members are accounted for.
301 *Idem* at 749.
302 11 U.S.C. § 1107.
303 Section 14 DBC.
304 L.M. LoPucki (n120) at 769.
305 L.M. LoPucki (n120) at 770.

explanation. For these reasons the team production theory does not provide the conditions for efficient bankruptcy law.

6.1 The primacy of shareholder value maximization

Blair and Stout argue that it is stakeholder value that should have primacy when running a corporation.[306] In this aspect their theory differs from Alchian and Demsetz who state that not stakeholder, but shareholder value should have primacy. LoPucki rather follows the opinion of Blair and Stout than that of Alchian and Demsetz, being of the opinion that a corporation should maximize value for all the constituencies with regard to a corporation rather than just one.[307]

That a corporation should – at least in part – create value for shareholders is not in dispute. Different authors, however, differ whether value should be created *solely* for the shareholders ('shareholder primacy') or *also* for shareholders ('stakeholder primacy').[308]

The argument for rewarding shareholders is that the shareholders are the monitor in a corporation, whose task it is to minimize inefficiencies that stem from agency problems. In return they receive compensation from the residual that is created by the team production. This way the deployment of the assets is arranged in a way that maximizes the value of the assets.[309]

An argument that is often used when disputing the argument set out above is that shareholders are not the residual claimant, because positive law does not give shareholders the possibility to decide whether certain expenses will be made, which diminish the available

306 M.M. Blair and L.A. Stout, 'A team production theory of corporate law' (n262) at 251, 266–267; and 288–289 and M.M. Blair and L.A. Stout, 'Director accountability and the mediating role of the corporate board' (n262) at 212–214.

307 L.M. LoPucki (n120) at 750–751. This one constituency in bankruptcy is the creditors.

308 The US have a primarily shareholder oriented model. See: Supreme Court of Delaware, 722 A.2d 5 (1998) *Malone* v. *Brincat*. The Netherlands have a stakeholder model. See for example: Supreme Court 13 July 2007, *JOR* 2007, 178 (*ABN Amro*). Two important publications that advance shareholder primacy are A.A. Berle and G.C. Means, *The modern corporation and private property*, (New York: MacMillan 1932) and M. Friedman, 'The social responsibility of business is to increase its profits', *The New York Times Magazine* September 13–33 at 122–126. With regard to stakeholder primacy the publication of Freeman 1984 has had a great impact.

309 Shareholder primacy can mean that the interests of stakeholders are taken into account. However, these interests will only be taken into account if this is beneficial for shareholder value. See also: A. J. Meese, 'The team production theory of corporate law: a critical assessment', *William and Mary Law Review* 43 (2002) 1629–1702 at 1635–1636.

residual, or that the residual is kept intact and paid out as dividend.[310] This, however, is not a convincing argument for not seeing shareholders as the residual claimants of a corporation.

The fact that in most jurisdictions shareholders cannot decide whether a dividend is paid out or not is not a convincing point for the argument that shareholders are not the residual claimants. It is not relevant whether a corporation pays out dividend on a yearly basis or not. The relevant fact is that, seen over the entire life span of the corporation, the shareholders get the residual.

Another argument often made against shareholder primacy is that in most jurisdictions shareholders do not have the necessary tools to oust directors in a simple way, which would signify that shareholders cannot be seen as principals. Whether this argument holds is questionable. Shareholders do have tools to correct directors when they do not perform their task as agent in accordance with the wishes of the shareholders as principals. They can speak and vote at shareholder meetings, sometimes they can adjust the compensation of directors and in the worst case they can start a proxy battle.

The fact that shareholders cannot simply oust a director whenever they want should be seen in light of the fact that shareholders are rational actors. If a certain group of shareholders on a certain point in time could simply fire directors, just because the decisions these directors made do not provide a certain group of shareholders with enough profit, a common pool problem would ensue. Shareholders would have no regard for shareholders and the corporation in the future and the corporation would probably quickly go under in a barrage of battles between shareholders. The reason for this is that directors would be forced to take only the interest of the – quite random – group of current shareholders into account. This means that when the group of shareholders regularly changes, the policy of the corporation probably would change often. This in turn leads to contradictory policies and (probably) reduced profits.[311]

The argument made by Blair and Stout that other stakeholders than the shareholder-stakeholder should also receive a part of the residual is based on their assertion that not only shareholders make a firm specific investment (the monitoring), but that all stakeholders do this. These non-shareholder-stakeholders expect a reward for this firm specific investment that, if not given to them, creates a situation in which no incentive would exist to

310 L.A. Stout, 'Bad and not-so-bad arguments for shareholder primacy', *Southern California Law Review* 75 (2002) 1189–1210 at 1193.

311 For example, if hedge funds bought a large amount of shares from pension funds, directors would see themselves faced with a need to provide for profits on the short term rather than on the long term.

generate a value surplus.[312] Blair and Stout, however, fail to ask themselves what – in the end – realizes the highest value: rewarding firm specific investments of stakeholders or not.[313] They do not weigh benefits against costs.[314] While a conclusive answer to the question asked above can only be realized by performing an enormous amount of empirical research, the theoretical arguments point toward the conclusion that the costs of rewarding stakeholder firm specific investments are greater than the benefits.

The costs of rewarding stakeholders stem mainly from the fact that directors have no guideline as to how to distribute the surplus.[315] How much should the stakeholders get? Which stakeholders deserve a part of the surplus and which do not? Maximizing the value for all stakeholders and shareholders is practically impossible.[316] This means that directors will have a hard time determining the corporation's policy, because they need to figure out which interests they will want to advance and which ones they do not.[317] It also leads, by lack of a 'measuring stick', to a situation in which directors can advance their own interests without punishment, while stakeholders and shareholders engage in costly rent seeking over what is left after the directors have served themselves.[318] Furthermore, there would be no incentive for the different constituencies to maximize the total value of the corporation for the team.[319] They would only be interested in enlarging their own share of the pie. Therefore no one would have a reason to monitor the directors with regard to the total outcome of the team production. This can lead to a diminished value of the corporation as a whole.

The aforementioned arguments are not only relevant in the discussion about the focus on shareholder value, but it can also be used to show that the mediating hierarch model as proposed by Blair and Stout will not work. For lack of a guideline the mediating hierarch

312 M.M. Blair and L.A. Stout, 'A team production theory of corporate law' (n262) at 266–267. Blair and Stout nowhere take into account the stakeholder who does not make firm-specific investments.

313 I leave aside the question of whether all stakeholders in a corporation have really made a firm-specific investment.

314 See: A.K. Sundaram A.C. Inkpen, 'The corporate objective revisited', *Organization Science* 15(3) (2004) 350–363 at 357.

315 *Idem*, at 354.

316 *Ibid*; and M.C. Jensen, 'Value maximization, stakeholder theory, and the corporate objective function, European Financial Management 7(3) (2001) 297–317 at 301.

317 D. Millon, 'New game plan pr business as usual? A critique of the team production model of corporate law', *Virginia Law Review* 86(5) (2000) at 1026. Mitchell and others developed a list of 27 different definitions of stakeholders. They conclude that it is 'somewhat overwhelming' to define relevant stakeholders. See: K. Mitchell, B.R. Agle and D.J. Wood, 'Toward a theory of stakeholder identification and influence: defining the principle of who and what really counts', *The Academy Management Review* 22(4) (1997) 853–886.

318 A.K. Sundaram and A.C. Inkpen (n314) at 357; A.J. Meese (n309) at 1635 and D. Millon (n317) at 1031. See also: L.A. Stout (n310) at 1200 with reference to M.J. Roe (n149).

319 A.J. Meese (n309) at 1667.

will be exposed to political power play by the different constituencies, who will all strive to get the largest possible portion of the surplus. This is especially relevant in relation to shareholders, who have certain statutory rights in relation to management.[320] Also, since there is no-one monitoring the monitor, there is a risk that the mediating hierarch will apportion himself a larger portion of the value surplus than he deserves. It is questionable whether 'corporate cultural norms of fairness and trust' will prevent this behaviour. The argument that directors will want to have a good reputation among other directors is, at least, not convincing. It is more probable that a director has a good reputation if he takes care of the other directors, which does not necessarily mean that he takes care of the whole team.[321] Especially in jurisdictions where directors effectively choose and appoint each other.

While the arguments mentioned above show that a focus on shareholder value will prevent the incurrence of the costs mentioned above, there are also other arguments for a focus on this particular constituency. For one thing, it is very easy to become a shareholder in a publicly traded corporation and share in the value surplus. However, it is quite hard for a shareholder to become a non-shareholder-stakeholder.[322] Furthermore, it is the shareholders who bear most of the risk of a corporation. Unlike stakeholders, shareholders do not have a fixed claim against the corporation and it is them who bear the costs of risk taking.[323] Because the shareholders are the only constituencies who are not risk averse, a focus on stakeholder value would give directors an incentive to behave in a risk aversion fashion as well. This can lead to missing important entrepreneurial investment opportunities and, as a consequence, a diminished value of the corporation.[324]

6.2 Team production theory does not work in bankruptcy

The criticism on team production theory in the preceding paragraph was directed at team production theory in general. Criticism, however, can also be directed against the team production theory of bankruptcy as proposed by LoPucki as a normative theory.

LoPucki gives two main arguments that supposedly support his claim of normative superiority over the creditors' bargain theory. The first is that the deployment of assets in bankruptcy based on team production theory is consistent with the original, efficient team production agreement by using assets to create value for all stakeholders in the corpora-

320 D. Millon (n317) at 1027.
321 See: A.J. Meese (n309) at 1666.
322 A.K. Sundaram and A.C. Inkpen (n314) at 354.
323 *Ibid.*
324 *Ibid.* But it is not necessary to discuss that special position here.

tion.[325] However, as set out in section 6.1 of this Part, it is questionable whether a stakeholder model is efficient for a corporation. Although in bankruptcy shareholders are replaced by creditors as the constituency for which value has to be created, the rent seeking argument and self-interested directors arguments are still valid.

Furthermore, the arguments used to show that the original team production agreement would be honored in bankruptcy can also be used to show that non-legally enforceable claims should not be honored in bankruptcy. LoPucki states that not honouring these claims would keep these 'claimants' from participating in a team production agreement in the future. The same, however, is true for creditors.[326] For the same reason the argument that creditors know that their entitlements will not be honored in bankruptcy and thus know that they can be disadvantaged should be rejected.

LoPucki's argument that the creditors' bargain theory merely states that substantive rights should be equal inside and outside bankruptcy and does not dictate what these substantive rights should be, is also applicable to the team production theory in bankruptcy. The team production agreement can take any form possible. This would probably lead to different results for corporations and different treatment for stakeholders, i.e. a normative underpinning of the contents of the actual team production agreement.

The second, and only remaining argument that supports LoPucki's claim of normative superiority of his theory over the creditors' bargain theory is that team production theory minimizes the externalization of costs.[327] This, in essence, is merely the rehabilitation view in other words. And, as argued in section 4 of this Part, the externalization of costs as proposed by the creditors' bargain theory weighed against its benefits is more efficient, and leads to a larger overall societal value, than redistribution in bankruptcy.

Part D: General conclusion

In the end the discussion about normative bankruptcy law boils down to the question whether there is a place for redistribution of wealth in bankruptcy. The creditors' bargain theory is very clear in that redistribution should be avoided as much as possible. Redistribution of wealth in bankruptcy induces forum shopping, which may result in costs that prevent value maximization of the pool of assets of the debtor. The arguments that the creditors' bargain lays out in this respect are quite convincing. The doctrine of absolute

325 L.M. LoPucki (n120) at 769.
326 G.D. Hoekstra (n44) at 45.
327 L.M. LoPucki (n120) at 770.

priority that I discuss provides a good illustration of the implications of following this theory.

The risk sharing theory, the value view and team production theory all provide for the incorporation of redistributive policies in bankruptcy in a different way. However, the arguments that the proponents of these theories advance are not convincing and can be refuted. Furthermore, the proponents of redistribution of wealth have not yet shown to be able to provide for a clear frame of reference that sets outs when redistribution is justified.

For these reasons the creditors' bargain theory should be seen as the theory that provides for efficient bankruptcy law. As shown, this model has not yet been fully incorporated in US or Dutch bankruptcy law. With respect to the Netherlands, the proposed reform of the Dutch Bankruptcy Code provides a good opportunity for the Dutch Minister of Justice to adopt the creditors' bargain theory as guiding model in drafting its proposals. This would ensure efficiency of Dutch bankruptcy law.

3 Shaping bankruptcy. What form should it take?*

Introduction

The structure of bankruptcy law regarding reorganizations in the United States and the Netherlands has been roughly the same over the past decades. In both countries a bankruptcy is governed by the rules laid down in a specific bankruptcy statute and a judge is involved in overseeing the procedure.[1] Especially in the Netherlands there has been relatively little discussion about this structure.[2] The structure of bankruptcy law, however, should not be taken as a given. This Article calls the current structure of bankruptcy law into question and aims to provide an answer to the question what form bankruptcy law, in particular the law with regard to reorganizations, has to take in order for it to be efficient.[3]

This Article takes Chapter 11 of the U.S. Bankruptcy Code and the Dutch Bankruptcy Code (*Faillissementswet*) as a starting point. With this frame of reference three different kinds of alternatives for the administrative reorganization procedure that have been advanced in the past are discussed and assessed on their merits. These kind of alternatives are: i) ex ante capital structures, ii) mandatory auctions and iii) options-theory.[4] By comparing the different alternatives for a reorganization, benefits and costs can be weighed. In the end some observations will be made with regard to existing bankruptcy law.

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1 This kind of structure will be referred to as an administrative reorganization procedure.

2 The Dutch Minister of Safety and Justice has launched the legislative program 'Recalibration of Bankruptcy Law' in 2012, which is aimed at modernizing Dutch bankruptcy law. However, the program does not aim to change the structure of reorganizational proceedings. See for more information about this legislative program: Jochem M. Hummelen, A response to the financial crisis: recalibration of bankruptcy law, *11 Int. Corp. Resc.* 5 (2014). At the date of publication of this Article there were no bills submitting to Parliament regarding reorganizational proceedings.

3 This Article is limited to efficiency of bankruptcy law with regard to corporate debtors. In this respect efficiency is defined as economic value maximization. In this Article no attention will be given to the question whether economic value maximization should be the only goal of bankruptcy law. See for an overview of this discussion: Douglas G. Baird, 'Bankruptcy's uncontested axioms', 108 *Yale L.J.*, 573 (1998). All the proposals that are discussed in this Article and which aim to provide a more efficient alternative for bankruptcy law use this same measuring stick.

4 The reason that specifically these alternatives are being discussed, is that they are the most complete alternatives for the administrative reorganization procedure and have figured prominently in the scholarly debate over the last two decades.

The outline of this Article is as follows. Part A provides for a sketch of current American and Dutch bankruptcy law. In Part B the administrative reorganization procedure in general and alternatives for this procedure are discussed. Special attention will be given to the question whether the different alternatives solve contended problems of the administrative reorganization procedure and whether the proposals do not introduce other inefficiencies. In Part C the contended inefficiencies of critics are weighed and observations are made. Part D contains a general conclusion.

Part A: Bankruptcy procedures in the U.S. and the Netherlands

1 Bankruptcy procedure in the U.S.

The current U.S. Bankruptcy Code entered into force in 1978.[5] It is laid down in Title 11 of the U.S. Code.[6] For corporate debtors the most important parts of the Bankruptcy Code are Chapter 7 and Chapter 11.

Chapter 7 provides for a court supervised liquidation of a debtor. A Chapter 7 case begins with the filing of a petition with the bankruptcy court.[7] This filing triggers an 'automatic stay', that stays collection efforts against a debtor.[8] Furthermore, after filing a petition the U.S. Trustee appoints a trustee to administer the case and liquidate the assets of a debtor.[9] These assets can be sold either piecemeal or jointly, also referred to as going-concern sale. After the sale of the assets of a debtor the proceeds are distributed among the creditors and the bankruptcy ends.[10]

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5 Its last major modification took place in 2005 with the enactment of the Bankruptcy Abuse Prevention and Consumer Protection Act (BACPCA). However, in December of 2014 a commission of the American Bankruptcy Institute is expected to publish its report on the reform of Chapter 11. At the time this Article was written, this report was not yet available. See for more information: http://commission.abi.org/.

6 The current Bankruptcy Code was preceded by the Bankruptcy Act of 1898. This Act was also called the 'Nelson Act' and was the first modern federal bankruptcy law of the United States. It was significantly amended in 1938 by the Chandler Act.

7 This petition may be either voluntary or involuntary. See 11 U.S.C. § 301(a) and 303(b).

8 11 U.S.C § 362. See 11 U.S.C. § 362(b) for exception on the automatic stay.

9 11 U.S.C.§ 701 and 704. In Alabama and North Carolina the trustee is appointed by the bankruptcy court. The U.S. Trustee is part of the Department of Justice of the United States. If there are no assets or all assets of the debtor are exempted from liquidation a 'no asset' report will be filed with the court and no distribution to the creditor will take place. See: Federal Rule of Bankruptcy Procedure 5009.

10 11 U.S.C. § 726. Section 726 acknowledges six classes of claims. Each class of claims must be paid in full before a lower class can receive anything.

A debtor can also file for a Chapter 11 bankruptcy.[11] Chapter 11 of the Bankruptcy Code provides for the reorganization of a debtor.[12] Filing of a Chapter 11 petition also triggers an automatic stay.[13] Generally in Chapter 11 cases no trustee is appointed, but the debtor himself stays in control of the operation of the business as 'debtor-in-possession'.[14] During the bankruptcy the debtor-in-possession may use, sell or lease property of the estate and obtain financing in the ordinary course of business.[15] The U.S. Trustee monitors the debtor-in-possession and the operating of its business. Furthermore, the U.S. Trustee appoints the members of the creditor committee and organizes a creditor meeting.[16]

During the first 120 days after a bankruptcy petition is filed a debtor has the exclusive right to propose a reorganization plan.[17] This 'exclusivity period' may be extended up to a maximum of 18 months.[18] After the exclusivity period has expired any party in interest may propose a plan.[19] The Bankruptcy Code states that the proposed plan has to designate classes of claims and interests for treatment.[20] The proponent of a plan is free in the classification of the creditors in the different classes, but within a class each claimant has to be treated equal under the plan.[21]

The proponent of a reorganization plan must not only provide the court with the plan itself, but also with a disclosure statement. This disclosure statement has to provide creditors with 'adequate information' with regard to the debtor, so creditors can make an informed decision on the plan.[22]

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11 This petition may also be either voluntary or involuntary. A Chapter 11 case may be qualified as a 'small business case' in the case of a small business debtor (11 U.S.C. § 101(51C)) or a 'single asset real estate' case if the debtor conducts no other substantial business than the operation of a single real estate property or project (11 U.S.C. § 101(51B). In this Article no further attention will be devoted to the distinction between these cases.

12 I.e. the restructuring of the liabilities of a debtor. A liquidating plan is also permissible under Chapter 11.

13 11 U.S.C. § 362.

14 11 U.S.C. § 1107(a). The bankruptcy court can appoint a trustee. It can also appoint an examiner. The role of the examiner is usually investigatory, but the court may grant the examiner broader powers. 11 U.S.C. § 1106.

15 11 U.S.C. § 363(c) and 364. Prior approval by a court is unnecessary, unless ordered otherwise.

16 11 U.S.C. § 341 and 1102. The creditor committee ordinarily consists of the unsecured creditors who hold the seven largest claims.

17 11 U.S.C. § 1121(b). 11 U.S.C. § 1123(a) and (b) list the mandatory and discretionary provisions of a reorganization plan.

18 11 U.S.C. § 1121(d). The exclusivity period may also be curtailed by the court.

19 If a trustee is appointed he may file a plan. The U.S. Trustee may not file a plan (11 U.S.C. § 307).

20 11 U.S.C. § 1123(a)(1).

21 There are some limits to the classification of creditors. According to the Fifth Circuit "*[a] fair reading of [11 U.S.C. § 1122] suggests that ordinarily 'substantially similar claims', those which share common priority and rights against the debtor's estate should be placed in the same class.*" See: *Matter of Greystone III Joint Venture*, 995 F.2d 1274 (5th Cir. 1991), on reh'g, (Feb. 27, 1992).

22 11 U.S.C. § 1125.

After the disclosure statement is approved by the court a vote takes place on the proposed reorganization plan or plans. If a creditor is not impaired by the reorganization plan he is deemed to have approved a plan and his consent is unnecessary.[23] Other creditors have the right to vote on the plan. Starting point for acceptance of a plan is that all classes have to consent to a plan in order for it to be eligible for confirmation.[24]

If not all impaired classes have voted in favor of a proposed reorganization plan the court can still confirm the plan on the basis of a 'cram down'. A cram down is possible if at least one class of claimants votes in favor of the reorganization plan and the proposed plan does not discriminate unfairly and is fair and equitable with regard to the opposing classes.[25]

No unfair discrimination means that different groups with the same priority cannot be treated unequal, unless there is a valid reason.[26] In order for a plan to be 'fair and equitable' it has to meet the requirement of 11 U.S.C.A. §1129(b). With regard to secured creditors this section holds that a plan may be confirmed if a fully secured creditor opposing the plan retains his lien on the collateral to the extent of the value of the collateral and the creditor is paid, with interest, over the life of the plan, the amount of the allowed secured claim with interest.[27] With regard to unsecured creditors and shareholders the section provides that a plan may only be confirmed if a shareholder receives nothing or retains an interest until the unsecured creditors are paid in full.[28] This last rule is the 'absolute priority rule' and ensures that shareholders do not receive payment before creditors are paid in full.

After all requirements are met the bankruptcy judge will confirm the reorganization plan and all creditors and the debtor are bound to it.[29] The confirmation of the plan also provides for a general discharge of all debts that arose before the date of confirmation.[30] This way the bankruptcy will come to an end.

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23 11 U.S.C. 1126(f). A class that is impaired by the plan, but does not receive anything is deemed to have voted against the plan. 11 U.S.C. § 1126(g).

24 11 U.S.C. § 1129(a)(8). A class is deemed to have consented to the proposed plan if an amount of creditors representing two thirds of the amount impaired and half of the number of claims within the class has voted in favor of the proposed plan. 11 U.S.C. § 1126(c). In case of equity it is sufficient if the consenting shareholders represent two thirds of the amount of impaired equity capital. 11 U.S.C.§ 1126(g).

25 11 U.S.C. § 1129(a)(10) and 1129(b)(1). The requirements of 11 U.S.C. § 1129(a) should be met whether all classes have accepted the plan or not.

26 11 U.S.C. § 1129(b)(1).

27 11 U.S.C. § 1129(b)(2)(A)(i)(I). 11 U.S.C. § 1129(b)(2)(A)(ii) states that a secured creditor has a right to an asset sale. A plan can also be confirmed if the secured creditor receives the 'indubitable equivalent' of his claim. 11 U.S.C. § 1129(b)(2)(A)(iii).

28 11 U.S.C. § 1129(b)(2)(B)(ii).

29 11 U.S.C. § 1141(a).

30 11 U.S.C. § 1141(d)(1).

2 Bankruptcy procedure in the Netherlands

The proposals discussed in this Article are all geared towards American bankruptcy law. This, however, is not the only existing system of bankruptcy law in the world. One could, for example, also look at Dutch bankruptcy law. The Dutch Bankruptcy Code (DBC) entered into force in 1896 and replaced the provisions regarding bankruptcy in the Code of Commerce of 1838 (*Wetboek van Koophandel*). Under the Dutch Bankruptcy Code two insolvency procedures are available for corporate debtors: bankruptcy (*faillissement*) or suspension of payments (*surseance van betaling*).[31]

The bankruptcy of a debtor in the Netherlands starts with the filing of a petition with the court.[32] After the debtor has been declared bankrupt by the court, a trustee (*curator*) will be appointed.[33] The debtor-in-possession does not exist under Dutch bankruptcy law, but the trustee can keep management in place.[34] The trustee is supervised by a supervisory judge (*rechter-commissaris)* and will need approval from this judicial officer for most acts of administration.[35] Usually no creditor committee is appointed, although the law provides for the possibility of installing one.[36]

Dutch bankruptcy law provides for an automatic stay, although secured creditors can still enforce their claims by means of their right of summary execution.[37] This last possibility of individual debt collection can be prevented if the supervisory judge proclaims a cooling-off period (*afkoelingsperiode*).[38] This cooling-off period has a duration of two months and can be extended once by two more months.

The starting point of a Dutch bankruptcy procedure is liquidation. This means that – like a Chapter 7 procedure – the trustee will sell all assets of the debtor, either piecemeal or going-concern, and the proceeds are distributed among the creditors according to their

31 Bankruptcy is laid down in Sections 1–213kk DBC; suspension of payments in Sections 214–283 DBC. Suspension of payments is meant as a temporary solution for an acute liquidity problem. It provides, as the name implies, for a suspension of payments. This procedure will not be further discussed in this Article, as it is not used very often. However, some judgments that are discussed hereinafter have been pronounced during a suspension of payments procedure. Since the procedure for a reorganization plan under a suspension of payments procedure is (almost) equal to the procedure for a reorganization plan in a bankruptcy these judgments can also be applied in a bankruptcy situation.

32 This petition can be filed either voluntarily or involuntarily. Section 1 DBC.

33 Section 14 DBC.

34 Management, however, will have to follow instructions from the trustee. Furthermore, this construction is seldom used in the Netherlands.

35 Section 64.

36 Section 74 and 75 DBC. A creditor committee can consist of a maximum of three members.

37 Section 33; 57 DBC and 3:248 and 3:268 DCC.

38 Section 63a DBC.

relative priority. Unlike in the United States Dutch bankruptcy law has no separate reorganization procedure for which a debtor can file. It is, however, possible for the debtor to propose a reorganization plan (*faillissementsakkoord*) to the creditors during the bankruptcy procedure.[39] This possibility is reserved exclusively for the debtor. Proposal of a reorganization plan by the trustee or a creditor is not possible. Furthermore, shareholders and creditors with a right of preference are not bound to a reorganization plan.[40] As such Dutch law does not contain an explicit absolute priority rule.

A proposed reorganization plan is accepted if more than half of the acknowledged and conditionally acknowledged ordinary creditors that are present at the meeting of creditors, representing at least half of the total amount of ordinary claims, approve.[41] Creditors do not vote in classes. If the previously mentioned requirements are not met the supervisory judge can still cram down the proposed plan if three fourths of the acknowledged and conditionally acknowledged creditors present at the meeting of creditors have approved of the proposed plan and the rejection of the plan is the consequence of unreasonable voting behavior.[42]

After a debtor has proposed a reorganization plan there is no requirement to file a disclosure statement. The trustee, however, – and the creditor committee if one is appointed – has an obligation to provide the creditors with written advice with regard to the proposed reorganization plan.[43] After this advice has been given creditors vote on the proposed plan in a meeting of creditors. Since creditors with a right of preference and shareholders, unlike in the United States, are not bound to the reorganization plan, they are not eligible to vote on the reorganization plan.[44]

If the proposed plan is approved by the creditors or crammed down, the court will hold a confirmation meeting (*homologatiezitting*). The Dutch Bankruptcy Code contains four provisions that provide for an imperative ground for refusal of confirmation and one discretionary ground.[45] One imperative provision states that the assets of the estate may not substantially exceed the amount of assets included in the reorganization plan.[46] Another

39 Section 138 DBC.
40 Section 157 DBC.
41 Section 145 DBC.
42 Section 146 DBC.
43 Section 140 DBC.
44 Section 143 and 157 DBC. I note that shareholders are often not eligible to vote on a proposed plan in the U.S. either. However, this is because they do not receive or retain any interest in the debtor under the plan and are, thus, presumed to reject it. See: 11 U.S.C.1126(g).
45 Section 153 DBC.
46 Section 153(2)(1) DBC.

provision states that confirmation has to be refused if the execution of the reorganization plan is not safeguarded enough.[47]

After the plan is confirmed the reorganization plan is binding on all creditors with a right to vote, even if creditors have not voted or have not submitted their claims for verification. The debtor is discharged of all debts affected by the reorganization plan and the bankruptcy comes to an end.

Part B: Structure of reorganization procedures

1 The administrative reorganization procedure

1.1 The administrative reorganization procedures

In part A an overview of the American Chapter 11 procedure and the Dutch *faillissementsakkoord* were given. Both procedures are an example of an administrative reorganization procedure. In such a procedure claimants and the debtor bargain in a way that is structured by the law. This kind of bargaining involves a 'hypothetical sale' of the debtor. This means that the liabilities of the debtor are sold to the existing claimants for a price lower than the amount of the outstanding claims. This way the debtor is reorganized.[48] The idea is that such a hypothetical sale is efficient, because the debtor is worth more in the hand of the existing claimants than outside parties.[49] In other words, a reorganization preserves the 'going-concern value' of the debtor. This is the value that is inherently linked to the continuation of a distressed corporation.

The result of the bargaining is what parties agree to be the value of the debtor. This value is then laid down in a reorganization plan, which is voted on by the creditors. If a certain number of creditors consent to the reorganization plan, it is confirmed or denied confirmation by a judge. In this respect the judge is thought to be the most suitable party to determine the value of a corporation.

47 Section 153(2)(2) DBC. This rule can roughly be compared to the American feasibility test.

48 It is also possible to liquidate a corporation under an administrative reorganization procedure.

49 The U.S. Supreme Court has affirmed that "*Congress presumed that the assets of the debtor would be more valuable if used in a rehabilitated business than if 'sold for scrap'*". *U.S. v. Whiting Pools, Inc.*, 1983-2 C.B. 239, 462 U.S. 198, 203, 103 S. Ct. 2309, 76 L. Ed. 2d 515, 10 Bankr. Ct. Dec. (CRR) 705, 8 Collier Bankr. Cas. 2d (MB) 710, Bankr. L. Rep. (CCH) P 69207, 83-1 U.S. Tax Cas. (CCH) P 9394, 52 A.F.T.R.2d 83-5121 (1983).

1.2 Costs of an administrative reorganization procedure

However, criticism with regard to the administrative reorganization procedure has been expressed over the years. Especially the U.S. Bankruptcy Code and Chapter 11 have been criticized. Several authors have argued that existing U.S. bankruptcy law is inefficient. They argue that it should be modified or even repealed and replaced by another kind of procedure. Criticism against Chapter 11 has mostly been directed at four specific points: i) valuation of assets, ii) (direct) costs, iii) speed, and iv) perverse incentives.[50]

In order to be able to make a valid comparison between the administrative reorganization procedure and the proposed alternatives it is necessary to set out the argument made by the different authors with regard to the costs of an administrative reorganization procedure. This section aims to do so. These costs can then be weighed against the alternatives for the administrative reorganization procedures that will be discussed in the following sections.

1.2.1 Valuation uncertainty

As stated above, an administrative reorganization procedure involves a hypothetical sale of a corporation. This means that the parties involved do not have a fixed figure with regard to the value of the reorganized company.[51] These parties reach a value of the corporation by means of negotiation. In order for a reorganization to be efficient, however, a corporation has to be correctly valued.[52]

From a normative point of view a correct valuation is necessary to ensure that no wealth is redistributed in the bankruptcy of the debtor. No wealth redistribution means that the order or relative priority is respected in bankruptcy.[53] Or, in other words, that there has to be absolute priority. Otherwise the claimants in the bankruptcy receive either too small or too big a part of their claim compared to the situation in which the real value of the reorganized company would be known.

In the event of a reorganization a valuation of a debtor will also be necessary from the point of view of positive law. Under U.S. law, as set out above in §1 of Part A, a plan has

50 See Part C.3 for a discussion whether these criticisms are (completely) justified.

51 This problem does not exist in the event of a liquidation, because an actual sale takes places and there is an indisputable figure what the value of the company is. See for an example of the valuation problem: *Bittner v. Borne Chemical Co., Inc.*, 691 F.2d 134, 135–137, 9 Bankr. Ct. Dec. (CRR) 1065, 7 Collier Bankr. Cas. 2d (MB) 376 (3d Cir. 1982).

52 This section only deals with valuation of the assets of the debtor. The administrative reorganization procedure as well as other proposals discussed in this Article have little to say about valuation of the claims of the debtor.

53 Thomas H. Jackson, 'Of liquidation, continuation and delay: an analysis of bankruptcy policy and non-bankruptcy rules', 60 *Am. Bankr. L.J.* 399, 406, (1986A).

to be 'fair and equitable' otherwise a judge cannot cram down a reorganization plan over the objection of a dissenting class. The requirement of being fair and equitable entails absolute priority for the creditors and shareholders of the debtor.[54] As explained above, to ensure this absolute priority a valuation of the corporation will have to take place.[55] Furthermore, the assets that serve as collateral for secured claims have to be valued. Not only to determine the entitlements of the secured creditors, but also because of debtor-in-possession financing.[56] Such financing is only possible if the existing lien holders are 'adequately protected'.[57] A valuation of the collateral will have to take place to determine whether existing lien holders are protected and how much room is left for a priming lien.[58]

Under Dutch law a valuation of the bankrupt debtor is also necessary. For example, under Section 153(2)(1) DBC the judge will have to deny confirmation of a proposed reorganization plan if the assets of the estate substantially exceed the proposed pay-out under the reorganization plan.[59] According to the Supreme Court of the Netherlands this provision holds that a judge should make an arithmetic comparison between the assets of the estate and the proposed pay-out and no more than that.[60] In light of Section 153(2)(1) DBC the judge will have to value the assets of the debtor to be able to establish whether the proposed plan satisfies the legal requirement imposed by that provision.[61]

Reorganizing a debtor under an administrative reorganization procedure therefore involves a valuation. There are, however, several impediments to a correct valuation of a debtor. First of all, because there is no fixed value, parties can advance only an estimate of the valuation of the bankrupt debtor. In advancing this estimate senior creditors have an incentive to argue for a low valuation of the debtor, for this provides them with a bigger part of the corporation. Junior creditors on the other hand have an incentive to advance a high valuation, because the higher the valuation the higher the pay-out to these creditors.[62]

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54 11 U.S.C. § 1129(b).

55 See also Douglas G. Baird and Donald S. Bernstein, 'Absolute priority, valuation uncertainty, and the reorganization bargain', 115 *Yale L.J.* 1930, 1935 (2006).

56 Lucian A. Bebchuk and Jesse M. Fried, 'A new approach to valuing secured claims in bankruptcy', 114 *Harvard L. Rev* 2386, 2388 (2001).

57 11 U.S.C. § 364(d)(1)(B).

58 This problem does not arise when the pre-bankruptcy lender and the debtor-in-possession lender are the same.

59 Section 153(2)(1) DBC states: "*Zij zal de homologatie weigeren indien de baten des boedels, de som, bij het akkoord bedongen, aanmerkelijk te boven gaan*." With regard to the assets it should be noted that it is probable that under Dutch law a judge should take the going-concern sale of the assets into account in assessing the value. See: Court of Appeal Leeuwarden 21 July 2006, *LJN* AY4796.

60 HR 24 November 2006, *NJ* 2007, 239.

61 B. Wessels, *Het akkoord*, Deventer: Kluwer 2010, 53.

62 K. O'Rourke, 'Valuation uncertainty in Chapter 11 reorganization', 2005 *Colum. Bus. L. Rev.* 403, 432.

Besides strategic incentives other impediments that come into play in regard to correctly valuing the debtor are 'actual uncertainty' and 'judicial valuation uncertainty'.[63] Actual uncertainty is uncertainty regarding the factual value of a corporation. Parties usually aim to diminish this kind of uncertainty by hiring an expert to perform a valuation of the bankrupt corporation by means of an accepted valuation method.[64] These valuation methods, however, still result in only an educated guess. Moreover, the valuations are submitted by parties involved in the bankruptcy. These parties are biased.[65] And even if the real value of a corporation can be established, it remains to be seen if the judge accepts the established value. It may be that the judge is biased either pro-debtor or pro-creditor and that this bias skews the valuation of the debtor.[66] It may also be that the judge simply does not possess the necessary skills to value the debtor.[67]

A final complication for the parties negotiating over the value of the debtor and the judge determining this value is that the value of the debtor may change during the bankruptcy. The first source of this change of value is that parties may seek to delay negotiations to create nuisance value and that, as a result, the debtor incurs more direct costs. A second source of these costs is the depreciating value of the debtor as a result of foregone investment opportunities and continuing uncertainty with regard to the future of a corporation.

In short, a hypothetical sale can therefore lead to an incorrect valuation. The proposals for a Chameleon and Contingent Equity corporation, options-theory and the proposal for mandatory auctions are all aimed at solving the valuation problem.[68]

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63 O'Rourke 2005, p. 414–415.

64 The most common valuation methods are Discounted Cash Flow, the Market Comparison and Precedent Transaction.

65 O'Rourke 2005, p. 427.

66 Keith Sharfman, 'Judicial valuation behavior: some evidence from bankruptcy', 32 *Fla. St. U. L. Rev.* 387, 390 (2005) and literature cited there.

67 O'Rourke 2005, p. 448–449. A related complication is that a judge usually decides on the basis of information provided to him by the parties. This information may also be biased. See: Baird and Bernstein 2006.

68 Barry E. Adler, 'Financial and political theories of American corporate bankruptcy', 45 *Stan. L. Rev.* 311 (1993); Barry E. Adler, 'Finance's theoretical divide and the proper role of insolvency rules', 67 *S. Cal. L. Rev.* 1107 (1994A); Barry E. Adler, 'A theory of corporate insolvency', 72 *N.Y.U. L. Rev.* 343 (1997); Michael Bradley and Michael Rosenzweig, 'The untenable case for Chapter 11', 101 *Yale L.J.* 1043 (1992); Lucian A. Bebchuk, 'A new approach to corporate reorganizations', 101 *Harv. L. Rev.* 775 (1988); Lucian A. Bebchuk, 'Using options to divide value in corporate bankruptcy', 44 *Eur. Econ. Rev.* 829 (2000); Philippe Aghion, Oliver Hart and John Moore, 'The economics of bankruptcy reform', 8 *J. of L., Econ. & Org.* 523 (1992); Philippe Aghion, Oliver Hart and John Moore, 'Improving bankruptcy procedure', 72 *Wash. U. L.Q.* 849 (1994); Oliver Hart, Rafael La Porta Drago, Florencio Lopez-de Silanes en John Moore, 'A new bankruptcy procedure that uses multiple auctions', 41 *Eur. Econ. Rev.* 461 (1997); Douglas G. Baird, 'The uneasy case for corporate reorganizations', 15 *J. of L. Studies* 127 (1986) and Douglas G. Baird, 'Revisiting auctions in Chapter 11', 36 *J. of L. and Econ.* 633 (1993). It is noted that these proposals are not directed at solving the valuation problem in relation to collateral for secured claims.

1.2.2 Direct costs

The criticisms on bankruptcy law discussed in this Article are also directed at the contended direct costs of an administrative reorganization procedure. The different authors argue that the process of a Chapter 11 bankruptcy can take a very long time and that such a drawn-out procedure is highly costly. They further argue that a lot of costs involved with Chapter 11 are caused by the use of a multitude of professionals involved in the reorganization process and that their proposals will diminish the direct costs of bankruptcy.

Of course, the starting point is the lower the direct costs of an insolvency procedure, the better. It will, however, be very hard – if not impossible – to conduct a costless insolvency procedure. Therefore, the real question is whether an administrative reorganization procedure is disproportionally costly in comparison to alternatives.

There are several kinds of direct costs related to an administrative reorganization procedure. For a Chapter 11 procedure the starting point is that all professionals paid out of the estate need to be approved.[69] These professionals usually include attorneys (debtors counsel) and financial advisors. At the end of the procedure most of these professionals also have to have their requested compensation approved by the court.[70] Furthermore, the estate has to pay for the expenses of professionals hired by court appointed creditor committees.[71] Of course, if a trustee or examiner is appointed his fees also have to be reimbursed.[72] Other direct costs of an administrative reorganization procedure are, for example, court filing fees and the quarterly fees due to the United States Trustee.

For Dutch law the starting point is that there is always a court appointed trustee.[73] His fees are to be paid from the estate. However, the Association of Supervisory Judges in Bankruptcies (Recofa) has drawn up guidelines that set out the maximum hourly fees for trustees.[74] Furthermore, the trustee can retain attorneys and professionals on behalf of the estate with the consent of the supervisory judge. These professionals are usually accountants. The attorneys hired by the trustee generally are not involved in the reorganization itself, but rather in pending litigation against the debtor. Their fees are not limited, but are subject to approval by the supervisory judge based on the Recofa Guidelines.[75] Furthermore, the appointment of a creditor committee is possible, but is an exception. This is usually only

69 11 U.S.C. § 327(a).
70 11 U.S.C. § 330 and 331.
71 11 U.S.C. § 330. See about the hiring of professionals hired by creditor committees in Chapter 11 bankruptcies 11 U.S.C. § 1103(a).
72 11 U.S.C. § 330.
73 Section 14 DBC.
74 In practice these guidelines are almost always observed.
75 § 28 Recofa Guidelines.

done in very large cases. The expenses of the creditor committee have to be reimbursed by the estate, but only insofar as they are 'necessary' and approved by the supervisory judge.[76] The amount of the costs incurred by the creditor committee – if appointed – is usually limited.

1.2.3 Speed

Another factor that is often cited as being relevant for the efficiency of the administrative reorganization procedure is the length of the procedure. The argument is quite simple: the longer the procedure, the higher both the direct and indirect costs.[77] The argument with regard to the direct costs has been set out in the preceding section. The idea behind the argument with regard to the indirect costs is that managers and shareholders of an unviable firm wish to postpone a liquidation in hope of turning the company back into solvency. And such postponement of a liquidation costs money. An example that is often cited by critics of Chapter 11 is the bankruptcy of Eastern Airlines in the late eighties of the previous century.[78] In this bankruptcy Eastern Airlines was allowed to continue operations long after they should have been terminated. As a result the creditors received a substantially lower pay-out than if the company had been liquidated at the start of the bankruptcy procedure.

1.2.4 Perverse incentives for management

A final element of criticism that has been directed at Chapter 11 and is discussed in this Article are the contended perverse incentives for management. Such perverse incentives can arise because of agency problems, which in turn are related to the reason firms exist. This reason, so it is generally acknowledged, is the existence of transaction costs.[79] Transaction costs are the costs incurred by someone when using the market to exchange goods. For example, if someone wants to buy a car he will incur certain costs. Ex ante he will have to incur costs to establish a contract. In case of a car the buyer has to search for someone who has the car the buyer wants. He also has to inform himself about the mechanics of the car, so he can assess the technical condition of the car. Ex post the buyer will incur costs to enforce the contract. An example of such costs are those made to enforce a warranty provided for in the contract.

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76 G.W. van der Feltz, *Geschiedenis van de Wet op het faillissement en de surseance van betaling II* 20 (1st ed. 1897).

77 Karin S. Thorburn, 'Bankruptcy auctions: costs, debt recovery, and firm survival', (58) *J. of Fin. Econ*. 2000 337, 339 and Lynn M. LoPucki and Joseph W. Doherty, 'The determinants of professional fees in large bankruptcy reorganization cases', (1) J. Empirical Legal Studies 2004 111, 113.

78 See about this bankruptcy: Lawrence A. Weiss and Karen H. Wruck, 'Information problems, conflicts of interest, and asset stripping: Chapter 11's failure in the case of Eastern Airlines', 48 *J. of Fin. Econ*. 55 (1998).

79 This idea was first developed by Ronald Coase in his piece 'The nature of the firm'. See: Ronald H. Coase, 'The Nature of the Firm', 4 *Economica* 386 (1937).

If the costs of producing the same good within a firm are lower than the costs of 'producing' the good via the market (i.e. the transaction costs), a firm will be established. If one recognizes that a firm is a 'nexus of contracts', then the costs of producing a good within a firm can be described as the costs incurred in relation to these contracts.[80] Jensen and Meckling have argued that one of the most important forms of these costs are agency costs, which are the result of the agency problem. The agency problem is the problem that arises in situations of agency relationship. This is when one person (the 'agent') performs some kind of task for another person (the 'principal').[81] Because the agent is assumed to be a rational actor, he will not always act in the best interest of the principal. This is made possible by the fact that, generally, the agent has better information than the principal. Thus, it is difficult for the principal to control whether the agent is acting in his (the principal's) best interest.[82]

These agency problems come into play in a corporate context. In this respect it is relevant that corporations are formed because it provides for the separation of ownership (shareholders) and control (managers). This separation provides for an opportunity of specialization. Shareholders provide capital and bear risk and managers can use their knowledge to invest the provided capital.[83] However, this separation of ownership and control, seen as an agent-principal relationship, also causes agency problems.[84] This is not surprising. The managers are (at least in part) hired to establish value for the shareholders, but remain rational self-interested people.[85] Because of agency costs a governance regime is put into place to limit the amount of perverse incentives for management. This governance follows from relevant provisions in the law, contractual covenants and market discipline.

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80 The term 'nexus of contracts' was coined by M.C. Jensen and W.H. Meckling. See: Michael C. Jensen & William H. Meckling, 'Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure', 3 *J. Fin. Econ.* 305, (1976). However, Alchian and Demsetz already described the firm as a 'contractual form'. See: Armen A. Alchian and Harold Demsetz, 'Information costs, and economic organization', 62 *Am. Econ. Rev.* 777, 778 (1972). Armour, Hansmann and Kraakman write about a 'nexus for contracts'. See: J. Armour, H. Hansmann and R. Kraakman, 'What is corporate law' in: Kraakman et al., *The anatomy of corporate law*, p. 6 (Reinier Kraakman et al. eds., 2nd ed. 2009). For the purpose of this Article this does not make a real difference.

81 The seminal piece on agency theory is written by M.C. Jensen and W.H. Meckling. See: Jensen and Meckling 1976. See also: Eugene F. Fama, 'Agency problems and the theory of the firm', 88 *J. of Pol. Econ.* 288 (1980) and Eugene F. Fama and Michael C. Jensen, 'Agency problems and residual claims', 26 *J. of L. and Econ.* 327 (1983).

82 J. Armour, H. Hansmann and R. Kraakman, in: Kraakman et al. 2009, p. 35–36.

83 Alan J. Meese, 'The team production theory of corporate law: a critical assessment', 43 *Wm. & Mary L. Rev.* 1629, 1630 (2002).

84 Jensen and Meckling 1976, p. 86.

85 Whether managers are hired purely to create shareholder value or should pursue stakeholder value is a separate discussion. However, for now the important point to note here is that in both conceptions managers are the agents of the shareholders as principals.

Under American law, management of the debtor continues to be in charge of the corporation after it has been declared bankrupt.[86] This continuation of management power also provides for continuation of agency problems in a bankruptcy context.

The debtor-in-possession structure was introduced because, according to Congress, this would lead to a timely filing for bankruptcy by management, since they would retain their jobs under the reorganization procedure. This, in turn, would prevent unnecessary liquidations.[87] Furthermore, since management was already well acquainted with the corporation, it would be more capable of leading it through the reorganization process.[88] Finally, retaining management as debtor-in-possession would save the costs of a trustee.[89]

However, according to Adler as well as Bradley and Rosenzweig the debtor-in-possession structure may give a perverse incentive to management to file for reorganization rather than liquidation even if the latter is more efficient. They are worried that because of this the debtor-in-possession structure makes the reorganization process of Chapter 11 pro-debtor and inefficient.

Adler argues that unnecessary costs arise in an administrative procedure, because pre-bankruptcy management controls both the corporation and the reorganization process.[90] Control of the corporation flows from the fact that the debtor remains in possession during bankruptcy; control of the process flows from the fact that the debtor has an exclusive right to file a plan of reorganization.[91] Because of this, control management would be able to extract concessions from creditors who would want to minimize the length of the reorganization process and the costs involved with the reorganization.[92] Creditors would also give in to management, because they fear that management would take unjustified risks with the debtor's assets in an attempt to make the corporation solvent again.[93] Because creditors anticipate that the aforementioned costs would be made they would incur extra costs with regard to monitoring the debtor prior to bankruptcy in an attempt to protect their interests.[94]

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86 11 U.S.C. § 1107(a).
87 H.R. REP. NO. 595, 95th Cong., 1st Sess. 233 (1978).
88 H.R. REP. NO. 595, 95th Cong., 1st Sess. 235 (1978).
89 H.R. REP. NO. 595, 95th Cong., 1st Sess. 233 (1978).
90 Adler 1993A, p. 315.
91 See: 11 U.S.C.§ 1107(a) and 1108 for the debtor-in-possession. 11 U.S.C. § 1121 gives the debtor the exclusive right to file a reorganization plan for 120 days after the order for relief. This point is also made by LoPucki. See: LoPucki 1993, p. 692.
92 Barry E. Adler, Bankruptcy primitives, 12 *Am. Bankr. Inst. L. Rev.* 219, 220 (2004).
93 Adler 1993A, p. 316.
94 Adler 1993A, p. 317.

Bradley and Rosenzweig also contend that perverse incentives for managers exist under Chapter 11. According to Bradley and Rosenzweig these perverse incentives are present because managers would have a strong preference for reorganization of a corporation over liquidation. The reason being that managers continue to control the corporation during bankruptcy and have a bigger chance of retaining their job once the corporation is reorganized.[95] Just as Adler they argue that because management remains in control during bankruptcy it would be encouraged to take unduly risks and burden the corporation with excessive debts.[96] And, when management is seen as the agent of shareholders, management has an incentive to try and reorganize a corporation rather than liquidate it, because this way shareholders retain an interest in the corporation.[97]

2 Ex ante capital structures

Now that the administrative reorganization procedure has been discussed, we have some reference for discussing the proposals described in this section. The first alternative for the administrative reorganization procedure is the ex ante capital structure. An ex ante capital structure is a contractual structure that, according to several authors, would form an efficient replacement for the U.S. Bankruptcy Code or at least Chapter 11.[98] Hereinafter three proposals for this kind of capital structure are discussed and assessed. These proposals are: the Chameleon Equity proposal by Adler, the Contingent Equity solution by Bradley and Rosenzweig and the menu approach as advocated by Rasmussen.[99]

95 Bradley and Rosenzweig 1992, p. 1045. See: 11 U.S.C. § 1107(a) and 1108 for the debtor-in-possession. Management also has control over a corporation, because once in bankruptcy creditors can no longer exercise their individual rights of debt collection. See: 11 U.S.C. § 362. Bradley and Rosenzweig explicitly leave aside the question whether operation of a corporation by a trustee might also remove the problem of management. See: Bradley and Rosenzweig 1992, p. 1086, fn. 101.

96 Bradley and Rosenzweig 1992, p. 1047.

97 Bradley and Rosenzweig 1992, p. 1051. Management can, for example, overstate the value of the corporation, thus prompting a reorganization, which would leave the shareholders with an interest in the corporation.

98 All proposals are limited to corporate debtors. Adler seems to argue for the abolishment of Chapter 11. Bradley and Rosenzweig argue that all form of court supervised reorganizations should be abolished. See: Bradley and Rosenzweig 1992, p. 1078. The proposal by Rasmussen aims to replace current bankruptcy law. Both Adler as well as Bradley and Rosenzweig take the Chapters 7 and 11 of the U.S. Bankruptcy Code as a reference. Whether their arguments are also valid under Dutch law is discussed below in Part D.

99 Adler 1993A; Barry E. Adler, 'A world without debt', 72 *Wash. U. L.Q.* 811 (1994B), Adler 1994A; Adler 1997; Bradley and Rosenzweig 1992 and Robert K. Rasmussen, 'Debtor's choice: a menu approach to corporate bankruptcy', 71 *Tex. L. Rev.* 51 (1992).

2.1 Chameleon Equity

Professor Adler has argued that – if no legal impediments existed – investors would implement a contractual structure that would prevent the need for bankruptcy law with regard to corporate reorganizations.[100] This contractual structure would be more efficient than an administrative procedure, because the contractual structure would cost less.[101]

As described in §1.2.4., Adler contends that perverse incentives exist for management under the current reorganization procedure. Adler further argues that an administrative reorganization procedure is inefficient because of the valuation problem that exists when a hypothetical sale takes place. To eliminate the valuation problem, and to prevent the arising of the costs incurred because of perverse incentives for management, Adler proposes to introduce a contractual structure by the name of Chameleon Equity.[102]

2.1.1 The Chameleon Equity structure

The basic idea behind a corporation that is structured on the basis of Chameleon Equity is that the corporation would not issue debt, but only fixed obligations by the name of Chameleon Equity obligations.[103] These fixed obligations would provide the holder with the same rights to payments from a corporation, but the law would eliminate the possibility to collect individually if a corporation defaults on its obligations.[104] Thereby eliminating a potential 'race to the courthouse'.[105]

The Chameleon Equity obligations would be issued in tranches that differ in priority. If a corporation is unable to meet its obligations the class of creditors which obligations the

100 Adler 1993A, p. 311 and Adler 1997, p. 351. The main legal impediments Adler notes are: the inability to waive management's right to file for bankruptcy (11 U.S.C. § 301), the deductibility of interest, but not of dividend payments (26 U.S.C. § 163(a)), the inability to prevent management from issuing traditional debt and the ability of nonconsensual claimants to seek individual recourse against a debtor. See: Adler 1993A, p. 334–340 and Adler 2004, p. 223. Lubben argues that these impediments are already a clear indicator that Adler's theory is not viable. Stephen J. Lubben. Some more realism about reorganization: explaining the failure of Chapter 11 theory, 106 *Dick. L. Rev.* 267, 285 (2001). Tabb is also critical of changing tax, corporate and commercial law to facilitate Adler's proposal. See: Charles J. Tabb, 'Of contractarians and bankruptcy reform: a skeptical view', 12 *Am. Bankr. Inst. L. Rev.* 259, 267 (2004).

101 Adler 1993A, p. 312.

102 Adler 1997, p. 351–352. Adler is unclear about why it is insufficient to simply amend current bankruptcy law.

103 Adler 1993A, p. 323. A Chameleon Equity corporation would still have a residual class of traditional shareholders.

104 Adler 1994B, p. 816.

105 If there was only an individual system of debt collection when a debtor was insolvent, debts would be paid on a 'first come, first serve' base. Therefore, if there is not enough to repay every creditor, only the creditors who come early will be repaid. This leads to a situation in which creditors will try to be the first to seek recourse, because only then will they have a chance of being repaid in full.

corporation is unable to meet would transform into traditional equity – thus decreasing the amount of debt of the corporation – and the former class of shareholders would be wiped out.[106] The new traditional equity class would then have voting power over the corporation and would be able to decide whether they would want to liquidate or continue the corporation.[107] The other bond holders would remain unaffected and the corporation would still have to pay its fixed obligations to them. This, however, would not be a problem anymore, because the corporation has been transformed – without a bankruptcy process – from an insolvent corporation into a solvent corporation again.[108] So, Adler argues, the introduction of the Chameleon Equity corporation would prevent the arising of the common pool problem, while at the same time providing for a reorganization method that is more efficient than the administrative procedure.

2.1.2 The Chameleon Equity structure elaborated

Adler discusses several specific points in relation to the Chameleon Equity structure to show how it works. For example, Adler argues that in a Chameleon Equity corporation it would be prohibited to issue fixed obligations with acceleration-on-default clauses for classes that could survive the transformation of a lower class.[109] In a traditional corporation, acceleration-on-default clauses accelerate payment when a default occurs. This prevents opportunistic behavior by shareholders for a shareholder threatened with a default that would trigger an acceleration-on-default clause has an incentive to generate just enough capital to remain the residual claimant of the corporation. He will most likely try to generate this capital by risky investments. This preference for high-risk investment stems from the fact that without it the shareholders are likely to lose their status as residual claimants because of the default.[110]

In a Chameleon Equity corporation, however, default triggers the transformation of the lowest priority class of fixed obligations into equity. Unaffected classes therefore have no need for acceleration because this new equity class – of a solvent corporation – would risk its own investment and, accordingly, has no incentive to invest in risky projects.[111] So, the goal of an acceleration clause is already achieved. To minimize perverse incentives in case

106 Adler 1993A, p. 324; Adler 1994B, p. 816 and Adler 1997, p. 352.

107 Adler 1993A, p. 324. Furthermore, they would have to decide whether they would want to keep current management in place.

108 In the example given, transformation of one class of obligation holders is sufficient to let the corporation return to solvency. In practice, of course, it could be necessary to transform more than one class. When no class can be transformed the corporation will have to be liquidated. This would signal not only financial distress, but also economic failure. Adler 2004, p. 223.

109 Adler 1993A, p. 325.

110 Adler 1993A, p. 325.

111 Adler 1993A, p. 325.

a corporation is still insolvent after its transformation, high-priority classes should, according to Adler, require a corporation to have a relatively large percentage of low priority claimants.

Furthermore, Adler contends that a Chameleon Equity corporation would still be able to accommodate secured financing.[112] Collateral would only be offered to the highest-priority consensual claimants. As long as this class would not become the residual class, the need for collateral would prove unnecessary, since disputes among the secured creditors would not arise. If, and only then, the highest priority class of consensual claimants did become the residual class they would be able to foreclose on their collateral and receive payment on their claim.

2.2 Contingent Equity

Around the same time as Adler's Chameleon Equity corporation proposal was published Bradley and Rosenzweig launched their idea for the introduction of the Contingent Equity corporation.[113] In their proposal Bradley and Rosenzweig argue that judges are inefficient in determining the value of a corporation and that valuation of a corporation should be done by the market and that perverse incentives for management exist. The Contingent Equity corporation would supposedly eliminate these incentives.[114] Furthermore, Bradley and Rosenzweig argue that their proposal would eliminate the deadweight costs of bankruptcy significantly.[115]

In light of the efficiencies mentioned above Bradley and Rosenzweig argue that Chapter 11 should be repealed and all forms of administrative reorganization procedures abolished.[116] Furthermore, a law should be enforced that provides for the automatic cancellation of the interests of shareholders in the event of default by a corporation.[117] In return, Contingent Equity shares would be introduced.

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112 Adler 1993A, p. 327 and Adler 1994B, p. 819–821.

113 Bradley and Rosenzweig 1992.

114 Bradley and Rosenzweig 1992, p. 1047 and p. 1050. See: David A. Skeel, 'Markets, courts and the brave new world of bankruptcy theory', 1993 *Wis. L. Rev.* 465, 475–476.

115 Bradley and Rosenzweig 1992, p. 1050. These are the direct costs of a reorganization procedure, such as legal, accounting and advisory fees.

116 Bradley and Rosenzweig 1992, p. 1078. They do not explain what influence their proposal would have on commercial, corporate or tax law. See: Donald R. Korobkin, 'The unwarranted case against corporate reorganizations: a reply to Bradley and Rosenzweig', 78 *Iowa L. Rev.* 669, 717 (1993).

117 Bradley and Rosenzweig 1992, p. 1078.

The proposal is as follows. Corporations would continue to issue traditional debt. Whether it be junior, mezzanine or senior. Furthermore, the traditional class of shareholders would still exist. All debt holders, however, would receive one Contingent Equity share for every unit of currency that is lent.[118] These Contingent Equity shares are contingent shares – hence the name – and would not have any role to fulfill until the corporation defaults on its obligations.

If the corporation defaults – and does not pay its obligation to its debt holders – the claims of the traditional shareholders would be automatically cancelled. A default occurs if the amount currently due to the debt holders is higher than the value of the equity.[119] Bradley and Rosenzweig argue that this situation would occur when the corporation were unable to place new equity in the market, because in such event investors apparently hold the opinion that an additional residual claim would hold no value.[120] This way the market decides the value of the corporation and whether there is a net equity position that justifies prevention of a default.[121] This ensures that management – as agent of the equity class – will try to avoid a default rather than pursuing risky investment strategies that have a high chance of inducing default, since all claims of traditionally shareholders are cancelled.[122] Thus removing a contended inefficiency of bankruptcy procedure.

Another consequence of a default would be that the lowest ranking class of debt holders would lose their right to get their outstanding claim paid. At the same time their contingent shares would be transformed into traditional equity and they would effectively become the new residual class of shareholders.[123] Now the new class of shareholders has to decide whether to default again or pay the amount currently due to the debt holders.[124] Again this decision will be made by the market, since raising the capital necessary to pay the debt holders will require the issuance of new equity.[125] This process would repeat itself until a class of shareholders can issue enough equity to pay the creditor or – if the senior creditors class is reached – the creditors can decide to either run the corporation, sell its equity to outside investors or liquidate the corporation.[126] No judicial intervention would be involved.

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118 So, one million Contingent Equity shares would be given to a lender that lends one million. Whether it be Euros, U.S. Dollars or any other currency.

119 Bradley and Rosenzweig 1992, p. 1082.

120 Bradley and Rosenzweig 1992, p. 1082.

121 Bradley and Rosenzweig 1992, p. 1082. According to Bradley and Rosenzweig market participants would continually assess the value of the outstanding shares and contingent shares. Bradley and Rosenzweig 1992, p. 1085.

122 Bradley and Rosenzweig 1992, p. 1079.

123 Bradley and Rosenzweig 1992, p. 1082.

124 Furthermore, they would have to decide whether they would want to keep current management in place.

125 Bradley and Rosenzweig 1992, p. 1083–1084.

126 Bradley and Rosenzweig 1992, p. 1084.

2.3 The difference between Chameleon Equity and Contingent Equity

The alert reader will have noticed that there is one major difference between the Chameleon Equity structure and the Contingent Equity structure: the possibility to seek individual recourse.

Adler admits that a common pool problem exists when a debtor defaults and therefore in his proposal the possibility to seek individual recourse is eliminated.[127] According to Adler this would solve the common pool problem. Individual debt collection rights, however, are not only relevant when a debtor cannot pay his debt, but also when a debtor plainly refuses to pay his debt; even if he is able to. In this last situation individual debt collection is very useful. It ensures that a solvent debtor will follow through on his obligations and cannot randomly refuse payment. For this reason it is doubtful whether all creditors would deem it sufficient to receive Chameleon Equity obligations without the possibility of individual debt collection.[128]

Furthermore, it is questionable whether the common pool problem would really be eliminated by introducing the Chameleon Equity structure and removing the possibility for individual debt collection. This removal may prevent the involuntary liquidation of the corporation, but it exacerbates the risk of voluntary liquidation. Since the equity class will lose everything on default, they will fervently try and avoid this from happening. For example, by selling the assets of the corporation piecemeal to generate money, thus avoiding a default.[129] Bradley and Rosenzweig have acknowledged this risk of asset substitution. They, however, argue that these costs would in reality be substantially smaller than in theory. They imagine that the market would correct for these flaws by means of implementing strict covenants.[130]

In reality, however, covenants will prove to be impossible to draw up. Not only is there a risk of hidden information for the debt holders, but a corporation's operating results are not a reliable measuring stick for optimal investment behavior.[131] An approval clause for future investment will also not work, for this would give a debt holder an incentive to

127 Adler 1994B, p. 816.
128 Richard V. Butler and Scott M. Gilpatric, 'A re-examination of the purposes and goals of bankruptcy', 2 *Am. Bankr. Inst. L. Rev.* 269, 276 (1994).
129 Rasmussen 1994, p. 1197.
130 Bradley and Rosenzweig 1992, p. 1087.
131 Rasmussen 1994, p. 1172. Bad operating results are not always a result of bad management. There can also be exogenous factors that cause lower operating results.

refrain from approving a certain project if the debt holder foresees that a default would be more beneficial than a debt repayment.[132]

Bradley and Rosenzweig explicitly state that they expect no common pool problem to arise in case of a Contingent Equity corporation.[133] Therefore they do not propose to eliminate the possibility of individual debt collection. They state that they expect creditors to draw up contracts that contain the precise conditions under which default-contingent provisions can be enforced and the rule that cancels the interests of the residual claimants upon default. Thus, creditors have precisely defined relative rights and priorities and nothing to gain from the equity class.[134]

Adler argues that it is correct that in a Contingent Equity corporation the common pool problem for creditors in relation to shareholders would be prevented, but that a common pool problem would still exist because creditors would still have a lot to win from beating other creditors in their race to the courthouse. Which is precisely the kind of competition that would threaten the going-concern surplus of a corporation.[135]

2.4 The costs of automatic restructuring

The impossibility to seek individual recourse under the Chameleon Equity proposal and the possibility to do so in the Contingent Equity proposal, is the one major difference between these proposals. The similarities between the proposals are much greater than the differences. Both proposals are contractual structures implemented ex ante and both introduce automatic restructuring upon default. This means that both proposals face the same problems. Two of those problems loom quite large in particular: non-consensual claimants and transaction costs. Other relevant obstacles for replacing bankruptcy law with ex ante capital structures are behavior by management and monitoring costs.

Non-consensual claimants

Non-consensual claimants have not contracted with a debtor. Therefore a non-consensual claimants could not lose his right to individually collect from a debtor.[136] This – at least in

132 Robert K. Rasmussen, 'The ex ante effects of bankruptcy reform on investment incentives', 72 *Wash. U. L.Q.* 1159, 1197 (1994).

133 Bradley and Rosenzweig 1992, p. 1085, fn 98. As a consequence of their proposal there would no longer be a need for the automatic stay of 11 U.S.C. § 362.

134 Bradley and Rosenzweig 1992, p. 1085, fn 98

135 Adler 1993A, p. 333.

136 Butler and Gilpatric 1994, p. 275; Samuel L. Bufford, 'What is right about bankruptcy law and wrong about its critics', 72 *Wash. U. L.Q.* 829, 840 (1994) and Tabb 2004, p. 269 Adler admits as much. See: Adler 1993A, p. 339.

the Chameleon Equity proposal – creates the possibility for non-consensual claimants to compete for the assets of the debtor, while the Chameleon Equity creditors could only stand by and watch.[137]

Adler purports to solve this problem by not only eliminating individual debt collection for consensual claimants, but also for non-consensual claimants.[138] In return, non-consensual claimants would become the highest priority claimants of the debtor.[139] However, Adler fails to recognize that claimants are not always neatly divided between consensual and non-consensual claimants.[140] Some claimants think they deal consensually with the debtor, but in hindsight their decisions turn out to be based on fraud or misinformation. For others it is simply unclear whether their claim follows from a consensual or non-consensual dealing with a creditor.

In the Contingent Equity proposal of Bradley and Rosenzweig every creditor still has the possibility of individual debt collection until the debtor defaults. In practicality, however, this would not permit them to enforce their rights.[141] The group of non-consensual claimants with regard to a debtor can consist of thousands of claimants scattered over the entire globe, unaware of each others existence. How would these claimants – lowest ranking after equity – be supposed to remedy a default under an Contingent Equity regime? As Warren vividly illustrates:

> "Consider the plight of claimants against Dalkon Shields manufacturer A.H. Robbins, in a hypothetical situation in which Robins had defaulted on a senior debt obligation of $100 million. Would the thousands of women who were injured by the Dalkon Shield receive telephone calls requiring them to come up with a $100 million debt payment by sundown or face loss of their claims?"[142]

Therefore, even if the Chameleon Equity and Contingent Equity structure would work in theory, it is hard to imagine that these proposals could adequately deal with non-consensual claimants in reality. In other words: there is a collective action problem.

137 Adler 1993A, p. 340.
138 Adler 1993A, p. 340. This would of course form a breach on the freedom of contract so fervently supported by Adler. See: Tabb 2004, p. 270.
139 Adler 1993A, p. 340.
140 Tabb 2004, p. 270.
141 Elizabeth Warren, 'The untenable case for the repeal of Chapter 11', 102 *Yale L.J.* 437, 472 (1992).
142 Warren 1992, p. 472.

Imperfect markets and transaction costs

Another and perhaps even bigger problem is the assumption of perfect markets inherent in both Adler's proposal and that of Bradley and Rosenzweig. In reality, however, markets are not perfect and substantial transaction costs will be incurred.[143]

A problem that illustrates this point is that Adler seems to assume that illiquidity of assets does not exist. In real life, however, selling an asset for its true value can take time, money and effort.[144] Furthermore, in order for automatic restructuring to work there always has to be an active market on which equity can be traded. While this may be the case for publicly held corporations, it is highly doubtful that this is true for privately held corporations.[145] The problem with illiquidity is that the residual equity class is extinguished too soon.[146] Adler argues that this problem can be solved easily by means of implementing a certain waiting period after a default and before transformation of a class can take place. This way the residual equity class would have the time to demonstrate that the corporation is merely illiquid and not insolvent.[147] This, however, does not take into account that corporations sometimes may be able to sell the equity within the specified period of time, but only under high pressure. This time pressure will reduce the price of the equity being sold.[148] Furthermore, the significant costs of placing equity on the market should also be taken into account for a fair review of the contractualist proposals.[149]

Related to the point of illiquidity is the fact that a single default would trigger the automatic cancellation of the equity class, thus exposing nearly all corporations that carry debt to the risk of bankruptcy.[150] Even corporations that are highly solvent will be threatened with automatic cancellation due to the mere fact that their accountant forgets to pay a small bill.[151]

Moreover, there will be an enormous amount of administration and coordination costs involved in the introduction of an automatic restructuring regime.[152] These costs are firstly

143 Butler and Gilpatric 1994, p. 274.
144 This criticism is also valid for the Contingent Equity proposal of Bradley and Rosenzweig. See: Tabb 2004, p. 269.
145 It is also questionable whether investors would want to buy equity in a closely held corporation. Especially if it is a minor interest. See: Skeel 1993, p. 484.
146 Lynn M. LoPucki, 'Strange visions in a strange world: a reply to professors Bradley and Rosenzweig', 91 *Mich. L. Rev.* 79, 100 (1992); Korobkin 1993, p. 716–719 and Skeel 1993, p. 483–484.
147 Adler 1994B, p. 822–823.
148 Skeel 1993, p. 483.
149 Skeel 1993, p. 483 and Lubben 2001, p. 286.
150 Korobkin 1993, p. 718–719.
151 LoPucki 1992, p. 104.
152 LoPucki 1992, p. 101–103 and Korobkin 1993, p. 720–721.

caused by the fact that the debtor has to coordinate the contracts with each individual debtor to ensure that the automatic cancellation regime is in place.[153] There will be costs involved in this effort. These costs have to be borne by all corporations, in contrast to the bankruptcy regime where coordination costs are only borne by the corporations involved.[154] Adler argues that these costs would be made primarily by some early pioneers of the structure and that these costs would be trivial in the long run.[155] Thus, while the costs of enforcing a contract – including the costs of reorganizing – would be severely diminished, the ex ante costs of this contract would rise only slightly. Whether these costs really would be trivial remains to be seen. The implementation of special provisions, like a grace period for the equity class, would require specifically tailored contracts. Which would result in complex and costly contracts.[156]

A second source of costs caused by introducing an automated restructuring regime are the costs of extensive litigation. This litigation will mainly be about the question whether a default really occurred. Adler states that these costs are also made under bankruptcy law.[157] This point of view, however, fails to take into account that because of the severe consequences of a default, litigation would probably be more extensive and thus costlier. The class next to the equity class, for example, would have every incentive to declare default, even for the nuisance value of their claim.[158]

And even in the absence of transaction costs it remains questionable whether creditors would choose to write a contract like the one proposed by Adler or Bradley and Rosenzweig. The reason being that a debtor's contracts are not concluded all at the same time, but in a sequential nature.[159] Because of this sequential nature a creditor (B) that comes after another creditor (A) will have an incentive to refuse to give up on his right of individual debt collection, because in such event creditor B can offer a lower interest rate.[160] This method will only work if the contract of creditor A is already fixed. Since creditor A knows he can be exploited if he is the only creditor that gives up on his right of individual debt collection, creditor A will also refuse to give up on his right of individual debt collection.[161]

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153 Korobkin 1993, p. 720; Butler and Gilpatric 1994, p. 277; Rasmussen 1994, p. 1197; Robert K. Rasmussen and David A. Skeel, 'The economic analysis of corporate bankruptcy law', 3 *Am. Bankr. Inst. L. Rev.* 85, 108 (1995).

154 Susan Block-Lieb, 'The logic and limits of contract bankruptcy', 2001 *U. Ill. L. Rev.* 503, 550.

155 Adler 1993, p. 324; Adler 1994B, p. 817 and Adler 1994A, p. 1135.

156 Block-Lieb 2001, p. 550.

157 Adler 1994B, p. 817 and Adler 1994A, p. 1118.

158 Korobkin 1993, p. 720.

159 Stanley D. Longhofer and Stephen R. Peters, 'Protection for whom? Creditor conflict and bankruptcy', 6 *Am. L. & Econ. Rev.* 249, 253 (2004).

160 Longhofer and Peters, p. 263.

161 Longhofer and Peters 2004, p. 264.

Strategic behavior

Adler as well as Bradley and Rosenzweig argue that a major source of inefficiency of Chapter 11 are the perverse incentives for management, because they keep control over the corporation and the reorganization process during bankruptcy of a corporation.[162] To eliminate these incentives they propose to introduce the Chameleon Equity corporation and the Contingent Equity corporation, respectively. Both procedures would make it possible for management to be ousted immediately upon default.[163] Although neither proposal is really explicit on what should happen after a default that would improve management.[164]

Adler suggest that after an equity cancellation the new equity class would hold a vote on management.[165] This, however, would result in substantial costs, which consist of both the costs of holding an election and the costs of foregone investment opportunities.[166] This could lead to the ordinary creditors striking a deal with management not to make extraordinary efforts to forestall default. In exchange, management would retain their position after default.[167] Not only would this save the ordinary creditors the costs of a change of management, it could even provide them with a net benefit. This is true when the value of a corporation is higher than the outstanding debt to the secured and unsecured creditors.[168] When this is the case unsecured creditors have a strong incentive to get a corporation to default on technical grounds, because they will become entitled to the surplus of value that exceeds the amount of debt owed to the secured creditors.

Furthermore, it is questionable whether cancellation of shareholders' claims upon default would result in managers seeking optimal operating strategies. It could well be that management would abandon those strategies well before actual payment is due.[169] The reason being that management would rather play it safe than seeking optimal investments with a greater risk of job loss.[170]

The argument that management of a healthy corporation would not adopt suboptimal strategies, because they would have no reason to fear default is inadequate. Even healthy

162 Adler 1993A, p. 315; Bradley and Rosenzweig 1992, p. 1045–1047.
163 Adler 1993A, p. 324; Bradley and Rosenzweig 1992, p. 1079.
164 See: Aghion, Hart and Moore 1994, p. 865.
165 Adler 1993A, p. 325.
166 Skeel 1993, p. 486 and Rasmussen 1992, p. 99.
167 Skeel 1993, p. 486.
168 Skeel 1993, p. 485.
169 Bradley and Rosenzweig themselves raise this objection. See: Bradley and Rosenzweig 1992, p. 1086–1087.
170 Rasmussen 1994, p. 1200 and Korobkin 1993, p. 721. This is especially true for bad management. They would want to avoid default at any cost.

corporations may default. Whether it be by mistake or by temporary cash flow problems.[171] Good management would guard against these risks. This can lead to suboptimal behavior. For example, if management does not invest in projects with net present value, but holds available funds as a buffer to prevent default. Creditors would have no incentive to change this behavior, because this behavior would minimize the risk of default on the obligations of the corporation against these creditors. Management would have no incentive to change their strategies, because this leads to an increased risk of them losing their jobs. In this respect an agency problem exists.

It is important to note that this kind of suboptimal behavior would always occur. For this reason covenants 'debt obligations are only payable from certain sources, and drastic changes in the corporation's operating strategies would require creditor approval' would not work.[172]

Monitoring

Because of the severe consequences of default it is to be expected that a debtor will try and narrow the scope of default terms.[173] These narrower covenants would result in increased costs. Of course there are the increased costs of drafting the covenants. Under current law little costs are incurred with regard to having broad covenants. These costs would increase because of the consequences of default under a Chameleon Equity or Contingent Equity regime. This, in turn, increases the need for precisely drafted and tailored covenants, which are costly to draw up.[174] A cost that neither Adler nor Bradley and Rosenzweig seem to take into account completely.

Another consequence of narrower covenants is that the need for monitoring increases. Under current law covenants can function as tripwire, signaling the need for increased monitoring.[175] Because breach of a covenant under an automatic restructuring regime

171 Korobkin 1993, p. 722. Temporary cash flow problems can arise, for example, because of a temporary spike in interest rates or a major customer failing to pay. They can also arise because the debtors of the debtor default on obligations and the debtor receives equity instead of cash, which it is unable to sell within a sufficiently short period of time.

172 Bradley and Rosenzweig 1992, p. 1087. This covenant is proposed by Bradley and Rosenzweig to prevent management from taking unduly risk in an ultimate effort to pay outstanding debt obligations. This is a different situation than described here. The covenant described would also be strongly opposed by the equity class, because it would lead to an increased risk of default and, thus, to an increased risk of automatic cancellation. Korobkin 1993, p. 726.

173 Skeel 1993, p. 490.

174 Rasmussen 1994, p. 1198.

175 Rasmussen 1994, p. 1199.

means default, this tripwire function would be lost and creditors would need to monitor their debtor more closely.[176]

Rasmussen has argued that the implementation of Chameleon Equity would cause a cost by means of removal of the incentive for the secured creditor to monitor specific assets. This monitoring of certain assets is seen as the explanation of secured credit.[177] Since the highest priority claim holders have entire-corporation priority rather than asset specific priority they would have no benefit of monitoring specific assets.[178] Adler, however, sees an easy solution for this cost. A Chameleon Equity corporation could limit a claimant's priority to the value of collateral, place secured claimants in a low priority class and give the claimant the right to demand an auction for their collateral in case of a default on his claim.[179]

2.5 Bankruptcy as a default rule: a choice by menu

Another proposal involving an ex ante capital structure as a replacement for bankruptcy law has been advanced by Rasmussen. He has argued that bankruptcy should be seen as a term of contract between the investors of a corporation.[180] For this reason he proposes to introduce a menu of choices for a corporation to choose from. This choice would decide what kind of procedure would be followed in case of financial distress so as to reach an efficient outcome.[181]

2.5.1 Bankruptcy as a term of contract

Rasmussen starts by arguing that bankruptcy is a foreseeable event for the parties involved at the moment a creditor decides to extend credit to a debtor.[182] This fact is therefore reflected in the lending decision. A lender will compare the return it can expect from the borrowing corporation with the best available alternative, thus setting a minimum price. The maximum price is set by the available alternative sources of financing for the borrower.[183] However, when calculating the price the lender will not only take the probability of default, but also existing bankruptcy law into account. The reason for this is that default does not mean that a lender will not be repaid at all. Thus, bankruptcy should be seen as

176 Skeel 1993, p. 490.
177 Adler 1994B, p. 819.
178 Rasmussen 1992, p. 99
179 Adler 1994B, p. 821.
180 Rasmussen 1992, p. 53.
181 Rasmussen 1992, p. 53.
182 Rasmussen 1992, p. 56.
183 Rasmussen 1992, p. 56. The price of the loan is the interest that is being charged.

a term of the contract between the corporation and a creditor that shows what a lender will receive once the borrower enters bankruptcy.[184] It is not, according to Rasmussen, the term of contract between the creditors themselves to maximize their respected returns.[185]

Once it is accepted that bankruptcy is a term of contract, the fact that bankruptcy law is mandatory can be questioned.[186] Rasmussen argues that those advocating the mandatory nature of bankruptcy law have to provide for a justification of this statement.[187] In light of this he discusses two possible justifications for mandatory bankruptcy law: the common pool problem and the standardization argument.

Rasmussen contends that the common pool problem is not a satisfactory justification for the mandatory nature of bankruptcy law.[188] The reason being that lenders price their loans with bankruptcy law in mind. Costs associated with common pools are therefore already taken into account in calculating an interest rate as to even out the risk that lenders will not be able to get their loan repaid in full. Because the shareholders are the residual claimants of a corporation they will bear the costs of suboptimal action. The equity class is therefore in the best position to ensure the largest return to the corporation.[189] For this reason they should select the applicable rules in bankruptcy.

The standardization argument is, according to Rasmussen, also not a satisfactory justification for the mandatory nature of bankruptcy law.[190] The standardization argument can be broken up into two separate arguments: the transaction cost argument and the strategic behavior argument. The transaction argument holds that if each corporation had to design its own bankruptcy rules the cost of this effort would exceed the efficiency gains. The strategic behavior argument holds that fear that different creditors may be subject to different bankruptcy regimes may lead a creditor to try and maximize his return under the assumption that the other creditors would try and minimize his return. This fear would be justified if a debtor cannot credibly offer only one bankruptcy regime.

Rasmussen, however, thinks the standardization argument unconvincing. He argues that the introduction of a menu approach solves both the transaction cost argument as well as

184 Rasmussen 1992, p. 57.
185 Rasmussen 1992, p. 59. With reference to the creditors' bargain theory of Baird and Jackson.
186 See for the mandatory nature of American bankruptcy law: *U.S. v. Royal Business Funds Corp.*, 724 F.2d 12, 15, 11 Bankr. Ct. Dec. (CRR) 923, 9 Collier Bankr. Cas. 2d (MB) 1045, Bankr. L. Rep. (CCH) P 69505 (2d Cir. 1983).
187 Rasmussen 1992, p. 63.
188 Rasmussen 1992, p. 64–65.
189 For they have the most to lose.
190 Rasmussen 1992, p. 65–67.

the strategic behavior argument.[191] The menu approach would minimize transaction costs, because the options are known in advance. Creditors would therefore choose between several standard procedures.[192] If the possibility to change a selection were limited after a corporation has taken out credit, the strategic behavior problem would be eliminated.[193]

Rasmussen makes one exception to the proposition that the investors should be able to choose the applicable provisions in bankruptcy.[194] This is when non-consensual claimants are involved. Because they have not contracted with the corporation, they have not been able to bargain over the terms over the contract. Which makes it likely that the corporation will try and externalize the costs of bankruptcy on these claimants. The solution for this problem, according to Rasmussen, is to have a mandatory bankruptcy regime for this specific class of claimants.[195]

But, if parties could choose, then why would they not just choose Chapter 11? Rasmussen argues that the reason for this is that the costs of Chapter 11 are quite high.[196] These costs are related to the fact that American bankruptcy law gives shareholders certain procedural protections. An example of such a protection is the exclusivity period.[197] Another example is the fact that the bankruptcy court may hold a valuation hearing. And that valuation is a hypothetical value of the corporation and not an objective figure.

2.5.2 The bankruptcy menu

The proposed bankruptcy menu would have five options available for the investors to choose from: i) no-bankruptcy (including a possibility for a contingent equity structure), ii) liquidation only (auction-regime), iii) an administrative reorganization procedure, iv) a selective automatic stay (excluding the financing creditor) and v) a custom-designed bankruptcy system.

The first option involves that the corporation would commit to never filing for bankruptcy, but would rely on only individual debtor collection or become a contingent equity corpo-

191 Rasmussen 1992, p. 66.
192 Rasmussen 1992, p. 66. One of the options on the menu would still be to create a whole new bankruptcy procedure. See below. A benefit of the menu approach would be that lenders would be able to anticipate on the different bankruptcy regimes and would be able to show the different interest rates they charge, thus showing the costs of bankruptcy to a debtor.
193 Rasmussen 1992, p. 66.
194 Rasmussen 1992, p. 67.
195 Rasmussen 1992, p. 67.
196 Rasmussen 1992, p. 80.
197 11 U.S.C.§ 1121 gives the debtor the exclusive right to file a reorganization plan for 120 days after the order for relief.

ration upon default.[198] This bankruptcy would be most suited for corporations consisting of a single asset, no corporation-specific value contribution by the shareholders and a secured creditor whose claim exceeds the value of the asset. In this scenario creditors would have nothing to gain from a bankruptcy procedure, because it is clear that the secured creditor should sell the asset and receive all the proceeds.[199]

The second option is that a corporation can only file for liquidation by means of an auction.[200] Rasmussen argues that this option would be preferred by shareholders in a public corporation. Because the corporation is auctioned bankruptcy would take a relatively short time, thus reducing the direct costs that would be made in a reorganization process and providing for a relatively quick pay-out. At the same time, Rasmussen argues, the corporation will be kept intact if that provides for value maximization. A possible benefit of 'reorganizing' a corporation by means of an auction is that the pro rata sharing rule applies. General creditors may benefit from this rule, thus prompting lower interest rates for the debtor.[201] This would eventually be to the benefit of the shareholders. Shareholders can diversify the risk of the corporation's bankruptcy by buying shares in different companies.[202]

An administrative reorganization procedure would – as the third choice – also be available under the menu approach.[203] This procedure would be preferred by shareholders who cannot diversify risk or who have non-pecuniary investments in the corporation. Furthermore, a hypothetical sale may – in the end – have lower costs than an actual sale and thus an administrative reorganization procedure as a choice is justifiable.[204]

As a fourth option Rasmussen advances the option to choose for a selective automatic stay.[205] All creditors would be stayed upon filing – and be unable to exercise their collection rights – except for the financing creditor. The reason for the exemption of the automatic stay for the financing creditor is that this will give management an incentive not to shirk.

198 Rasmussen 1992, p. 100–102. Rasmussen uses the name 'contingent equity', but seems to refer to the Chameleon Equity proposal of Adler. See: Rasmussen 1992, p. 102, fn 217.

199 Rasmussen argues that the ability to file for bankruptcy and the consequential automatic stay of 11 U.S.C.§ 362 would provide shareholders with the opportunity to stall debt collection in the hope the corporation will turn solvent again. The costs of this delay would be reflected in the higher cost of credit. See: Rasmussen 1992, p. 101.

200 Rasmussen 1992, p. 102–105.

201 Rasmussen 1992, p. 104.

202 Rasmussen 1992, p. 104. Since managers cannot diversify their risk their incentive to engage in risky adventures is reduced. For if a corporation went bankrupt under the auction-option, management would be ousted.

203 Rasmussen 1992, p. 105–106.

204 Rasmussen 1992, p. 105. With reference to Frank H. Easterbrook, 'Is Corporate Bankruptcy Efficient?', 27 *J. Fin. Econ.* 411, 416–417 (1990).

205 Rasmussen 1992, p. 106.

For the financing creditor – so Rasmussen assumes – can detect whether the corporation fails because of endogenous or exogenous events.[206] In the first instance management has shirked and the financing creditor should be able to call the loan. In the second instance the financing creditor will renegotiate the loan. For this renegotiation to be able to succeed the financing creditor and the debtor need time, thus the other creditors should be barred from exercising their rights.[207]

The fifth and final option is to let corporations create their own bankruptcy regime. Rasmussen sees no objection to let corporations create their own regime if the gains exceed the cost of such an effort.[208] The only condition is that non-consensual creditors should be subject to a mandatory rule.

2.5.3 Selecting and changing options

In the proposal of Rasmussen a corporation will choose an option from the menu at the time of its incorporation. Furthermore, it is conceivable that a corporation would wish to change its choice over time as the corporation evolves.[209]

With regard to choosing an option at the inception of a corporation a moral hazard problem exists.[210] Especially with regard to the options on the menu that present some form of insurance for the shareholders. Shareholders in a corporation that have chosen an option which leaves them with an interest after the reorganization know that they will not bear the full costs of failure. They would, presumably, have a taste for riskier investments as these options presents them with a certain kind of 'insurance'.

Rasmussen, however, argues that the moral hazard problem is at most equal to mandatory bankruptcy law.[211] First, Rasmussen argues, there is always a moral hazard problem. Even in a solvent corporation the shareholders do not bear the full risk of failure.[212] Second, the insurance payoff given under the relevant options is not a set amount, but rather a percentage of the reorganized corporation. This means that shareholders have an incentive to

206 Rasmussen does not discuss the situation that both endogenous and exogenous circumstances lead to the bankruptcy of a corporation.
207 Rasmussen 1992, p. 106.
208 Rasmussen 1992, p. 106–107.
209 Rasmussen 1992, p. 111–112.
210 Rasmussen 1992, p. 112. A moral hazard problem occurs when someone does not bear the full consequences of their action.
211 Rasmussen 1992, p. 113–114.
212 For a certain amount of risk is borne by the debt holders. At the same time the shareholders receive the entire surplus of the corporation after the debt holders have been satisfied.

avoid projects that are too risky. As a result, although they will not bear the full consequences of failure, they will certainly feel some consequences.

Another problem is that corporations change. They evolve over time. This means that most corporations probably like to change their choice for a bankruptcy regime over time.[213] However, simply allowing corporations to randomly change their choice would take away many of the contended benefits of the menu approach, because a corporation could not make a credible commitment to its creditors. This is especially true if a corporation could switch from an option that deprives shareholders of a pay-out in case of bankruptcy to an option that does give shareholders a pay-out. If this were possible a lender would anticipate this behavior and charge a higher interest rate.[214]

In light of the above Rasmussen argues that no objections exist for corporations that wish to change from the administrative reorganization procedure option to the auction option.[215] If corporations wish to change the other way around Rasmussen argues that this should only be possible with the consent of all the creditors.[216]

Moreover, corporations will sometimes probably wish to change to or from the no-bankruptcy option.[217] With regard to a change to the no-bankruptcy option Rasmussen sees a risk of preferential payment. Where other options include a pro rata payment for general creditors, the no-bankruptcy option provides for the possibility of preferential treatment of a certain creditor.[218] Rasmussen suggests solving this problem by either demanding unanimous creditor consent or by setting a certain waiting period before the corporation could change.[219]

A switch away from the no-bankruptcy option could induce shareholders to seek an option that includes an automatic stay to protect their interests, thus preventing collection efforts of a creditor that would be available under the no-bankruptcy option. Rasmussen argues that unanimous creditor consent is the best available way to prevent such behavior.[220]

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213 Rasmussen 1992, p. 116–117.
214 Rasmussen 1992, p. 117.
215 Rasmussen 1992, p. 117.
216 Rasmussen 1992, p. 118. For example, a corporation would probably wish to make this kind of change if it went from a public corporation to a private corporation by means of a leveraged buyout.
217 Rasmussen 1992, p. 188.
218 Since bankruptcy law is not applicable under the no-bankruptcy option preference law would also not be applicable.
219 Rasmussen 1992, 119.
220 Rasmussen 1992, p. 119–120.

Finally, Rasmussen argues that changing to or from the selective stay option should also be regulated.[221] Moving away from the selective stay option would need the approval of the financing lender. Moving to the selective stay-option would need unanimous creditor consent. Otherwise there would be a risk of preferential treatment of the financing creditor.[222]

2.6 Costs of the menu approach

Some of the flaws inherent in the proposals for automatic restructuring are also inherent in the menu approach. For example, the problem of dividing non-consensual and consensual claimants also exists under the menu approach.[223] Furthermore, the problem of transaction costs also exists under the menu approach, because a contract would have to be closed between the debtor and all of his creditors.

With regard to the problem of transaction costs Rasmussen tries to provide a solution by advancing that the debtor includes his choice for a bankruptcy regime in his articles of association.[224] This, of course, can hardly be qualified as a choice made by the creditors of the corporation.[225] Furthermore, it is unlikely that a debtor has sufficient information at the time of his incorporation to make an efficient choice.[226] This problem may be solved by the ability to change regimes. However, the fact that Rasmussen requires consent by all creditors to make certain changes makes his proposal highly impractical.

Furthermore, how would the creditors receive notice of a change of choice? Sending every creditor notice to invite them to consent with a change of choice bears a certain amount of costs.[227] If not for the costs of sending the notice then for the effort it takes to determine who is eligible to consent. If the choice can be made by simply changing the charter of a business and leaving it that way for a certain period of time, creditors would still need to know under what bankruptcy regime a business functions so they can adjust their prices accordingly.[228] Rasmussen sees a solution for this problem in the possibility for a creditor

221 Rasmussen 1992, p. 120.
222 Rasmussen 1992, p. 120.
223 Tabb 2004, p. 270 for a description of this problem.
224 Robert K. Rasmussen, 'Resolving transnational insolvencies through private ordering', 98 *Mich. L. Rev.* 2252, 2254 (2000).
225 Tabb 2004, p. 268.
226 Tabb 2004, p. 269 and Skeel 1993, p. 482.
227 LoPucki 2000, p. 2244.
228 This, of course, would reintroduce a moral hazard for the class of shareholders, who could simply change the charter as to chose the option that is most convenient for them at any given time.

to search corporate records.[229] These searches, however, would have to be performed regularly and at certain costs. Furthermore, each search would have to be analyzed and verified on correctness, which brings along further costs.

Many small creditors will not undertake such efforts and simply extend credit. They will therefore not monitor the debtor, but take as a starting point that the debtor has chosen the bankruptcy regime that is most disadvantageous to the creditor and price their credit on the basis of this assumption.[230] This may provide for inefficiencies. It may also be that there are maladjusting creditors present in the pool of creditors. Maladjusting creditors are creditors who are unable to adjust their prices to the amount of risk forced upon them, because they do not have sufficient bargaining power to avoid bearing those risks.[231] These creditors are not merely tort victims, but also employees, taxing authorities and trade creditors.[232] As Rasmussen admits, maladjusting creditors cannot price their credit to the amount of risk and the debtor will have an incentive to chose a bankruptcy option that exploits this.[233] It is true that the costs involved are caused by the maladjustment of certain creditors, but the point is that the menu approach promotes this kind of behavior.[234]

2.7 The costs of contractualism

As described in the preceding section the menu approach has a problem with giving proper notice to its creditors and the markets of which option is presently applicable to a corporation. This problem of notice, however, also plays a role in the other proposals discussed in this Article that are based on contractualism.[235] Furthermore, contractualism does not provide for proper control over the assets of a corporation. Without asset constraint the debtor has a broad opportunity to transfer, both in good faith and in bad faith, assets prior to default. This can leave the creditors with few assets to seek recourse on.[236] This problem

229 Rasmussen 2000, p. 2266.

230 Lynn M. LoPucki, 'The case for cooperative territoriality in international bankruptcy', 98 *Mich. L. Rev.* 2216, 2245 (2000).

231 Elizabeth Warren and Jay L. Westbrook, 'Contracting out of bankruptcy: an empirical intervention', 118 *Harvard L. Rev.* 1197, 1214 (2005). Warren and Westbrook have empirically tested that in 79.5% of their researched samples there was at least one maladjusting creditor.

232 Big creditors with small claims may also be maladjusting, because the size of the claim does not justify the research needed to calculate the risks and price their credit accordingly. However, if one creditor holds many small claim large inefficiencies can arise.

233 Rasmussen 2000, p. 2266.

234 LoPucki 2000, p. 2249.

235 See: Jay L. Westbrook, 'Bankruptcy control of the recovery process', 12 *Am. Bankr. Inst. L. Rev.* 245, 248 (2004A), where several aspects of the problem of notice are discussed.

236 Westbrook 2004A, p. 249 and Jay L. Westbrook, 'The control of wealth in bankruptcy', 82 *Tex. L. Rev.* 795, 833–834 (2004B).

could be solved by contractual covenants, but it is questionable whether these covenants would be effective.[237] Post default the contractualist proposals lack a mechanism for control of the asset, so that rights can be enforced and sales can be effectuated.[238] The different proposals say nothing about who would control the assets of the debtor after a default, who would appoint the controller or what his objective would be.[239]

Westbrook argues that if a contractual solution for financial distress is preferred, only a dominant security interest would provide a workable solution.[240] In this respect he specifically refers to article 9 of the U.S. Uniform Commercial Code.[241] This article provides for a method of both notice and asset control. Westbrook argues that the holder of the security interest would have to be dominant. This would prevent the arising of a competition for which bankruptcy regime is applicable and provides for complete control over the debtor and its assets.[242]

Related to Westbrook's assessment are the assertions made by Picker. According to Picker a common pool problem can arise with regard to a debtor. He argues, that security rights can severely minimize this.[243] Thus suggesting that bankruptcy law has a very limited function at most.

According to Picker parties involved in extending credit can minimize the common pool problem by structuring their relationships.[244] Picker gives the example of a secured creditor that is owed more than the assets would be worth if a corporation failed.[245]

Furthermore, if the parties anticipate a common pool problem, they will also try to minimize the harms of the common pool. Therefore they will charge interest rates that compensate the losses that are to be expected.[246] These losses are a consequence of the fact that a debtor will pursue a riskier investment strategy if creditors are involved. The reason being that it is not the debtor's money that will be lost if he fails. To prevent this 'debtor misbehavior'

237 Westbrook 2004A, p. 249. These covenants would not affect the asset transfer itself, but only give a creditor a contractual obligation.
238 Westbrook 2004A, p. 249.
239 Westbrook 2004B, p. 835.
240 Westbrook 2004A, p. 247. Westbrook, however, thinks the widespread use of a dominant security interest is both unfeasible and undesirable.
241 Another example is the figure of the floating charge, which is found in Great Britain.
242 Westbrook 2004A, p. 249–250.
243 Randal C. Picker, 'Security interests, misbehavior, and common pools', 59 *U. Chi. L. Rev.* 645 (1992).
244 Picker 1992, p. 647–648.
245 Picker 1992, p. 648.
246 Picker 1992, p. 647–648.

a creditor can, according to Picker, monitor or he can acquire ex ante rights by contract.[247] Picker contends, however, that contractual solutions do not suffice to prevent debtor misbehavior. Not only will the debtor still be able to take increased risks, it will also be very difficult, if not impossible, to draft a contract that ensures that a debtor will choose the strategy that is most beneficial for the creditor.[248] And, furthermore, if a contract can be drafted and that contract is breached, the creditor still has to convince a judge of this fact.[249] Thus, Picker asserts, creditors will generally monitor their debtor.

However, monitoring produces additional problems for creditors. When multiple creditors are involved there is the risk that creditors will duplicate each other's monitoring.[250] Furthermore, if a creditor monitors he has information that he can use to his advantage. Which means that he can, if he deems it necessary, try to seek full payment from a debtor, thus trying to avoid the pro rata regime that is used in bankruptcy.[251] In other words, there is a risk of creditor misbehavior.

3 The auction-alternative

There have also been non-contractualist proposals that are intended as an improvement in efficiency with regard to bankruptcy. Two prominent examples of such proposals are the mandatory auction regime and options-theory. These proposals will be discussed in the following sections.

3.1 A mandatory auction regime

Baird, in a series of articles, has shown to be critical of the justification for the existence of an administrative reorganization procedure.[252] He argues that it may well be that a

247 Picker 1992, p. 653.

248 Picker 1992, p. 656–657. An example of increased risk taking is asset substitution. This means that a debtor will substitute low-risk assets for high-risk investments.

249 Picker 1992, p. 657.

250 Picker 1992, p. 657.

251 Picker 1992, p. 657 and p. 671.

252 Baird 1986, Douglas G. Baird, 'A world without bankruptcy', 50-SPG *Law & Contemp. Probs.* 173 (1987), Baird 1993, Douglas G. Baird and Robert K. Rasmussen, 'The end of bankruptcy', 55 *Stan. L. Rev.* 751 (2002), Douglas G. Baird and Robert K. Rasmussen, 'Chapter 11 at twilight', 56 *Stan. L. Rev.* 673 (2003), Douglas G. Baird, 'The new face of Chapter 11', 12 *Am. Bankr. Inst. L. Rev.* 69 (2004). Baird takes the Chapters 7 and 11 of the U.S. Bankruptcy Code as a reference. Whether his arguments are also valid under Dutch law is discussed below in Part D. Other proponents of mandatory auctions are Jackson and Jensen. See: Thomas H. Jackson, *The logic and limits of bankruptcy law* 218–224 (reprint 2001) and Michael C. Jensen, Corporate control and the politics of finance, 4 *J. Applied Corp. Fin.*, 13, 31–32 (1991).

bankruptcy regime that would provide for a mandatory auction of a corporation on the open market shortly after it has filed for bankruptcy is more efficient than a reorganization procedure. Baird contends that there are three reasons why an auction is more efficient: i) the elimination of the valuation problem, ii) lower costs and iii) the lack of going-concern surplus in corporations.

As discussed above in §1 of this Part an administrative reorganization procedure involves a hypothetical sale. Baird argues that this valuation is 'tricky' and that there is no reason to assume that the shareholders or the judge will value a corporation more correctly than outsiders.[253] Shareholders have an incentive to overvalue the corporation, because the higher the valuation the more they will receive. And, because a judge receives no benefits and suffers no costs, he has no incentive to value a corporation correctly.[254] So, while it may be that outsiders may not value a corporation correctly, it is not said that they are less capable of valuing a corporation.[255]

Furthermore, by eliminating the hypothetical valuation and providing for an actual one the deployment and the distribution question are separated.[256] This prevents the inefficient use of assets, because parties are fighting over who gets what. After the sale the assets will be owned by someone who has an incentive to put the assets to its best use, because he will incur both the costs and the benefits. The claimants in the bankruptcy can then argue about their relative entitlements.[257]

With regard to costs Baird notes that it is not so much the direct costs with regard to administrative reorganization procedures that cause inefficiencies, but rather the indirect costs.[258] Management – as an agent of equity – has an incentive to delay a reorganization procedure as long as possible, hoping that the corporation's fortunes may change for the better and they receive a bigger part of the pie.[259] So, it could be that the corporation's operations are continued long after it should have been liquidated or that the corporation does not take the necessary steps to remain competitive. These costs may be eliminated under a mandatory auction regime, but a mandatory liquidation would give management

253 Baird 1986, p. 136–137.

254 Baird 1986, p. 137. See also: Rasmussen and Skeel 1995, p. 93.

255 Shareholders could, of course, still remain in control of the corporation after the auction, but they would need to make the highest bid.

256 Baird 1993, p. 634.

257 Baird 1993, p. 634. Baird does note the possibility of prepackaged reorganization plans that effectively separate the deployment and the distribution question and eliminate arguments over relative entitlements. Baird, however, contends that these cases are 'the exception'. See: Baird 1993, p. 640.

258 Baird 1993, p. 641–644. Baird assesses that the direct costs of an administrative reorganization procedure are relatively small.

259 Baird 1993, p. 643–644.

an incentive to stall the filing for bankruptcy as long as possible, because bankruptcy would mean that equity would lose its interest in the corporation.

A mandatory auction regime, however, would only be warranted if the costs of an administrative reorganization procedure outweigh those of a public auction. In this respect Baird sees no reason why a corporation should not yield the same amount of money in a speedy auction than in a reorganization procedure.[260] Thus reducing indirect costs, while raising the same amount of money.

Another reason Baird contends that mandatory auctions are justified is that he advances that the traditional justification for having an administrative reorganization procedure – going-concern surplus – does not exist in the large majority of corporations.[261] By discussing major bankruptcies in the United States and nineteenth century cotton mills in Great Britain, Baird argues that modern corporations hardly have any specialized assets dedicated exclusively to them.[262] Thus, assets may work just as well in corporation A as in corporation B and there is no need to retain the specific judicial entity to preserve the value held in certain assets or a configuration of these assets.[263]

3.2 The costs of a mandatory auction regime

Current U.S. bankruptcy law already provides for the opportunity of an auction of a bankrupt corporation if this maximizes value.[264] However, it also provides for the opportunity of reorganizing a corporation by means of Chapter 11. It is this last possibility that supporters of a mandatory auction want to abolish. Throughout the years, however, several drawbacks on mandatory auctions have been advanced in the literature.

Baird contends that the valuation problem that exists in a reorganization procedure is solved by introducing mandatory auctions, because an actual price is paid for the bankrupt corporation. The advantage of this is, according to Baird, that discussions about the valuations over claims can be postponed until it is clear what there is to divide.[265] This, however, does not eliminate the cost of assessing and prioritizing the different claims in a bankruptcy.

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260 Baird 1993, p. 647.

261 Baird and Rasmussen 2002, p. 768.

262 See throughout Baird and Rasmussen 2002; Baird and Rasmussen 2003 and Baird 2004.

263 Baird and Rasmussen 2002, p. 768. The same goes, according to Baird, for teams of people. Teams may provide for value, but that value is not bound to a particular corporation. See: Baird and Rasmussen 2002, p. 776.

264 A. Michele Dickerson, 'The many face of Chapter 11: a reply to professor Baird', 12 *Am. Bankr. Inst. L. Rev.* 109, 114 (2004).

265 Baird 1993, p. 634.

Costs which can constitute a substantial part of the total costs of a bankruptcy.[266] Furthermore, the need for valuation of assets is not completely eliminated under a mandatory auction regime. This is especially true in case there are secured creditors with claims limited to the value of certain assets of the debtor. In this case a judge would have to decide what the value of those assets – and thus the claim of the creditor – are.[267]

Another reason that the need for valuation would not be completely obviated under a mandatory auction regime is the problem of the residual claimant. Ideally an auction would be conducted by the residual claimants of the debtor, since they have the greatest incentive to attain the highest price for the bankrupt corporation. It is, however, not always clear who the residual claimants of a debtor are. Especially when there are multiple layers of debt. This reintroduces the need for a judge to value a debtor to be able to determine who the residual claimants are.[268]

The problem with a mandatory auction regime is not only limited to vicissitudes over valuation, but also lies in the problem of imperfect markets. The consequence of these imperfect markets is that value maximization of the bankrupt debtor will not always be achieved.

For example, the natural potential buyers of a bankrupt corporation are its competitors. Assuming that the corporation went bankrupt because of exogenous causes it is likely that the competitors face the same depressed market as the bankrupt corporation. It will therefore be hard to raise the capital necessary for buying the bankrupt corporation as a going-concern. Therefore leading to a lack of competition among bidders.[269]

Another reason for lack of competition are the costs involved in preparing a bid. There will be substantial costs involved in preparing a bid. Investment bankers have to be brought on and the corporation will have to be valued in order to be able to make an accurate bid.[270] Furthermore, costs will have to be made to arrange for financing the bid.[271] These costs

266 Easterbrook 1990, p. 416.

267 Adler 1993A, p. 321.

268 Easterbrook 1990, p. 415–416. Baird acknowledges this problem. See: Douglas G. Baird, 'The hidden virtues of Chapter 11: an overview of the law and economics of financially distressed firms, Chicago law and economics working paper', 6–7 (1997).

269 See extensively about this subject: Adrei Shleifer and Robert W. Vishny, 'Liquidation values and debt capacity: a market equilibrium approach', 47 *J. of Fin.* 1343 (1992). Also see: Aghion, Hart and Moore 1992, p. 528; Rasmussen and Skeel 1995, p. 109 and Dickerson 2004, p. 117. Baird recognizes this problem. See: Baird 1997, p. 6–7.

270 Adler 1993A, p. 320–321; Skeel 1993, p. 478.

271 Charles W. Adams, 'An economic justification for corporate reorganizations', 20 *Hofstra L. Rev.* 117, 142 (1991).

will only be recouped by the winner of the auction. A potential buyer would therefore need to have a reasonable chance of winning the auction at a price lower than the company's actual value.[272] These costs may well result in bidders not entering the market for the bankrupt corporation, because they consider their chances of winning too low. This results in a lack of competition, which in turn results in lower prices.[273]

Prices will also be lower, because when a bidder wins an auction it not only wins a corporation, but also the substantial risk of a depressed value of the corporation during the time it is in possession of a corporation. For this reason the bidder will only want to buy the corporation at a discount.[274]

Finally, the argument that no going-concern surplus exists in modern businesses can be questioned. It may be that modern businesses do not have many specialized assets, but the going-concern surplus does not only reside in specific assets. It also resides in relationships. Relationships between people, between assets and between assets and people.[275] The going concern-surplus flows from the big web of relationships that is formed by a corporation. For example, the relationship between two completely fungible assets can already constitute a going-concern surplus.[276]

The reality of imperfect markets therefore leads us to the conclusion that a regime that would only allow for mandatory auctions would be inefficient. Such a regime would fail to provide for value maximization in every case.

4 (Stock) market based approaches

Besides auctions there have been several proposals to use the market in combination with options in relation to the reorganization of a corporation. The authors of these proposals

272 Lynn M. LoPucki and Joseph W. Doherty, 'Bankruptcy fire sales', 106 *Mich. L. Rev.* 1, 41 (2007). The lower price is necessary to recoup the costs involved in preparing the bid.

273 Baird acknowledges that competition among bidders is crucial for this. See: Baird 1993, p. 650. LoPucki and Doherty researched prices of thirty large public bankrupt companies sold between 2000 and 2004 in the United States. They found that companies sold for an average of 35% of book value, but reorganized for an average of 80% of book value. Further, they found the average number of bidders per sale to be 1.6. See: LoPucki and Doherty 2007.

274 Aghion, Hart and Moore 1992, p. 527.

275 Lynn M. LoPucki, 'The nature of the bankrupt firm: a response to Baird and Rasmussen's the end of bankruptcy', 56 *Stan. L. Rev.* 645, 652 (2003). See also: Dickerson 2004, p. 122 with regard to keeping teams together.

276 LoPucki 2003, p. 653. LoPucki gives the example of *Matter of 26 Trumbull Street*, 77 B.R. 374 (Bankr. D. Conn. 1987). The estate consisted of a lease valued at $60,000 by the bankruptcy judge and equipment valued at $21,500. These two assets were sold together for $165,000.

argue that use of the market will solve the valuation problem inherent in administrative reorganization procedures.

Below two of the proposals advanced in the literature will be discussed. First, the options theory of Lucian Bebchuk will be discussed.[277] His theory is a further development of the slice-of-capital theory advanced by Mark Roe.[278] The voting options theory, as an elaboration on the options-theory as advanced by Bebchuk, will also be discussed.[279]

4.1 Options theory

Bebchuk has advanced a proposal that uses options to provide for a method to divide the value of a reorganized company among its participants.[280] The main aim of the proposal is to improve the existing administrative reorganization procedure.[281] Bebchuk sees at least three inefficiencies in these administrative procedures: i) the valuation problem and resulting strategic behavior, ii) corporations emerging from reorganization with unsound capital structures, iii) the substantial costs involved in the reorganization process.[282]

The valuation problem and the resulting problem of strategic behavior have already been discussed above in §1 of this Part. Because reorganization involves a hypothetical sale the reorganized company has no fixed value, which the participants involved can divide. This leads to strategic behavior. Senior creditors will have an incentive to advance a low valuation, because this leaves them with a bigger part of the reorganized company. Shareholders will advance a high valuation, because this leaves them with an interest in the company.[283] As a result there is a possibility that a dissatisfied party could induce concessions by threatening to withhold its consent to a reorganization plan.[284]

277 Bebchuk 1988 and Bebchuk 2000.

278 Mark J. Roe, 'Bankruptcy and debt: a new model for corporate reorganization', 83 *Colum. L. Rev.* 527 (1983). This theory will be discussed in passing.

279 Aghion, Hart and Moore 1992; Aghion, Hart and Moore 1994 and Hart, La Porta Drago, Lopez-de Silanes and Moore 1997.

280 Bebchuk 1988 and Bebchuk 2000. Participants cannot establish how much everyone should get if they do not know how much there is to divide. To this effect Bebchuk also provides for an answer to the valuation problem. Furthermore, Bebchuk takes the size and ranking of claims involved as a given. See: Bebchuk 1988, p. 778.

281 Bebchuk 1988, p. 776–777. Bebchuk takes the Chapter 11 of the U.S. Bankruptcy Code as a reference. Whether his arguments are also valid under Dutch law is discussed below in Part D.

282 Bebchuk 1988, p. 780.

283 Bebchuk 1988, p. 778–779; Bebchuk 2000, p. 831–832.

284 Roe 1983, p. 540.

With regard to unsound capital structures Bebchuk notes that the capital structure of a corporation should be chosen to maximize the corporation's value, but that in reality there are often strategic factors that play a role in the choice for a capital structure.[285] I will expand upon this point in relation to Roe.

As for the substantial costs Bebchuk points to the direct cost of a reorganization procedure, but also to the loss of value that is possibly involved as a result of lengthy reorganizations and resulting uncertainty.[286]

Roe has also assessed that the inefficiencies that Bebchuk describes exist.[287] With regard to unsound capital structures Roe – like Bebchuk – notes that strategic factors play a role in the determination of the capital structure of the reorganized corporation. Roe gives special attention to the use of debt in a capital structure to obviate the valuation problem.[288] For example, if parties state that a corporation is worth at least € 6 million, but less than € 10 million, debt can overcome the problems that arise because of these different estimates. For parties could agree to a capital structure that consist of – for example – € 5 million due to senior creditors whether the value turns out to be €6 or 10 million. The other creditors would get the rest, whether that be € 1 or € 5 million. This capital structure would obviate the valuation problem, but there is very good chance that it is not the most efficient one.

Roe contends that the inefficiencies described can be largely solved by requiring courts to confirm only reorganization plans that involve only all-common-stock capital structure. And that the valuation problem of public corporations could be solved by selling a slice – Roe proposes 10% – of common stock in the market and then extrapolate the sale price to find the value of the reorganized corporation.[289]

4.1.1 The options procedure

Bebchuk has stated that he thinks the proposal by Roe is flawed.[290] Roe's method relies heavily on the market for the valuation of a corporation. Bebchuk, however, argues that it is not without question that the market will correctly value a corporation.[291] Furthermore, selling only a slice of the corporation's capital may result in incorrect valuation, because

285 Bebchuk 1988, p. 780 and Bebchuk 2000, p. 832.
286 Bebchuk 1988, p. 780 and Bebchuk 2000, p. 832.
287 Roe 1983, p. 537–545.
288 Roe 1983, p. 539–540.
289 Roe 1983, p. 530.
290 Bebchuk 1988, p. 790.
291 Roe admits this himself. See: Roe 1983, p. 575–580.

there would be an incentive for some participants to manipulate the market price.[292] Finally, Bebchuk notes that Roe's proposal could only be applied to corporations that trade publicly.[293]

Therefore Bebchuk introduces his own proposal, which does not rely on accurate market pricing, but does make use of the market. Bebchuk takes as a starting point that while the value of the reorganized company – named RC by Bebchuk – is not known, it is known which part of the value of RC each participant has to claim. Consequently, if the value of RC is described as V, the claim of a participant can be described as a function of V.[294]

Furthermore, Bebchuk assumes that RC has a given capital structure. In his proposal Bebchuk describes the possibility of giving RC an all-equity structure, with new shareholders being able to later change that capital structure. Or the possibility that the capital structure is set by an expert.[295]

The first step would then be to categorize the different claimants into different classes and give all these classes an equal amount of 'option rights' in the new, reorganized company in return for their outstanding claims.[296] These rights provide the different classes of participants with different rights. For the most senior class each right is redeemable by the corporation for the pro rata fraction of the participants claim. Or – if the right is not redeemed – the holder of the right has a right to get his pro rata fraction of the RC's securities.[297] The rights related to the intermediate class provide its holders with the same rights as those of the senior class, only they will – in case of non-redemption – have to pay a price equal to their pro rata fraction of the total claim of the classes above. The most junior class has a non-redeemable right. It provides the holder with the right to purchase his pro rata fraction of the company's securities for a price equal to his pro rata fraction of the total claim of the classes above.[298]

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292 Bebchuk 1988, p. 790. This incentive would be most prevalent for the shareholders and junior creditors, who would gain most from a higher value of the corporation. Roe, however, disputes whether participants are sufficiently cohesive to really be able to manipulate the market price. See: Roe 1983, p. 579–580.

293 Bebchuk 1988, p. 790.

294 Bebchuk 1988, p. 783 and Bebchuk 2000, p. 834.

295 Bebchuk 2000, p. 834.

296 Bebchuk 1988, p. 782 and Bebchuk 2000, p. 834–835.

297 These securities are called RC units. If RC has 100 RC units and, for example, 100 shares of common stock and 50 shares of preferred stock, each RC unit will consist of 1 common share and half a preferred share.

298 Bebchuk 1988, p. 800–801. This way the old shareholders will be able to get their part of the equity back if they hold the opinion that the old corporation was worth more than the total amount of debt. For example, because the corporation was run inefficiently by inadequate management. In this situation creditors would be overpaid. That is, they get equity worth more than the total amount of debt. Bebchuk's proposal gives the old equity class an opportunity to correct for this. See also: Aghion, Hart and Moore 1994, p. 863–864.

An example may clarify the above.[299] Suppose there are three classes of participants. Class A with 100 senior creditors each owned € 1; class B with 100 junior creditors each owned € 1 and 100 shareholders – class C – each holding one share. At a certain point in time (T1) each senior creditor receives option rights. In the example above each creditor receives 1 option right.[300]

If RC consists of 100 RC units at the moment the options can be exercised (T2) then V is equal to 100 RC units. When one combines the different rights that belong to the option rights in the example it is clear that the obligation of RC is to distribute 100 RC at T2. If class C wishes to exercise its options it would have to submit € 200 to RC.[301] In return each member of class C will receive one RC unit and RC will redeem the option rights of class A and B. If no class C rights are exercised, class B can exercise their options for a total of € 100, redeem all rights of class A and receive 100 RC units. If neither class C or B exercises their rights, class A members will simply receive 100 RC units in total.[302] If only a part of the option rights distributed are exercised by a certain class then the received proceeds will be distributed pro rata to the higher ranking class. Participants will therefore never receive less than what they are entitled to and are not dependent on accurate market pricing. For this reason Bebchuk thinks his proposal superior to that of Roe.[303]

Although in Bebchuk's proposal participants do not depend on accurate market pricing, they may use the market to sell their option rights if they think the market is more accurate in pricing the value of their respective claims. For Bebchuk proposal holds that the option rights that are distributed to the participants of RC could be traded on the market between T1 and T2.[304] This means that if the market does not undervalue RC then participants will be able to sell their option rights right after T1 and capture the value of their entitlement.[305] If, however, the market does undervalue the value of the reorganized company then an option rights holder will still receive what he is entitled to.

For example, if class A thinks that the value of his right is € 0.90, but the market prices the right at € 0.50. Class A claimants will then not sell their option-rights and receive 100 RC

299 This example is derived from Bebchuk 1988. See: Bebchuk 1988, p. 781–782 et seq.
300 With the different rights that belong to the different classes accorded to them.
301 This is the sum of the total value of the claims of class A and B.
302 Bebchuk 1988, p. 787.
303 Bebchuk 1988, p. 789.
304 Bebchuk 1988, p. 789.
305 Bebchuk 1988, p. 789.

units. Everything there is to give and that what they are entitled to.[306] Class A claimants will therefore not have anything to complain about.[307]

After T2 the company is out of insolvency and has an equity class. This equity class can appoint new directors that – as an agent of the shareholders – have an incentive to maximize the value of the corporation.[308] This maximization could be reached by continuing the corporation, but also by liquidation of the corporation.[309]

4.1.2 Possible complications

Bebchuk himself raises several complications with regard to his proposal. The most important of these complications are: i) the reinstatement of beneficial contracts, ii) secured claims and iii) concentration of claims.[310] Bebchuk, however, argues that these complications are no impediment to the introduction of his proposal.

With regard to beneficial contracts Bebchuk notes that it could be that defaulting on certain contracts is unfavorable for the participants in a corporation. For example, if the interest rate of a loan has risen after the loan was taken out. Bebchuk, however, does not see these contracts as a complication. The contracts that are favorable to the creditors should be specified in a reorganization plan. The contractual counterparties of the debtor with the reinstated contracts will not be affected by the bankruptcy and does therefore not participate in the division of option rights.[311]

With regard to secured claims Bebchuk simply argues that the statutory regime should be followed. If the law provides for a right of immediate payment then provisions to this end should be included in a reorganization plan.[312] Bebchuk does therefore not consider the problems related to secured claims to be a specific problem of his options approach.

Finally, it can be that one participant holds such a large part of the claims of the corporation that he ends up with a controlling block of shares in the reorganized company. Because he has a controlling block of shares these shares will be more valuable than the shares of

306 Bebchuk 1988, p. 791.

307 Except that the market does not function well. The option system proposed, however, cannot be blamed for this.

308 The incentive for the (former) claimholders to maximize the value of the corporation stems from the fact that they are now the residual claimants of the corporation. See: Aghion, Hart and Moore 1994, p. 864–865.

309 Bebchuk 2000, p. 837.

310 Bebchuk 1988, p. 800–804.

311 Bebchuk 1988, p. 802.

312 Bebchuk 1988, p. 802–803. A reorganization plan would still be necessary under Bebchuk's proposal to determine some essential features of the reorganized corporation, such as the capital structure.

the other participants. Bebchuk, however, argues that this problem can arise under any reorganization regime that divides securities between a corporation's participants.[313] In his opinion this problem could be solved by a mandatory sale of an amount of shares needed to reach a certain threshold.[314] This, however, would probably lead to depressed prices for the large blocks of shares that have to be sold mandatorily.[315] Which would be unfair to a creditor that happens to have a large claim.

4.2 Options theory 2.0

Aghion, Hart and Moore have used Bebchuk's option theory and have expanded it in several ways.[316] The main difference between their proposals is that a formal voting process over cash and non-cash bids solicited by the bankruptcy judge is conducted in the voting options proposal.[317] The basic idea behind their proposal, however, is the same as that of Bebchuk: use of the market to solve the valuation problem.

In the voting options proposal, just as in Bebchuk's, all debts are cancelled upon the declaration of bankruptcy of a corporation.[318] A judge will be appointed and will have to determine the size and relative priority of all claimants.[319] Directly after his appointment the judge will solicit bids for the corporation's assets and proposals for continuing the operations of the corporation.[320] These bids may consist of cash bids, but also of non-cash bids. A non-cash bid means that a party offers securities in the post-bankruptcy company and provides for reorganization of the company.[321] Combinations of cash and non-cash bids

313 Bebchuk 1988, p. 803. Compare: Roe 1983, p. 575–576. Roe also thinks the argument of controlling shareholders unconvincing against a (stock) market based approach. See also: Aghion, Hart and Moore 1992, p. 541–542.

314 Bebchuk 1988, 803–804.

315 Alexander Dilger, 'The market is fairer than Bebchuk's scheme', Diskussionspapiere Ernst-Moritz-Arndt-Universität Greifswald nr. 9, 20–21 (2000).

316 Aghion, Hart and Moore 1992 and Aghion, Hart and Moore 1994. The proposal was in turn further elaborated on in: Hart, La Porta Drago, Lopez-de Silanes en Moore 1997.

317 Bebchuk does not see the introduction of a formal vote as the major improvement of the Aghion, Hart and Moore proposal over his own, but the fact that the bids must be already submitted before option rights can be traded. Bebchuk 2000, p. 837.

318 Aghion, Hart and Moore 1992, p. 533 and Aghion, Hart and Moore 1994, p. 862.

319 Aghion, Hart and Moore 1992, p. 533 and Hart, La Porta Drago, Lopez-de Silanes en Moore 1997, p. 464.

320 Aghion, Hart and Moore 1992, p. 533; Aghion, Hart and Moore 1994, p. 862 and Hart, La Porta Drago, Lopez-de Silanes en Moore 1997, 464.

321 Aghion, Hart and Moore 1992, p. 533; Aghion, Hart and Moore 1994, 862 and Hart, La Porta Drago, Lopez-de Silanes and Moore 1997, p. 464. An example of a non-cash bid is if management bids to 'buy' each share in the bankrupt corporation in return for one share in the reorganized corporation.

are also allowed. Aghion, Hart and Moore envision that the determination of relative size and priority of claims and the solicitation of bids will take three months.[322]

In the most extensive proposal the corporation – after the three months are up – issues 100 Reorganization Rights (RRs) and the judge reveals the bids received.[323] The issued RRs are initially allocated to the senior creditors, but the other claimants have the possibility to acquire RRs by exercising option rights in the inside auction. These RRs provide for the right to vote after all auctions have been concluded. By initially allocating the RRs with the senior creditors it is assured that no junior creditor will receive payment before all senior creditors have been fully paid.[324]

After this inside auction a public auction will be held in which outsiders can buy RRs from those who hold the RRs at that point in time.[325] This will provide creditors with an opportunity to sell their RRs for cash. Aghion, Hart and Moore envision that the inside and public auction together will take around one month to conclude.[326]

The idea behind having an inside auction before a public auction is that if the markets are imperfect, outsiders could overbid the corporation's original creditors, while still receiving RRs for a price lower than their true value. The inside auction tries to prevent this by giving insiders a preferential right to buy RRs.[327]

After the auctions have been concluded the RR holders meet and vote on what they consider to be the best offer received by the judge at the end of the first three months.[328] This proposal can consist of reorganizing of the corporation, but also of liquidating it. Just like in Bebchuk's proposal all RR holders are the residual claimant of the reorganized company and have an incentive to maximize the value of the company, thus ensuring that they select the best offer at hand.

322 Hart, La Porta Drago, Lopez-de Silanes en Moore 1997, p. 464.
323 Hart, La Porta Drago, Lopez-de Silanes en Moore 1997, 465.
324 Hart, La Porta Drago, Lopez-de Silanes en Moore 1997, 469. This feature is argued to be an improvement of Bebchuk's proposal.
325 Hart, La Porta Drago, Lopez-de Silanes en Moore 1997, 465. See also: Agion, Hart and Moore 1992, p. 535.
326 Hart, La Porta Drago, Lopez-de Silanes en Moore 1997, 465–466.
327 Hart, La Porta Drago, Lopez-de Silanes en Moore 1997, 467.
328 Aghion, Hart and Moore 1992, p. 536 and Hart, La Porta Drago, Lopez-de Silanes and Moore 1997, 466. Bebchuk contends that the fact that bids must already be submitted before the RRs are traded is a valuable contribution to his proposal. This provides the creditors with additional information which they can take into account in their decision whether to exercise their option or not. See: Bebchuk 2000, p. 837.

4.3 The costs of the option approach

Bebchuk and Aghion, Hart and Moore have drawn up elegant proposals to replace Chapter 11 of the U.S. Bankruptcy Code. There are, however, several objections that can be raised in relation to their proposals.

Disputed claims

A major problem with the options proposals – just as with a mandatory auction regime – is that these proposals do not provide a method to determine the relative size and priority of the different claims; a key feature of an administrative reorganization procedure.[329] Both Bebchuk and Aghion, Hart and Moore quite easily assume that assessing size and priority of the claims in a bankruptcy will be done in a clean and speedy manner.[330] Reality, however, is different and hardball litigation is certainly not unthinkable in larger bankruptcies.

Aghion, Hart and Moore do propose a solution for the problem of disputed claims.[331] They state that if, for example, only 10% of the claims is disputed the option approach would be used for the 90% of undisputed claims. Any cash generated during the restructuring is held in escrow by the judge. When the claim disputes are resolved the newly acknowledged claims would receive an equity stake in the reorganized company and the money held in escrow could be distributed accordingly.

This solution may work when only a small percentage of the claims is disputed. Aghion, Hart and Moore, however, do not explain what happens if a large percentage of the claims of a debtor is disputed or if there is one creditor with a claim that is a large claim relative to the total amount of claims. Furthermore, this solution fails to take into account that creditors cannot always be neatly divided into their levels of priority.[332]

Bias of failures in estimation

The lack of a method to determine size and priority of the different claimants is not the only problem with an option approach of bankruptcy. There is also the problem of failures in estimation by junior claimants.

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329 Baird 1997, p. 5; Lubben 2001, p. 275.

330 Bebchuk 1988, p. 798 and Aghion, Hart and Moore 1992, p. 534.

331 Aghion, Hart and Moore 1992, p. 541.

332 Lubben 2001, p. 275–276. Lubben gives the example of a unsecured creditor (creditor 1) that is subordinated to another unsecured creditor (creditor 2), because of a subordination clause. Other unsecured creditors, such as trade creditors (creditor 3), will not be bound by such a subordination. Creditor 2 is therefore subordinated to creditor 1, but not to creditor 3. At the same time creditor 3 is not subordinated to creditor 1.

Participants in the bankruptcy will have to estimate the value of the corporation. Their estimates, however, will not always be correct. Especially junior claimants are likely not to receive what they are entitled to. This can be the case both with regard to over and underestimation. In case of an overestimation of the value a junior claimant will lose by exercising his option even though the true value of the option lies below his estimate.[333] A junior claimant can also underestimate a corporation's value. This means he loses when he does not exercise his option because he estimates the value of the share to be lower than the exercising price even though the true value is higher.[334] The consequence of a wrong estimation by the junior claimants is that the senior creditors will either receive too much money or too many shares.[335] This is a violation of the absolute priority rule.

Transaction costs

Another point that should be taken into account are the transaction costs involved in using an option approach. There are costs involved in offering the options. These are typically administrative costs made by the debtor and the costs of the banker that conducts the offering and the transfer of the options.[336] Other costs would have to be made to raise the capital necessary to exercise the options.[337] Since the junior creditors would not need capital to buy back their own interest in the corporation, but only that of the higher ranking creditors the amount of capital is less than the capital needed under a mandatory auction regime. The costs will be considerable nonetheless.[338]

Information and illiquidity

Bebchuk himself raises two possible objections that can be made against his proposal: a change in the available amount of information and the necessity to invest financial resources.[339]

It could be argued that the amount of information needed to determine what the value of a corporation is, and as a consequence, what a claim holder should do with his option rights is increased with the introduction of Bebchuk's proposal. Bebchuk argues that this argument is invalid, since under an administrative reorganization procedure the participants also have to bargain under their own estimate of the value of the corporation.[340] Further-

333 Alexander Dilger, 'Forced to make mistakes: reasons for complaining about Bebchuk's scheme and other market-oriented insolvency procedures', 21 *Eur. J. Law. Econ.* 79, 85–86 (2006).
334 Dilger 2006, p. 85–86.
335 Dilger 2006, p. 85.
336 Adams 1991, p. 156; Adler 1993A, p. 320.
337 Adams 1991, p. 152–153.
338 Adams 1991, p. 153.
339 Bebchuk 1988, p. 795–797 and Bebchuk 2000, p. 839–840.
340 Bebchuk 1988, p. 795 and Bebchuk 2000, p. 840.

more, there is no reason to assume that participants have less information available. Rather, they will have an additional source of information available: the market.[341]

The market, however, will only be a helpful source of information if the options are not undervalued.[342] A participant will have to decide on his own whether to exercise his options and therefore he will need to value the company. Furthermore, under the option approach each participant will need to make his own estimate. This way an advantage of an administrative reorganization procedure – collective gathering and sharing of information – is lost.[343]

Second, with regard to financial resources Bebchuk recognizes that some participants would need to invest, before they can receive that what they are entitled to.[344] They may not wish or be able to invest in the corporation again. Bebchuk reasons that this objection is unconvincing. Participants will have their right redeemed by the corporation or can sell their option right on the market in most cases. In other cases, when a participant does not have the financial resources to make the necessary investment, he could borrow the necessary amount.[345] This assertion, however, can also be questioned. There will be claimants that have substantial outstanding credit and who would run the risk of themselves becoming insolvent because they lose their claims.[346] Furthermore, claimants will not always be able to sell their options. This is especially true for small companies, for which it is questionable that a liquid trading market will exist.

Aghion, Hart and Moore: no real improvement

The Aghion, Hart and Moore proposal aims to form an improvement of that of Bebchuk. It aims to do so by, for example, allowing non-cash bids for the bankrupt corporation to eliminate the problem of liquidity constraints for bidders for the corporation.[347] However, other problems such as transaction costs and disputed claims are not solved by the Aghion, Hart and Moore proposal. Moreover, the contended main improvement of Bebchuk's proposal – the allowance of both cash and non-cash bids for the corporation – is no real improvement in this respect.

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341 Bebchuk 2000, p. 840. An individual creditor, however, may have less information available, because information is gathered on an individual basis. However, this collective action problem does not, according to Bebchuk, decrease the total amount of information available. See: Bebchuk 1988, p. 795–796.

342 Dilger 2006, p. 83–84.

343 Dilger 2006, p. 85.

344 Bebchuk 1988, p. 796 and Bebchuk 2000, p. 839.

345 Bebchuk argues that the participant could pledge his option rights to borrow the necessary funds. See: Bebchuk 2000, p. 839.

346 Dilger 2006, p. 86.

347 Baird 1997, p. 9.

With regard to cash bids the problem is that the winning bid has to be approved by the RR holders.[348] In a normal first-price auction the seller would sell the corporation to the highest bidder. A bidder would only gain from the auction if he bids lower than the true value of the corporation. In the Aghion, Hart and Moore proposal the RR holders can use this fact as a way to gather information on a potential maximum price. They could offer the corporation to a bidder for a price nearest to their valuation.[349] A bidder would anticipate this strategy and only bid a price that does not reveal his true valuation. This would result in no or only low cash bids.[350]

Non-cash bids on the other hand are unnecessary.[351] These bids regard the voters as the new owners of the corporation and concern the structure of the corporation.[352] Such non-cash bids provide voters with an opportunity to base their vote on non-pecuniary aspects, such as the choice between different management teams or different capital structures. There is no reason, however, why shares cannot be directly allocated according to the options theory as advanced by Bebchuk and have the new shareholders make the decisions involved in the different non-cash bids.[353] Directly allocating shares takes away the restriction of being able to choose only among the different bids. Furthermore, no special laws for the protection of minority voters are necessary.

Part C: The way forward: repeal or change?

1 The advantage of the alternatives: correct valuation

Because a value cannot be determined precisely at the real value of the debtor there is room for bargaining and bias under an administrative reorganization procedure. This valuation problem can be illustrated by the judgment of the District Court in *Citibank v. Bear*:

> "My final conclusion as to the value of the company is that it is worth somewhere between $90 million and $100 million as a going concern, and to satisfy the people who want precision on the value, I fix the exact value of the company at the average of those, $96,856,850, which of course is a total absurdity that

348 Dilger 1999, p. 155.
349 Dilger 1999, p. 156. Dilger assumes some bargaining power at the side of the RR holders.
350 Dilger 1999, p. 156.
351 Dilger 1999, p. 156.
352 Other non-cash bids would only allow a dominant voter to redistribute value away from minority voters. Dilger 1999, p. 156.
353 Dilger 1999, p. 156.

> anybody could fix a value with that degree of precision, but for the lawyers who want me to make a fool estimate, I have just made it"[354]

This begs the question whether the value of the debtor should be determined by a judge or by someone else. The alternatives for the administrative reorganization procedure discussed in this Article argue that it should be someone else. They put their faith in 'the market'.[355] In a functioning market this provides for a more accurate way of valuing the debtor. However, the advantage of a valuation that is more precise should be weighed against the costs that are involved in introducing a market valuation.

2 The drawbacks of the alternatives

Just as with the valuation problem the problem with alternatives for the administrative reorganization procedure discussed in this Article are mainly a consequence of the fact that the world – including the markets – is imperfect.

The contractual alternatives to the administrative reorganization procedure, for example, fail to take into account that in reality claimants cannot be divided in a textbook manner. Furthermore, the contractualist proposals all seem to assume that assets can be sold immediately for its true value. Sometimes, however, selling assets for their true value takes time, effort and money. At the same time, it can be that the assets of the debtor have to be sold very shortly after the debtor is declared bankrupt. But in the Chameleon and Contingent Equity proposals the creditors would first have to decide collectively whether to default again or raise money by means of issuing equity. Furthermore, they would have to decide on whether to keep existing management in place. This would all cost time that the debtor does not have. Finally, with regard to contractual structures the transaction costs should not be underestimated. Drawing up contracts and covenants, reviewing them and litigating them costs money. Sometimes a lot of money.

With regard to auctions it is noted that the need for a valuation would not be completely obviated. For example, if the claims of a secured creditor are limited to the value of certain assets of the debtor. Furthermore, a mandatory auction can result in a suboptimal yield, because of a lack of competition. This can result in fire sales.

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354 *Citibank, N.A. v. Baer*, 651 F.2d 1341, 1347, 6 Bankr. Ct. Dec. (CRR) 552, 22 C.B.C. 939, Bankr. L. Rep. (CCH) P 67563 (10th Cir. 1980), quoting district court ruling.

355 It is noted that the menu approach also has 'administrative reorganization procedure' option.

With regard to the options approach it can be questioned whether this system would really work in practice. For example, Bebchuk does not provide for a satisfying solution for large amounts of disputed claims. Furthermore, creditors will have to pay to get what they are entitled to. Bebchuk proposes that creditors could just borrow the funds. But borrowing also costs money and it is questionable whether creditors would be willing to cooperate with such a procedure. Finally, conducting the options procedure takes time. It can be, however, that the assets of the debtor have to be sold within a few days. Just like the contractual solutions, options theory does not provide for a way to do this

3 How high are the costs of an administrative reorganization procedure really?

The critics of the administrative reorganization procedure – and Chapter 11 in particular – have argued that the costs of such a procedure are not only related to the valuation problem. According to them, direct costs, the lack of speed and the perverse incentives for management also make an administrative reorganization procedure inefficient. But are their arguments valid?

3.1 Direct costs

With regard to direct costs there have been several empirical studies. In 2000 Lubben found that the direct costs of Chapter 11 were on average 0.87% of total firm size (assets plus debts). When prepackaged bankruptcies were removed the direct costs were found to be 1.20%[356] 356 In the same year Lawless and Ferris performed a study on small bankruptcies. They established the median of costs of Chapter 11 to be 3.5% of debtor assets.[357]

In 2008 Lubben performed another study on the direct costs of Chapter 11.[358] He reported the costs of professional fees to be 4 to 4.5% for both a random dataset of 945 cases and a dataset containing only 99 big cases. The year before Lubben had asserted that more than 60% of attorneys retained in his sample were not bankruptcy specialists.[359] According to

356 Stephen J. Lubben, 'The direct costs of corporate reorganization: an empirical examination of professional fees in large Chapter 11 cases', 74 *Am. Bankr. L. J.* 509 (2000). Measured as a percentage of assets the direct costs were respectively 1.8% and 2.5%.

357 Stephen p. Ferris and Robert M. Lawless, 'The expenses of financial distress: the direct costs of Chapter 11', 61 *U. Pitt. L. Rev.* 629 (2000).

358 Stephen J. Lubben, 'Corporate reorganization and professional fees', 82 *Am. Bankr. L. J.* 77 (2008).

359 Stephen J. Lubben, 'The microeconomics of Chapter 11 – Part 1', 4 Int. Corp. Res. 31 (2007A) and Stephen J. Lubben, 'The microeconomics of Chapter 11 – Part 2', 4 *Int. Corp. Res.* 87 (2007B).

Lubben this suggested that a large amount of direct costs incurred during the bankruptcy are exogenous to Chapter 11.

In 2010 Lubben wrote his dissertation on the direct costs of Chapter 11.[360] In his book he reported that debtor professionals were on average responsible for 63.1% of total costs. Creditor committees were the cause of 22.5% of total Chapter 11 costs. Lubben also found that a prepackaged Chapter 11 case was not significantly cheaper in terms of direct costs than a regular Chapter 11 case. He hypothesizes that this can be explained by the shifting of costs to the pre-bankruptcy period.[361] Lubben further concluded that complexity and fee structure of the professionals retained are the key determinants of costs.

The amount of empirical research that is done on direct costs of Dutch bankruptcies is limited. This makes the work of Couwenberg and Lubben the more interesting.[362] In their work they compare the costs of business bankruptcy in the United States and the Netherlands.[363] They conclude that Dutch bankruptcies, on average, cost 3% of debtor size and that cases from the United States cost 12% of debtor size.[364] Couwenberg and Lubben argue, however, that in the United States a large part of the costs of Chapter 11 are unrelated to the actual insolvency process. In the United States professionals retained by the debtor perform a much broader array of services than in the Netherlands. Therefore Couwenberg and Lubben limit the direct costs of bankruptcy to that of the lead counsel for the debtor and accountants retained by the debtor.[365] Once this is done the costs of bankruptcy in the United States and the Netherlands are at nearly the same level. Couwenberg and Lubben suggest that the difference between direct costs in the United States and the Netherlands is caused by non-bankruptcy related professionals that are used in American bankruptcy.[366] These are costs that a debtor would have also incurred outside of bankruptcy when there would be, for example, a take-over.

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360 Stephen J. Lubben, 'Measuring the costs of Chapter 11. Professional fees in American corporate bankruptcy cases', Den Haag: Eleven Publishing 2010.

361 Lubben 2010A, p. 42. The costs made in the pre-bankruptcy period can be measured because attorneys are required to disclose pre-filing compensation received from the debtor. 11 U.S.C. § 329.

362 O. Couwenberg and Stephen J. Lubben, 'The costs of Chapter 11 in context: American and Dutch business bankruptcy', 85 *Am. Bankr. L. J.* 63 (2011).

363 Since Dutch bankruptcy law has no separate procedure for reorganization, they could only report on the direct costs of Dutch bankruptcies in general. With regard to the United States they use data on Chapter 11 cases.

364 Debtor size is defined as the sum of assets and liabilities divided by two. See: Couwenberg and Lubben 2011, p. 75.

365 Couwenberg and Lubben 2011, p. 76.

366 Couwenberg and Lubben 2011, p. 78.

When overlooking the evidence it therefore seems that the direct costs of an administrative reorganization procedure are not disproportionately high. Furthermore, a part of the costs – especially in a Chapter 11 procedure – would also have been incurred in a restructuring outside of bankruptcy.

3.2 Speed

Another question is whether, as some critics have argued, the length of an administrative reorganization procedure is a good proxy for costs? With regard to Chapter 11 empirical research has shown that the time that a corporation spends on this procedure has no relation to the costs incurred.[367] In this respect it is interesting that Warren and Westbrook have demonstrated that Chapter 11 is quite efficient in sorting out the 'winners' from the 'losers'. They have shown that cases destined for liquidation are disposed of rather quickly under Chapter 11.[368] This is good, because unnecessary costs are incurred in efforts to reorganize a corporation destined for liquidation. Under Dutch bankruptcy law the costs of a bankruptcy procedure are dependent rather on the effort and time it takes to sell the assets than the length of the procedure.[369]

What is more, say we do accept that speed is a good proxy for costs, is it then really true that Chapter 11 takes a lot of time, allowing managers to postpone an inevitable liquidation in attempt to turn it into solvency? Empirical research has demonstrated that the length of the Chapter 11 procedure has diminished over the course of the past decades. Where Frank and Torous report an average duration of 3.7 years for a Chapter 11 procedure, Brish, Welch and Zhu report a duration of around 2 years.[370] In 2009 Westbrook and Warren demonstrated an average time of eleven months for Chapter 11 procedures.[371] In their sample the typical case took nine months, but this was raised to eleven months on average because of a handful of long cases. After two years almost all cases were resolved. Under Dutch law the average bankruptcy proceeding takes longer to complete: on average 25 months.[372] This is, however, the duration of liquidation and reorganization cases combined. It is unclear how long reorganization cases take on average to complete. Furthermore,

367 Lubben 2008 and Lubben 2010A.

368 Elizabeth Warren and Jay L. Westbrook, 'The success of Chapter 11: a challenge to critics', 107 *Mich. L. Rev.* 603 (2009).

369 O. Couwenberg and A. de Jong, 'Costs and recovery rates in the Dutch liquidation-based bankruptcy system', 30 *Eur. J. of L. and Econ.* 105, 119 (2008).

370 J.R. Frank and W.N. Torous, 'An empirical investigation of U.S. firms in reorganization', 44 *J. of Fin.* 747 (1989) and A. Bris, I. Welch and N. Zhu, 'The costs of bankruptcy: Chapter 7 liquidation versus Chapter 11 reorganization', 59 *J. of Fin.* 1253 (2006).

371 Warren and Westbrook 2009.

372 Couwenberg and De Jong 2008.

in the cases studied all the assets were sold after 3.4 months on average.[373] It therefore seems that the speed of an administrative procedure is not a very good measuring stick for costs and that, even if it were a good measuring stick, administrative reorganization procedures generally do not last disproportionally long.

3.3 Perverse incentives for management

With regard to the perverse incentives for management, the critique of the administrative reorganization procedure implies that the governance regime in bankruptcy falls short. However, a governance regime in Chapter 11 has taken posture over the years. First of all, the law does not give unfettered control over the corporation or the reorganization process to management during a Chapter 11 procedure. Control over the corporation is limited by the fact that consent of the court is necessary for use, sale and lease of property and obtaining credit outside the 'ordinary course of business'[374] The court also supervises the reorganization to determine whether the debtor should retain the exclusive right to propose a plan, which has been limited under BACPCA to 18 months.[375] Management will also be supervised by a creditor committee, if one is appointed.[376]

Secondly, over the last years Chapter 11 has seen a rise of effectuating governance by means of contract control.[377] This is mainly done by means of debtor-in-possession financing. Corporations need money to successfully reorganize. After being declared bankrupt a corporation can arrange for this money by entering into a contract with a lender.[378] Usually the contracts for the financing have already been written at the time a corporation files for bankruptcy. In these contracts the lender can lay down strict covenants with regard to what management can and cannot do. The lender, for example, can stipulate that a reorganization plan should be filed by a certain date, effectively precluding management from endlessly trying to reorganize with the hope of turning the corporation back to solvency. The lending contract can also provide for the appointment of a Chief Restructuring Officer, when the lender deems pre-bankruptcy management insufficiently capable of reorganizing

373 Couwenberg and De Jong 2008.

374 11 U.S.C. § 363 and 11 U.S.C. § 364. See: 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, 447 (1995) and Christopher W. Frost, 'Running the asylum: governance problems in bankruptcy reorganizations', 34 *Ariz. L. Rev*. 89, 125 (1992).

375 11 U.S.C. § 1121.

376 Which will almost always be the case in large bankruptcies.

377 See extensively: David A. Skeel, 'Creditor's ball: the 'new' new corporate governance in Chapter 11', 152 *U. Pa. L. Rev.* 917 (2003), David A. Skeel, 'The past, present and future of debtor-in-possession financing', 25 *Cardozo L. Rev.* 1905 (2004) and Harvey R. Miller, 'Does Chapter 11 reorganization remain a viable option for distressed businesses for the twenty-first century', 78 *Am. Bankr. L.J.* 153 (2004).

378 11 U.S.C. § 364.

the corporation. Contracts of the kind described above effectively give the lender that provides for the debtor-in-possession financing control over a large part of the reorganization process. This severely reduces the contended perverse incentives for management under a reorganization procedure.

Finally, the argument that management would have a reorganization bias, because they continue to keep their job under this procedure has proven to be unjustified. Empirical research has shown that management turnover of bankrupt corporations is quite high.[379]

Under Dutch law a trustee will always be appointed and the debtor will incur costs for his work.[380] The fact that management knows that it will not be in charge of the debtor after filing for bankruptcy may reduce the incentive to timely file for bankruptcy. At the same time this means that the argument expressed by the American critics of the administrative reorganization procedure that management can protract a reorganization procedure longer than is optimal or take unjustified risks with the debtor's assets is not valid under Dutch law.

3.4 The valuation problem: an evolution

As described above, the administrative reorganization procedure has evolved over the years. This also goes for the valuation problem. American bankruptcy practitioners and scholars have especially seen a rise in the use of the 363-sale and the prepackaged reorganization. These options – next to the traditional reorganization plan – provide for an opportunity to choose the most suitable path for a reorganization.

When both the value of the assets as well as the value of the claims are unknown at the start of a bankruptcy procedure the traditional reorganization plan can be used. Parties can bargain over what they perceive to be the value of the debtor and over what their respective claims in relation to the debtor are. Possible perverse incentives for management to drag out the reorganization are diminished by the high turnover rate of management after bankruptcy filings and the conditions under which debtor-in-possession financing is provided.

379 Ethan S. Bernstein, 'All's far in love, war and bankruptcy? Corporate governance implications of CEO turnover in financial distress', 11 *Stan. J.L. Bus. & Fin.* 298 (2006) and Kenneth M. Ayotte and Edward R. Morrison, 'Creditor control and conflict in Chapter 11', 2009 *J. Legal Anal.* 511.

380 Section 4 DBC.

If the value of the assets is clear, but the value and relative priority of the claims is not, a 363-sale can be used.[381] This kind of sale has the advantages of a mandatory auction regime, but does not oblige a debtor to use it if, for example, there is a complete lack of competition and the debtor is better off being sold to its own claimants.

In a 363-sale the assets of the debtor are sold off outside the ordinary course of business and free and clear of liens.[382] Usually the debtor will seek a 'stalking horse' that is prepared to place a floor price for the debtor's assets. Generally speaking this stalking horse is entitled to a 'break up fee' if he does not win the bidding process. Then bids are solicited and the winning bid is filed with the bankruptcy judge for approval. For a judge to give approval to a proposed 363-sale the bid and the sale itself have to meet certain criteria. In *In re Gulf Coast* the court set out thirteen factors to be taken into consideration in reviewing a proposed sale.[383] One of the most important factors of which is whether there is a 'substantial business reason' for conducting a 363-sale over the Chapter 11 procedure. This business reason is usually argued to be present by stating that there is a risk of substantial value depreciation of the debtor's assets if there is no speedy sale. The number of 363-sales has risen substantially over the last years. A famous example of such a sale is the 2008 sale of the brokerage activities of Lehman Brothers to Barclay's Capital in just five days.

The Dutch equivalent of the 363-sale is the asset transaction (*activatransactie*).[384] Under this kind of transaction the trustee sells a part or all of the assets of the debtor to a third party.[385] In an asset transaction the trustee negotiates over an agreement with one or more potential buyers. Once an agreement is reached the supervisory judge has to approve of the proposed sale. There is no statutory law governing the guidelines for approval of the sale by the supervisory judge. However, a trustee will generally have to file a standard form that has been drawn up by the Association of Supervisory Judges in bankruptcies (*Recofa*).[386] This form consists of ten questions regarding the proposed sale to ensure that the price reached under the proposed agreement is the highest price possible. Creditors have no influence on the procedure.[387]

If the value of both the assets and the claims of the debtor are known a debtor can opt for a 'prepack'. In a prepack a debtor reaches agreement with its creditors on a reorganization

381 11 U.S.C. § 363.
382 11 U.S.C. § 363(b) and (f).
383 *In re Gulf Coast Oil Corp.*, 404 B.R. 407 (Bankr. S.D. Tex. 2009).
384 Section 101 and Section 176 DBC.
385 This third party can also be existing management or the old shareholders.
386 The form is annex 14 of the Recofa richtlijnen.
387 The only exceptions are the cases where a creditor committee has been appointed. The trustee will then have to ask this committee for (non-binding) advice. Section 69 and 78 DBC.

plan and solicits the necessary votes for the plan prior to filing for bankruptcy.[388] A prepackaged plan can only be confirmed if a disclosure statement has been filed, the requirements for creditor approval that are applicable in Chapter 11 are met and the creditors and equityholders – insofar as they are impaired by the plan – did not have an unreasonably short period of time to vote on the plan.[389]

The Dutch Bankruptcy Code has no explicit provisions for a prepackaged bankruptcy. Rather, it makes a prepackaged reorganization plan impossible by stating that votes for a proposed reorganization plan can only be solicited directly after the meeting of creditors.[390] This means that there is no room for a prepackaged reorganization plan, but only for a prenegotiated one. This may prevent an efficient reorganization from happening, because of the fact that the voting over the plan takes too much time. The Dutch Bankruptcy Code should be amended on this point.

Part D: General conclusion

Do not throw away old shoes before you have new ones. The same goes for a bankruptcy procedure. In this Article I have argued that a repeal of the administrative reorganization procedure in the United States and the Netherlands is unwarranted. We are better off by simply fixing the shortcomings of the current procedure. I hope that this point of view will be followed by American and Dutch legislators.

388 11 U.S.C. § 1126(b) and Federal Rules of Bankruptcy Procedure 3018(b).
389 11 U.S.C. § 1126(b), § 1126(c) and Fed R. Bankr. p. 3018.
390 Section 139 DBC.

4 An assessment of Dutch bankruptcy asset sales*

1 Introduction

In the Netherlands, it is unusual that a debtor who files for bankruptcy (*faillissement*) files a reorganization plan (*faillissementsakkoord*) and continues to exist. Generally, the assets of a debtor will be sold in an asset sale and the proceeds will be distributed among the creditors. Such an asset sale can be piecemeal, but it can also be a going-concern sale.[1]

If a Dutch trustee wishes to sell assets of the bankrupt debtor before the debtor has entered the 'state of insolvency' (*staat van insolventie*), it needs to meet the threshold of Section 101 of the Dutch Bankruptcy Code (*Faillissementswet*).[2] This Section provides that an asset sale – both public and private – is allowed i) if and to the extent that this is necessary to cover the costs of bankruptcy or ii) if and to the extent that assets could not be preserved without loss to the estate.[3] If one of these grounds is present, the trustee is allowed to sell part of or all of the assets of the debtor shortly after the debtor has been declared bankrupt.[4]

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* This chapter was published as an article in International Insolvency Law Review 2014, issue 3, p. 271–297.

1 Luttikhuis reports that in 2.9% of all corporate bankruptcies ended in 2004 a full going-concern sale was achieved and in 3.4% a partial going-concern sale. A.P.K. Luttikhuis, *Corporate recovery. De weg naar effectief insolventierecht*, Tilburg University 2007, p. 35. Empirical research by Van Dijck has shown that in 65% of bankruptcies of legal entities researched by him the value of the estate is insufficient to pay the salary of the trustee in full. Suggesting that in most bankruptcies the assets of the debtor only have limited value. See: G. van Dijck, 'Biedt een basisvergoeding soelaas? Empirisch onderzoek naar salaristekorten in faillissement', *TvI* 2013, no. 3. However, Couwenberg and De Jong report a continuation of business activities of a bankrupt debtor by means of a going-concern sale in 64.2% of their set of 137 bankruptcies. Their set consisted of bankruptcies with a debt of at least € 227,000 or in which the debtor had 10 or more employees. See: O. Couwenberg and A. de Jong, 'Costs and recovery rates in the Dutch-liquidation based bankruptcy system', Eur. J. Law Econ. 2008, no. 26, p. 113–114. Furthermore, Knegt reports a going-concern sale – explicitly excluding a sale of only the inventory – in 63% of the cases in a set of 286 bankruptcies. R. Knegt, *Faillissementen en selectief ontslag: een onderzoek naar 'oneigenlijk gebruik' van de Faillissementswet*, Hugo Sinzheimer Institute 1996, p. 19.

2 According to Section 173 DBC the debtor enters into a state of insolvency if no reorganization plan has been proposed at the claims admission meeting (*verificatievergadering*), a proposed plan has been dismissed or confirmation of a proposed plan has been denied. Because debtors rarely enter the state of insolvency and, if they do, asset sales are rarely concluded in this stage of the bankruptcy, I focus on asset sales under Section 101 DBC.

3 Section 101(1) DBC: "*De curator is bevoegd goederen te vervreemden, indien en voor zover de vervreemding noodzakelijk is ter bestrijding der kosten van het faillissement, of de goederen niet dan met nadeel voor de boedel bewaard kunnen blijven.*" I use the term 'asset sale' to denote a sale of an asset, both by means of a private sale and a public auction.

4 HR 27 August 1937, *NJ* 1938, 9 (*Nieuw Plancius*)

Under Section 101(2) DBC asset sales that are concluded before the debtor has entered the 'state of insolvency' also fall under the regime of Section 176 DBC.[5] This entails that the trustee can either sell assets by means of a public auction (*openbare verkoop*) or – with permission from the Supervisory Judge – by means of a private sale (*onderhandse verkoop*).[6]

Sometimes assets of the debtor are also sold outside the context of Section 101 DBC. This is the case if they are sold by a creditor who uses its right of summary execution (*parate executie*).[7]

In this Article I assess – in light of the creditors' bargain theory – to what extent the process of disposing assets in Dutch bankruptcies contains obstacles for a trustee to maximize the value of these assets.[8] According to the creditors' bargain theory the goal of bankruptcy law is to maximize the value of the available pool of assets for the investors as a group.[9] Without bankruptcy law, creditors can only seek recourse on an individual basis. If there is not enough to satisfy every creditor, creditors will race to seek recourse on the debtor's assets and a suboptimal value is likely to be realized. In other words: a common pool problem arises.[10] The creditors' bargain states that creditors will therefore choose a collective

5 After the debtor has entered the state of insolvency asset sales are only regulated by Section 176 DBC.

6 The Parliamentary History states that it is to be expected of a trustee that it confers with the Supervisory Judge in case of a public auction. See: G.W. van der Feltz, *Geschiedenis van de Wet op het faillissement en de surseance van betaling*, bewerkt door G.W. baron van der Feltz, deel II (1897); Heruitgave bewerkt door S.C.J.J. Kortmann en N.E.D. Faber, Serie Onderneming en Recht, Deel 2-II, Zwolle: W.E.J. Tjeenk Willink 1994, p. 64–65. Section 176(2) states that if the trustee is not able to sell the assets quickly or the assets cannot be sold at all, the trustee can dispose of the assets in a way that is to be approved by the Supervisory Judge.

7 Section 57 DBC. See hereafter § 4.

8 For the question whether assets sales should be the only option in bankruptcy I refer to: J.M. Hummelen, 'Shaping bankruptcy. What form should it take?', University of Groningen Faculty of Law Working Paper no. 12/2013. Available at SSRN: http://ssrn.com/abstract=2328236.

9 The creditors' bargain theory was developed in the 1980's by D. G. Baird en T.H. Jackson. See: T.H. Jackson, 'Bankruptcy, non-bankruptcy entitlements and the creditors' bargain', *Yale L J* 1982-April, p. 857–907; D.G. Baird & T. H. Jackson, 'Corporate reorganizations and the treatment of diverse ownership interests: a comment on adequate protection of secured creditors in bankruptcy', *U Chi L Rev* 1984-Winter, p. 97–130; T. H. Jackson, 'Of liquidation, continuation and delay: an analysis of bankruptcy policy and nonbankruptcy rules', *Am Bankr L J* 1986A-Fall, p. 399–428 and T.H. Jackson, *Logic and limits of bankruptcy law*, Cambridge: Harvard University Press 1986B. The notion 'investors as a group' includes everyone with a 'right' to the debtor's assets under nonbankruptcy law. This includes employees of the debtor and shareholders, but not – for example – the power of management to control day-to-day operations. See: Jackson 1986B, p. 33. 'Right' is defined as the right to the income stream generated by the firm's assets, the right to receive payment out of the assets, or the rights to the assets upon dissolution. See: Baird en Jackson 1984, p. 100 (footnote 15). See extensively about the creditors' bargain theory as normative theory for bankruptcy law: J.M. Hummelen, 'Efficient bankruptcy law in the U.S. and the Netherlands. Establishing an assessment framework', EJCLG 2014, no. 2 (forthcoming).

10 Jackson 1982, p. 864, Jackson 1986A, p. 402–403, Jackson 1986B, p. 10 and D. G. Baird, 'The uneasy case for corporate reorganizations', *J Legal Stud* 1986-1, p. 132–133.

method of debt collection in order to prevent overuse and maximize the value of the pool of assets.[11]

This collective method of debt collection is called 'bankruptcy law' and according to the creditors' bargain theory should be shaped according to the following three principles:[12]

1. '[B]ankruptcy law at its core should be designed to keep individual actions against assets, taken to preserve the position of one investor or another, from interfering with the use of those assets favored by the investors as a group.
2. Bankruptcy law should change a substantive nonbankruptcy rule only when doing so preserves the value of assets from the group of investors holding rights in them.
3. [B]ankruptcy (…) should be (…) concerned with the interests of those (…) who have property rights in the assets of the firm (…).'

The first principle concerns the question of how assets should be deployed to realize the highest value for the investors as a group.[13] It is meant to prevent individual recourse that is not in the interest of this group.[14] When deploying the assets, the creditors' bargain theory argues, this should be done in the way a sole owner of the assets would.[15] For, if a business only has one owner, he will deploy the assets in a way that would advance maximization of the value of the pool of assets. This is so, because he is the only one who will incur both the costs and the benefits through his decisions with regard to the asset.

The second principle concerns substantive rights. Such substantive rights should only be changed, insofar as this results in an enlargement of the value of the pool of assets for the investors as a group.[16] This limitation stems from the fact that changing substantive rights in bankruptcy can result in an incentive for a creditor to pick his own interest over the interest of the investors as a group, when such a change results in an advantage for a specific

11 In reorganization proceedings bankruptcy law prevents not only overuse, but also underuse. In other words: it solves an anticommons problem. See about this: D. G. Baird & R. K. Rasmussen, 'Anti-bankruptcy', *Yale L J* 2010-January, p. 648–699. The first application of anticommons to bankruptcy by a European scholar can be found in R.J. de Weijs, 'Harmonisation of European Insolvency Law and the need to tackle two common problems: common pool & anticommons', *Int. Insol. Rev* 2012, p. 67–83.

12 Baird and Jackson 1984, p. 100 and 103. With regard to principle 2, I interpret 'nonbankruptcy rules' as being those rules that are not exclusively applicable in bankruptcy.

13 Jackson 1986A, p. 404.

14 Baird and Jackson 1984, p. 106.

15 Baird and Jackson 1984, p. 104. Sole owner means that only one person has the right to use an asset and no one else can assert any claim against the asset. This situation will not occur very often in reality.

16 Baird and Jackson 1984, p. 100.

creditor.[17] As a result, the creditor will try to have a debtor declared bankrupt, if that is more beneficial for the position of the creditor.[18]

The third principle concerns which interests should be taken into account in bankruptcy law. It holds that that bankruptcy law should only be involved in the interests of the holders of a property right.[19] Other interests such as the public interest or preserving employment have no place in bankruptcy law and should be dealt with in non-bankruptcy law.[20]

I argue that in assessing an asset sale under this theory one should take into account both price and process (§ 2). In view of this I specifically look at section 101 DBC (§ 3) and the position of creditors with a right of summary execution in relation to asset sales (§ 4). I also assess the different methods of sales that are possible in respect of an asset sale and the position of insiders in this respect (§ 5).

2 Guiding principles for trustee in asset sales?

The ultimate goal of the creditors' bargain theory is value maximization for the investors as a group.[21] This entails that in an asset sale the highest possible price should be achieved.[22] However, in assessing whether a proposed sale maximizes the value of the pool of assets, the absolute amount offered alone is not very useful. It does not say whether a certain price is the highest price possible.

The above is illustrated by a judgment of the Dutch Supreme Court regarding the term 'sale value' (*verkoopwaarde*) as used in Section 21(1)(a) Inheritance Tax Act 1956 (old). In this judgment the Dutch Supreme Court quoted the Court of Appeals, which had stated that 'sale value' is "*The price that would be offered by the highest bidder when the [asset] was offered in the most suitable way after the best possible preparation.*"[23]

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17 Baird and Jackson 1984, p. 104.

18 This is called forum shopping. The creditor 'shops' for a forum where he is most likely to have his claim paid.

19 See above for the definition of 'right'. The creditor can only claim his right if he were also able to claim it outside of bankruptcy. See: Jackson 1986B, p. 34–35.

20 Baird and Jackson 1984, p. 103.

21 Jackson 1986B, p. 5.

22 See further § 3.

23 HR 6 March 1963, *BNB* 1963/113 (*"de prijs die bij aanbieding ten verkoop op de voor het activum meest geschikte wijze na de beste voorbereiding (…) door de meestbiedende gegadigde besteed zou zijn")*. See about this judgment in the context of real estate foreclosure sales: I. Visser, *De executoriale verkoop van onroerende zaken door de hypotheekhouder*, Den Haag: Boom Juridische uitgevers 2013, p. 89 et seq.

Interestingly enough, Dutch bankruptcy law does not have a lot of rules regarding the process of an asset sale.[24] The Dutch Bankruptcy Code does not provide explicit provisions. Guidance in respect of the sale of assets for a trustee can be primarily found in the rules regarding liability of the trustee for his actions.[25] This can be liability of the trustee in his capacity based on the general norms of Section 6:162 DCC. It can also be in the form of personal liability. Such personal liability is warranted, when a trustee does not act as can be reasonably expected of a trustee that possesses sufficient insight and experience and who acts with precision and commitment.[26] This is the '*Maclou-norm*'.[27]

What does the risk of liability entail in respect of asset sales and value maximization? Case law provides few examples in this respect. In one case personal liability of the trustee was assumed, because he had sold the assets to the first bidder that he came across for a price that was too low.[28] In two other cases, however, liability was not assumed, even though the trustee could probably have realized a higher price.[29] In one case the District Court of Utrecht held that the trustee was justified in selling a software package quickly after the debtor was declared bankrupt, even though the software could have possibly yielded more money.[30] In another case the Court of Appeals of the Hague held that the trustee was not liable for the fact that the assets did not yield the appraised value, even though the trustee had not set a price reserve at the auction of the most valuable asset.[31]

The creditors' bargain theory acknowledges that bankruptcy proceedings take time. As to prevent opportunistic individual behavior by a single investor or a third party to the detriment of the value of the assets for the investors as a group, the creditors' bargain theory

24 Neither is the subject popular in literature. Exceptions are: J.H. Lemstra and J.H van der Weide, 'Kloeke curatoren', in: A.A.M. Deterink et al., *Doorstart*, Deventer: Kluwer 2008, p. 161–177 and G.C. van Daal, 'De klompen van de curator: biedingen op de boedel', in: J.G. Princen and A. van der Schee, *De ondernemende curator*, Deventer: Kluwer 2011, p. 207–219.

25 Compare: Van Daal 2011, p. 211.

26 HR 19 April 1996, *NJ* 1996, 727 (*Maclou en Prouvost*), r.o. 3.6. ('*…handelen zoals in redelijkheid mag worden verlangd van een over voldoende inzicht en ervaring beschikkende curator die zijn taak met nauwgezetheid en inzet verricht.*').

27 Personal liability further requires that the trustee can be personally blamed. HR 16 December 2011, *NJ 2012, 515* (*Prakke/Gips*).

28 District Court of Assen, 10 October 2007, *NJF* 2008, 183 (*Gulf Oliehandel/Boer*). A gas station was sold for € 300,000, while it was valued by the Court – based on an expert report – at € 670,000.

29 In another case a trustee was held liable, because he had sold the assets to the first bidder, without giving a third party – of who the trustee knew he was interested – an opportunity to bid. Unclear is whether the sale to the other party would have provided for a higher price. Court of Appeals Arnhem, 6 February 2007, *JOR* 2007, 106 (*Feenstra/Schouten & Van Muiswinkel Holding*).

30 District Court of Utrecht, 2 July 2003, *JOR* 2003, 273 (*2EPS-2EPC*). The trustee sold the software so quickly, because it was only suitable for MS-DOS and Windows was emerging as the dominant operating system.

31 Court of Appeals The Hague, 19 November 2013, *NJF* 2014, 67 (*Prakke/Gips*) after referral by the Dutch Supreme Court.

therefore prescribes that individual actions by creditors are stayed during the bankruptcy proceeding.[32]

The problem with the *Maclou-norm* in this context is that – while it may offer the trustee some guidance in the process of an asset sale – it does not prevent strategic behavior by creditors or third parties. For example, the *Maclou-norm* does not prevent that assets may be sold piecemeal in a public auction based on a right of summary execution, while a private going-concern sale would be value maximizing.[33] It therefore does not ensure that the process of the asset sale provides for value maximization.

3 The sale of assets under Dutch law: 101 DBC

3.1 The current assessment standard for asset sales

Bankruptcy asset sales – both private and public – fall under the supervision of the Supervisory Judge.[34] The Supervisory Judge is charged with supervising the management and liquidation of the estate.[35] He does not 'co-liquidate' the estate of the debtor.[36] In executing his supervision, according to the legislator, the Supervisory Judge has to check i) whether the trustee acts within the constraints of the law, ii) acts in the interest of the estate and iii) acts in an adequate manner.[37] Or in other words: the Supervisory Judge assesses lawfulness, fitness for purpose and how purposive the acts of the trustee are.[38] When making these assessments, the Supervisory Judge has to perform a full scale assessment.[39]

The current standard of assessment for an asset sale is laid down in Section 101(1) DBC. This Section provides that an asset sale – both public and private – is allowed i) if and to

32 Baird and Jackson 1984, p. 100 and Jackson 1986B, p. 157.
33 See further about the right of summary execution and the method of sale hereafter in § 4 and 5.
34 G.W. van der Feltz, *Geschiedenis van de Wet op het faillissement en de surseance van betaling*, bewerkt door G.W. baron van der Feltz, deel II (1897); Heruitgave bewerkt door S.C.J.J. Kortmann en N.E.D. Faber, Serie Onderneming en Recht, Deel 2-II, Zwolle: W.E.J. Tjeenk Willink 1994, p. 64–65 and HR 5 November 1913, *NJ* 1913, 1345.
35 Section 64 DBC.
36 Van der Feltz II 1897, p. 2.
37 Van der Feltz II 1897, p. 2.
38 B. Wessels, *Bestuur en beheer na faillietverklaring* (Insolventierecht IV), Deventer: Kluwer 2010, § 4012.
39 HR 10 May 1985, *NJ* 1985, 793 (*THB*), which judgment was given in the context of Section 69 DBC.

the extent that this is necessary to cover the costs of bankruptcy or ii) if and to the extent that assets could not be preserved without loss to the estate.[40]

When the Dutch Bankruptcy Code was introduced the legislator predicated a reticent attitude towards selling assets of a bankrupt debtor.[41] The argument of the legislator in this respect was that as long as a claims admission meeting had not taken place, there was a possibility that a reorganization plan was offered and the debtor had the right to get back his assets unharmed.[42] However, in the *Nieuw Plancius* judgment the Dutch Supreme Court took a different approach. It approved a sale of all the assets of the debtor before the claims admission meeting was held. A limitation of Section 101 DBC which would authorize the trustee to only sell a part of the assets of the estate of the debtor was found to be incompatible with the purpose of that Section.[43] Thus, the Supreme Court interpreted Section 101 DBC in a broad way and enabled trustees to sell part of or all of the assets of a debtor shortly after the debtor had been declared bankrupt. Nowadays debtors rarely enter into the state of insolvency in Dutch bankruptcies and asset sales are almost always concluded based on Section 101 DBC.

3.2 Maximizing value as a goal

3.2.1 The goal of bankruptcy in the Netherlands

In relation to assets sales the goal of the bankruptcy procedure also plays a role. The primary goal of bankruptcy – and task of the trustee – in the Netherlands can be described as realizing proceeds in relation to the estate (*boedel*) of the debtor for the benefit of the joint creditors (*gezamenlijke schuldeisers*).[44] Or in other words: satisfying claims of creditors as much as possible according to their rank.[45] However, it follows from case law that a trustee should under circumstances not only focus on the monetary interests of the joint creditors, but also has to take into account societal interests and the justified interests of the debtor.[46]

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40 Section 101(1) DBC: "*De curator is bevoegd goederen te vervreemden, indien en voor zover de vervreemding noodzakelijk is ter bestrijding der kosten van het faillissement, of de goederen niet dan met nadeel voor de boedel bewaard kunnen blijven.*"

41 Van der Feltz II 1897, p. 63–64.

42 Van der Feltz II 1897, p. 63–64.

43 See: HR 27 August 1937, *NJ* 1938, 9 (*Nieuw Plancius*) and Wessels IV 2010, § 4392.

44 G.W. van der Feltz, *Geschiedenis van de Wet op het faillissement en de surseance van betaling*, bewerkt door G.W. baron van der Feltz, deel I (1897); Heruitgave bewerkt door S.C.J.J. Kortmann en N.E.D. Faber, Serie Onderneming en Recht, Deel 2-I, Zwolle: W.E.J. Tjeenk Willink 1994, p. 371. See also: HR 23 december 1994, *NJ* 1996, 628 (*Notarissen THB II*).

45 G.D. Hoekstra, *De positie van de pandhouder in het faillissementsrecht*, Den Haag: Boom Juridische uitgevers 2007, p. 58.

46 See: HR 24 February 1995, *NJ* 1996, 472 (*Sigmacon II*), HR 19 April 1996, *NJ* 1996, 727 (*Maclou en Prouvost*) and HR 19 December 2003, *NJ* 2004, 293 (*Mobell*) for societal interests and HR 20 March 1981, *NJ* 1981,

In the literature it has been argued that the trustee also has to take into account the interest of third parties.[47] Or in other words: that the trustee should look at the interest of all parties involved. As such, the task of the trustee could be described as having to act in 'the interest of the estate'.[48] That is to say a mix of both the interest of the joint creditors and that of other parties involved, with primacy for the interests of the joint creditors.[49]

As the Supervisory Judge supervises the trustee, the prevailing opinion is that the Supervisory Judge should also take into account the interests of all parties involved when exercising his supervision.[50] In this respect, the Dutch Supreme Court – in the context of Section 69 DBC – has, for example, ruled that it is sometimes necessary that the Supervisory Judge weighs the interests of the estate and that of an individual creditor against each other.[51]

3.2.2 The goal of bankruptcy in the Netherlands and the creditors' bargain theory

The creditors' bargain theory describes the goal of bankruptcy in a different way. According to the creditors' bargain theory the goal is to maximize the value of the pool of assets for the investors as a group.[52] In this respect, a discussion about terminology arises.[53]

The term 'investors as a group' denotes everyone with a 'right' to the debtor's assets under nonbankruptcy law.[54] As such, this term includes, among others, secured creditors with a

640 (*Veluwse Nutsbedrijven*) for the justified interests of the debtor. See for a recent example from lower case law in which societal interests made that the trustee was held to ensure a decent slaughter of chickens even though this was not in the interest of the joint creditors: President District Court of Noord-Holland, 15 August 2013, *JOR* 2014, 23 (*Ut Eierhortje*).

47 Wessels IV 2010, § 4012 and F.M.J. Verstijlen and R.D. Vriesendorp, 'Enkele opmerkingen over Polak-Wessels Insolventierecht (I)', *WPNR* (6602)

48 Wessels IV 2010, § 4171.

49 Compare: Wessels IV 2010, § 4173. See for the primacy of the interests of the creditors: HR 3 juni 1910, *W* 9017 (*Tripels q.q./Nypels*).

50 See: Wessels IV 2010, § 4012 and F.M.J. Verstijlen and R.D. Vriesendorp, 'Enkele opmerkingen over Polak-Wessels Insolventierecht (I)', *WPNR* (6602). Different: District Court of Roermond, 25 February 2004, *JOR* 2005, 44; District Court of Groningen, 1 December 2005, *JOR* 2006, 87(*Thuiszorg Buro Holding*) and District Court of Amsterdam, 15 May 2009, *JOR* 2009, 242 (*Vendenco*). All three judgments state that the Supervisory Judge should not take into account interests of counter parties of the debtor.

51 HR 9 June 2000, *NJ* 2000, 577 (*Durmaz/Kramer q.q.*). Section 69 DBC gives creditors, a committee of creditors and the debtor the possibility to object against every act of the trustee or to obtain an order instructing the trustee to act or not act in a certain way.

52 Jackson 1986B, p. 5.

53 See extensively about the relation between the creditors' bargain theory and the current goal of Dutch bankruptcy law: Hoekstra 2007, p. 71–78.

54 Jackson 1986B, p. 33. As stated in footnote 7 above 'right' is defined as the right to the income stream generated by the firm's assets, the right to receive payment out of the assets, or the rights to the assets upon dissolution. See: Baird and Jackson 1984, p. 100 (footnote 15).

right of summary execution (*separatisten*) and creditors who have a fiduciary ownership.[55] The term 'joint creditors' does not envelop these 'investors'.[56]

Related to the term 'investors a as group' is the term 'pool of assets'. Assets are all 'things' that make the estate of the debtor more valuable.[57] The relevant questions under the creditors' bargain theory in this respect are: does the 'object' have value? And if so, to whom?[58] 'Estate' envelops the entire capital of the debtor, which capital can also consist of interests in property.[59] As such, the terms 'assets' and 'estate' seem to be alike.

As set out above, under Dutch law a trustee should not only focus on the monetary interests of the joint creditors, but should also take into account societal interests. This latter part of the task description does not seem to be in line with the creditors' bargain theory, which clearly states that bankruptcy should not be concerned with introducing substantive policies.[60] A substantive non-bankruptcy rule should only be altered, if this preserves the value of the pool of assets for the investors as a group.[61]

However, it can be questioned whether the fact that societal interests play a role in Dutch bankruptcies constitutes a substantive rule that deviates from non-bankruptcy law. The relevant non-bankruptcy provision in this respect is Section 6:2 of the Dutch Civil Code. This Section states that a debtor and creditor are required to behave themselves toward each other in accordance with the principle of reasonableness and fairness.

The principle of reasonableness and fairness is given further substance in Section 3:12 DCC. This Section states that when determining what the principle of reasonableness and fairness requires, one has to take into account general accepted legal principles, the funda-

55 See: Jackson 1986B, p. 91 for secured creditors. Luttikhuis does not explicitly state that these investors are not 'joint creditors', but does set out that they do not fall under the supervision of the trustee or the Supervisory Judge. See: A.P.K. Luttikhuis, 'De relatieve betekenis van toezicht', *TvI* 2004, 56.

56 Hoekstra 2007, p. 71–72.

57 Jackson 1986B, p. 89. Jackson notes that an asset can also be just the interest in a property. For example, in case of lease of a property.

58 Jackson 1986B, p. 97. Hoekstra notes that rights encumbered with a security interest fall under the term 'estate', but are no longer part of it after the creditor has exercised its right of summary execution. Hoekstra then argues that they, however, do continue to be an asset. Hoekstra 2007, p. 72. This seems to be an incorrect interpretation of the term 'asset'

59 Section 20 DBC. See also: B. Wessels, *Gevolgen van faillietverklaring (1)* (Insolventierecht II), Deventer: Kluwer 2012, § 2012, who notes that the term 'entire capital' (*gehele vermogen*) and 'estate' (*boedel*) are both used in the Dutch Bankruptcy Code. There seems to be no difference between these terms. Section 21, 22 and 22a DBC contain a list of goods that are not property of the estate. These exceptions will generally not apply to corporate debtors.

60 Baird and Jackson 1984, p. 101.

61 Baird and Jackson 1984, p. 100.

mental conceptions of law in the Netherlands and the relevant societal and personal interests which are involved. This entails that societal interests are not suddenly introduced as a new concept in bankruptcy. The debtor already had the obligation to take these interests into account outside of bankruptcy. Just as the personal interests of the debtor and the interests of third parties.[62]

3.2.3 Maximizing value and Section 101 DBC

The subject at hand is the current assessment standard for Dutch asset sales and whether this standard is in line with the creditors' bargain theory and thus ensures that the value of the pool of assets of the debtor is maximized. I have already concluded that the goal of Dutch bankruptcies differs somewhat from the goal of the creditors' bargain theory. As the goal of asset sales can be seen as furthering the achievement of the goal of bankruptcy, this argument would seem to entail that the current standard of Section 101 DBC is also not in line with the creditors' bargain. Or in other words: that the standard of Section 101 DBC does not warrant that value maximization is achieved. In this paragraph I devote specific attention to assessing Section 101 DBC in light of the creditors' bargain theory.

The first ground of Section 101 DBC states that asset sales are allowed to the extent that this is necessary to cover the costs of bankruptcy. This ground seems to be in accordance with the creditors' bargain theory. Bankruptcies costs money. And, while the costs incurred in this respect, as such, do not contribute to the enlargement of the value of the pool of assets, reimbursing them can be necessary to achieve value maximization. For, reimbursement of these costs enables bankruptcy procedures, which, in the view of the creditors' bargain theory, provides an economic benefit over individual debt collection.[63]

The second ground for assets sales provided for in Section 101 DBC states that an asset sale is allowed if and to the extent that assets could not be preserved without loss to the estate. It follows from the *Nieuw Plancius* judgment that the purpose of this ground is to "*prevent prejudice to creditors by keeping, what cannot be kept without prejudice to them*".[64] As such, the second ground of Section 101 DBC is formulated in a negative way.[65]

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62 That the interests of third parties are to be taken into account in the context of Section 3:12 DCC follows from: HR 20 May 1994, *NJ* 1995, 691 (*Körmeling/gemeente Vlaardingen*).

63 Jackson 1982, p. 860–865.

64 HR 27 August 1937, *NJ* 1938, 9 (*Nieuw Plancius*): "*…voorkoming van schade voor de schuldeischers door te bewaren, wat niet dan te hunnen nadeele bewaard kan worden…*". See also: Groene Serie Faillissementswet, Section 101, comment 1.

65 The predecessor of Section 101 DBC – Section 809 of the Commercial Code of 1838 – contained a positive formulation. It stated that the assets of a debtor that were not immediately perishable could be sold if it was in the interest in the estate not to keep them in kind.

3.2.4 Maximizing value and Section 101 DBC: overbidding

There is limited case law with regard to the question how the grounds of Section 101 DBC should be read. The case law that is available regards the acceptance of bids after an initial bid was accepted.

In one case the trustee had invited third parties to submit an initial bid.[66] After receiving these bids, the trustee negotiated exclusively with one bidder and entered into an agreement with this bidder under the condition of approval of the sale from the Supervisory Judge. When the trustee requested approval, a third party – that had also submitted an initial bid – requested the Supervisory Judge to withhold approval and stated that it was willing to pay NLG 500,000 (€ 227,000) more than the bidder with whom the trustee had negotiated. So, granting the request of the third party – and denying the sale to the first buyer – could result in a substantially higher yield for the assets.

But, both the Supervisory Judge and the District Court denied the request by the third party. The Dutch Supreme Court approves this denial. It first notes that the District Court held that the trustee had not lost sight of the interest of the estate to achieve the highest possible yield at the time he accepted the bid that he submitted for approval, because at that moment there was no higher bid.[67]

The Supreme Court then rephrases the findings of the District Court regarding reopening of the bidding. It states that the judgment of the District Court should be understood as meaning that according to the District Court it would be a violation of the requirements of an adequate management of the estate, if a third party could submit a higher bid – and obtain the assets – after the trustee has reached an agreement with a certain party and dismisses the appeal.[68] The Supreme Court then concludes by ruling that the District Court did not err in the law by making this judgment; thus leaving room for the conclusion that the District Court could also have ruled that the submitting of a higher bid was possible.

In another case – that was set in the context of liability of the trustee – the outcome was somewhat different.[69] In this case the trustee had provided a party with a bid book for five lots of assets. The bid book provided *inter alia* for a time limit for bids, which expired without a bid from the interested party.

66 HR 7 September 2001, *JOR* 2001, 244 (*Mayr-Melnhof/Spliet q.q.*).
67 *Id.*, r.o. 3.5.
68 I*d.*
69 District Court of Dordrecht, 13 June 2012, *JOR* 2013, 147 (*Noordeloos/Groot q.q.*).

However, the day after the time limit had expired, the trustee and the interested party reached an agreement with regard to the lot 'work in progress' under the condition of approval by the Supervisory Judge. The trustee requested this approval, but shortly after he had done so another party submitted a combined bid for three of the five bids, which the trustee concluded provided for a higher yield for the lot 'work in progress'. Consequently, the trustee informed the Supervisory Judge of the higher bid. As a result, the Supervisory Judge refused approval for the first bid and approved the second bid.

The first bidder then held the trustee liable for the fact that he informed the Supervisory Judge about the second, higher bid. The District Court of Dordrecht, however, ruled that the trustee was justified in doing so. The District Court states that whether the trustee was allowed to take into account the second bid, depended on the sale and purchase agreement. In this respect the Court notes that it is the duty of the trustee to realize the highest possible yield for the assets. It further rules that the trustee was justified in considering the second bid and informing the Supervisory Judge about it, both because the time limit of the bid procedure had expired and – unlike the case discussed above – the trustee was not in exclusive negotiations.[70]

The case law described above provides limited basis for making definitive conclusions regarding the grounds of Section 101 DBC. The cases set out above do seem to imply that in accepting bids in a private sale the trustee should let itself be guided by the highest yield possible, but that there can be situations in which the trustee is limited in its possibilities of taking 'overbids' into consideration. However, the exact boundaries for taking overbids into account are unclear.

From a perspective of value maximization, it is efficient to allow overbids until the Supervisory Judge approves the sale and it is finalized. Allowing overbids can be especially useful in cases in which the first winning bid did not come about in a level playing field or where the bidding is complicated due to the nature of the assets and the bidding process.[71] But allowing an overbid in other cases is, in principle, also justified, because it helps realize value maximization.[72] In this respect, allowing the original winning bidder to overbid the

70 *Id.*, r.o. 4.6–4.7.

71 See in this respect: *In re Corporate Assets*, 368 F.3d 761, 771 (U.S. 7th Cir.2004) and *In re Financial News Network*, 980 F.2d 165 (U.S. 2nd Cir. 1992). In these cases the unlevel playing field respectively the complicated bidding procedures were used as an argument to allow overbids.

72 Compare under U.S. bankruptcy law: *In re Corporate Assets*, 368 F.3d 761, 767 (U.S. 7th Cir.2004), in which the Court of Appeals acknowledged in the context of an overbid that the securing of the highest price for the bankruptcy estate is the governing principle.

overbidder is also justified. This provides an opportunity for the original bidder to submit an even higher bid and generate an even higher yield.[73]

At the same time the allowance of overbids could be construed as being inefficient in the long run. For simply allowing overbids to be taken into account under all circumstances may lead to a situation in which bidders are discouraged to submit their highest bid directly.[74] They will simply wait until the bid process has ended and then submit a slightly higher bid. As such, if it is clear that the overbidder simply waited to see what happened and only then submitted an overbid, the overbid should not be allowed.[75] Even if that bid is higher than the original winning bid.

Allowance of overbids that are only slightly higher than the original bid, will most likely also lead to inefficient results in the long run and is 'penny wise and pound foolish'.[76] As allowing will undermine confidence of bidders in the original bidding process.

4 Creditors with a right of summary execution and asset sales

4.1 The right of summary execution

Section 57 DBC states that a creditor with a right of pledge (*pandrecht*) or right of mortgage (*hypotheekrecht*) can exercise his rights as if there were no bankruptcy. This means that if the debtor is in default with the observance of an obligation for which the right of pledge or mortgage serves as security, the pledgee or mortgagee is entitled to summarily execute its rights and sell the encumbered assets.[77]

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73 Compare: *In re Muscongus Bay*, 597 F.2d 11, 13 (U.S. 1st Cir. 1979), in which the overbidder was not simply declared the winner, but the bid period was extended after an overbid was received.

74 Compare: Visser 2013, p. 99–100. See also: *In re Corporate Assets*, 368 F.3d 761, 767 (U.S. 7th Cir.2004).

75 Compare: *In re Food Barn*, 107 F.3d 558 (U.S. 8th Cir. 1997): "*…we are comfortable that this is not a situation in which a potential buyer purposely bided its time during the auction, taking an opportunity to survey the landscape of the sale, only later to submit an upset bid at the lowest possible price*."

76 See: *In re Gil-Bern*, 526 F.2d 627, 629 (U.S. 1st Cir. 1975), in which the order confirming the overbid as winning bid was set aside.

77 See: section 3:248 DCC for the right of pledge and 3:268 DCC for the right of mortgage. Section 7:54 DCC provides separate rule for the execution of a right of pledge under a financial collateral agreement (*financiële zekerheidsovereenkomst*). I will not discuss a pledge based on such an agreement any further. Pursuant to Section 3:235 DBC it is prohibited for the pledgee or mortgagee to contract a clause that makes it possible to encroach the encumbered assets. The goal of this rule is to prevent that a value surplus above the claim of the secured creditor – if a creditor is oversecured – goes to the secured creditor. See: H.J. Snijders and E.B. Rank-Berenschot, *Goederenrecht*, Deventer: Kluwer 2012, p. 441.

For creditors with a right of summary execution the advantage of such a right is threefold:[78] i) faster payment on their claim, ii) no need to contribute towards the costs of the bankruptcy (*algemene faillissementskosten*),[79] and; iii) the ability to influence the process of the asset sale.

The default rule for summary execution is a sale of the encumbered asset at a public auction.[80] The pledgee or mortgagee may bid at this sale.[81]

Dutch law also provides for the possibility of a summary execution in the form of a private sale. In case of a right of pledge both the pledgee and the trustee can – unless contractually excluded – file a request at the District Court and request the Judge for Preliminary Relief (*voorzieningenrechter*) to permit a private sale.[82] Such a possibility also exists in case of a right of mortgage, but in that case a draft-agreement has to be presented to the judge at the time the request is made and the possibility of a private sale cannot be excluded.[83] In case of a right of pledge it is also possible that the Judge for Preliminary Relief – at the request of the pledgee – permits the pledgee to become owner of the assets in exchange for an amount set by the judge.[84]

If the pledgee and the trustee both concur, they can also agree on a different method of sale of the pledged assets.[85] With regard to this possibility the Dutch Supreme Court has ruled that if a pledgee wishes to sell the pledged assets by means of private sale and requests the trustee to consent to this, the trustee should let its permission depend on the question whether this sale is expected to generate the highest yield.[86] It is also possible that the

78 Groene Serie Privaatrecht, Section 57 DBC, comment 2. The third advantage is described as 'control over the price for which the asset is sold'. However, this is primarily true in private sales. The secured creditor does have the ability to steer the process of the asset sale.

79 Section 182 DBC excludes creditors with a right of execution that exercise their right under Section 57 DBC from contributing towards the costs of bankruptcy.

80 Section 3:250(1) for the right of pledge and 3:268(1) for the right of mortgage. Section 3:250(2) provides that if the pledged asset is marketable on a commodity market or exchange, the public auction may take place on that market with assistance of an intermediary who is active on this market or exchange, under conditions and usages that apply to an ordinary sale on that market or exchange.

81 See: section 3:250(3) for the holder of a right of pledge and Parliamentary History Book 3 DCC, p. 826 for the holder of a right of mortgage.

82 Section 3:251(1) DCC.

83 Section 3:268(2) DCC. Unlike Section 3:251 DBC, Section 3:268 DBC does not provide that the possibility of a private sale can be contractually excluded. Such a contractual clause therefore would therefore qualify as invalid. Compare: Asser/Van Mierlo & Van Velten 3-VI* 2010/393.

84 Section 3:251(1) DCC.

85 Section 2:251(2). According to this section such an agreement may only be made at the time the pledgee is allowed to use its right of summary execution.

86 HR 8 April 1984, NJ 1984, 434 (*Van Gend & Loos/Lips q.q.).* The Supreme Court further ruled that the trustee cannot let its decision depend on whether or not the pledgee wishes to pay a part of the costs of the bankruptcy.

pledgee and the trustee agree that the trustee will sell the encumbered assets and pay the sale price to the pledgee.[87] This possibility also exists with regard to mortgaged assets.[88] Such an agreement, however, does require permission by the Supervisory Judge, as this is a sale based on Section 101 and 176 DBC.[89]

4.2 Section 101 DBC and creditors with right of summary execution

As stated in § 4.1 the right of summary execution can still be exercised during a bankruptcy. The 'investors' that have such a right can therefore interfere in the asset deployment process and, for example, prevent a going-concern sale of assets that is value maximizing for the investors as a group by selling an encumbered asset piecemeal.[90] Should these investors be allowed to act in such a way? The answer to this question is negative.

The right of summary execution in bankruptcy seems to be in clear breach with the first principle of the creditors' bargain theory, which states that bankruptcy law should stop investors from taking individual actions that are aimed at protecting the position of that individual investors and which prevent value maximization for the investors as a group.[91]

However, Dutch law provides the holder of a security interest with a right of summary execution outside of a bankruptcy situation.[92] Outright abolishing the right of summary execution could therefore result in a breach of the second principle of the creditors' bargain theory.[93] This principle states that changing substantive rights in bankruptcy is only allowed if this maximizes the value of the pool of assets for the investors as a group.[94]

If the incentives of the secured creditor and the investors as a group are aligned, there is no reason to limit the right of summary execution of the creditor. If this is value maximizing, the secured creditor should be permitted to sell the encumbered assets by means of a public auction or private sale. In this respect, it seems correct that a trustee should make its decision whether or not to consent to a private sale based on the question whether this sale is expected to generate the highest yield.[95] If the incentives are aligned, the secured

87 See: HR 25 February 2011, *NJ* 2012, 74 *(ING Bank/Hielkema q.q.)*.
88 HR 1 September 1978, *NJ* 1980, 345; HR 28 June 1985, *NJ* 1985, 887 (*Lier q.q./NMB*) and HR 13 March 1987, *NJ* 1988, 556 (*Spruit q.q./ABN*).
89 Tekst & Commentaar Insolventierecht, Section 57 DBC.
90 In this Article I limit myself to interference in the sale process by creditors with a right of summary execution.
91 Baird and Jackson 1984, p. 100 and Hoekstra 2007, p. 80.
92 See: Section 3:248 DCC for the right of pledge and Section 3:268 DCC for the right of mortgage.
93 See also: Hoekstra 2007, p. 81.
94 Baird and Jackson 1984, p. 100.
95 HR 8 April 1984, *NJ* 1984, 434 (*Van Gend & Loos/Lips q.q.*).

creditor and trustee can even consent to let the trustee sell the encumbered asset together with other assets in a private going-concern sale and achieve value maximization for the investors as a group in this way.

Problems arise, however, if the interests of the secured creditor and the investors as a group are not aligned. In this respect, there are at least three types of situations in which the secured creditor can prevent value maximization and a change of substantive rights is warranted.[96] The first is when the assets are worth more together than if sold separately.[97] Sale of a single asset by the secured creditor can decrease the going-concern value of the other assets. The second is when the secured creditor has no incentive to achieve the highest possible yield for an asset. For example, if a higher ranked creditor has a claim that exceeds the value of the encumbered asset.[98] The third example of a situation in which a secured creditor can prevent value maximization is if the asset is worth more than the claim of the secured creditor. In this case there is also no incentive for the secured creditor to achieve the highest possible yield.[99]

I note in this respect that an incentive exists for a secured creditor to sell an encumbered asset as quickly as possible, if waiting does not provide for a higher sale price. For, a secured creditor will incur costs to preserve an asset that the secured creditor can generally not use in its business.[100] Furthermore, the secured creditor incurs costs when it waits with a sale, because it will receive a nominally equal amount of money at a later point in time; which means that the amount received has less 'purchasing power'.[101] The secured creditor also incurs risks, such as the risk that an encumbered asset decreases in value.[102]

If a situation exists in which a private going-concern asset sale is value maximizing and the secured creditor does not wish to participate in such a sale, the trustee can request the Judge for Preliminary Relief to allow the sale.[103] However, this possibility can be contrac-

96 See: Luttikhuis 2004, p. 282 and J.M. Hummelen, 'Het faillissementsakkoord. De efficiëntie van de wettelijke regeling onderzocht vanuit het perspectief van de creditors' bargain theorie', TvI 2010, p. 168. There are more examples than these three situations. For example, if the secured creditor wishes to eliminate the debtor as competition for another company it finances.

97 Compare: Jackson 1986B, p. 182.

98 An example is the claim of the taxing authority on *bodemzaken*. This claim supersedes that of a holder of a non-possessory right of pledge. The incentive is somewhat diminished by the fact that the secured creditor has an interest in diminishing the undersecured part of the higher ranked claim in order to enhance chances on a payout on its own claim. An exception on this is if it clear that the secured creditor will not receive any payment on its claim.

99 Compare: Jackson 1986B, p. 182.

100 H.B. Oosthout, *De doorstart van een insolvente onderneming*, Deventer: Kluwer 1998, p. 50.

101 These costs are called time value costs. See: Baird and Jackson 1984, p. 114. See also: Hoekstra 2007, 86–87.

102 See: Baird and Jackson 1984, p. 121–125.

103 Section 3:251(1) and 3:268(1) DCC.

tually excluded in case of a right of pledge and does not make it possible that a public going-concern auction is forced upon the secured creditor. It further does not prevent that the secured creditor extracts a part of the value surplus realized by a going-concern sale in exchange for its cooperation.[104]

In light of the possibility of a secured creditor to interfere with the interests of the investors as a group, a complete abolishment for creditors with a right of summary execution in light of the creditors' bargain theory has been proposed in the Dutch literature.[105] The question, however, is whether such a complete abolishment is necessary. Perhaps current Dutch law already provides for the possibility to 'override' a secured creditor in situations in which exercising this right would prevent value maximization without completely abolishing the right of summary execution. In this respect, three provisions come to mind: i) Section 58 DBC, providing the trustee with an ability to give a secured creditor a certain amount of time to exercise its rights, ii) Section 63a DBC, which provides for a cooling-off period (*afkoelingsperiode*) with regard to security interests and iii) Section 3:13 DCC, which contains the doctrine of abuse of power (*misbruik van bevoegdheid*).

4.2.1 Reasonable time limit of Section 58 DBC

According to Section 58(1) DBC the trustee can set a 'reasonable time limit' (*redelijke termijn*) for creditors with a right of pledge or mortgage to exercise their right of summary execution.[106] If the creditor has not exercised its rights timely, the trustee can sell the assets under Section 101 and 176 DBC. In this case, the secured creditor keeps its position as preferred creditor, but has to share in the costs of the bankruptcy.[107]

According to case law the possibility of setting a time limit serves to ensure an expeditious settlement of the bankruptcy.[108] The Parliamentary History further states that the possibility of Section 58(1) DBC also has the function of protecting the estate against declining prices.[109]

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104 Compare: F.M.J. Verstijlen and G.D. Hoekstra, 'De separatist in het voorontwerp voor een Insolventiewet en de creditors' bargain', NJB 2009, 229.

105 Hoekstra 2007, p. 81–82 and 126. See for proponents of abolishing the right of summary execution outside the context of the creditors' bargain theory: N.W.M. van den Heuvel, *Zekerheid en voorrang*, Den Haag: Boom Juridische uitgevers 2004, p. 180–184 and J.J. van Hees, 'Herziening van het insolventierecht: een kwestie van denken én doen', *TvI* 1997, p. 105–106.

106 See about the question whether the secured creditor has to have completed only the sale or both the sale and transfer within the set time limit: T.T. van Zanten en F.J.L. Kaptein, 'Rechtsuitoefening in de zin van art. 58 lid 1 Fw: wat moet de separatist allemaal binnen de termijn doen?' *TvI* 2013, 10.

107 Section 182 DBC. This will general result in a substantially lower payout on the claim of the preferred creditor.

108 HR 11 April 2008, *NJ* 2008, 222 (*Cantor/Arts q.q.*), r.o. 3.6: '(…) *de termijnstelling strekt tot een voortvarende afwikkeling van de boedel*." This was also the goal under previous law: Van der Feltz I 1897, p. 476.

109 S.C.J.J. Kortmann and N.E.D. Faber (eds.), *Geschiedenis van de Faillissementswet. Wetswijzigingen, Serie Onderneming en Recht deel 2-III*, Zwolle: W.E.J. Tjeenk Willink 1995, p. 170

With regard to selling encumbered assets, I argue that – as a principle – under Dutch law a trustee can still sell assets that are encumbered with a security interest, even if the trustee has set a time limit under Section 58 DBC.[110] Under Section 101 DBC the trustee is entitled to sell assets of the estate. This provision does not make an exception for encumbered assets. The security interests simply follow the asset that is being sold following the principle of *droit de suite*.[111]

However, if the trustee does not respect the right of summary execution of the secured creditor and the right of pledge is extinguished because of third party protection, the trustee can probably be held liable for damages incurred by the secured creditor in this respect.[112] For, the trustee needs to respect the rights of the secured creditor.[113]

For assets with a right of pledge, this means that the trustee can only sell the assets encumbered with the security interest.[114] This will likely depress the value of the assets, as a purchaser will be reluctant to buy an encumbered asset that forms part of a going-concern asset sale and that can be summarily sold, because of failure of the seller to fulfill its obligations. The need to respect the right of summary execution also entails that the secured creditor should not have to share in the costs of bankruptcy in case of a sale by the trustee before the time limit of Section 58 DBC expires.[115]

With regard to the right of mortgage, Section 188 DBC provides that that right will be extinguished upon a sale by the trustee.[116] As such, the trustee is not entitled to sell an asset encumbered with a right of mortgage before a time limit under Section 58 DBC has expired.[117]

A question is whether the trustee is entitled to set a reasonable time limit, if the value of the encumbered assets is not declining and the secured creditor is not wavering with regard

110 See: S.C.J.J. Kortmann and N.E.D. Faber, 'Pand, hypotheek en fixatiebeginsel' in: J.C. van Apeldoorn et al, Onzekere zekerheid, Deventer: Kluwer 2001, p. 149. They seem to require 'compelling circumstances'.
111 Snijders and Rank-Berenschot 2012, p. 379.
112 Kortmann and Faber 2001, p. 150.
113 Van den Heuvel 2004, p. 18.
114 Unless the time limit of Section 58 DBC has expired.
115 Kortmann and Faber 2001, p. 150. See different: R.J. van Galen, 'Het primaat van de pandhouder', in: S.C.J.J. Kortmann et al., *Onderneming en vijf jaar nieuw burgerlijk recht*, Zwolle: W.E.J. Tjeenk Willink 1997, p. 593.
116 See for an argument arguing for applicability of Section 188 DBC in case of a right of pledge based on historic grounds: Van Galen 1997, p. 598–600. The text of Section 188 DBC is, however, clear and I am not convinced that the extensive interpretation that Van Galen advocates is right.
117 Compare: Kortmann and Faber 2001, p. 150.

to using its rights. The view that such decline or wavering is necessary has been defended in the literature.[118] It can also be found in a judgment of the District Court of Amsterdam.[119]

However, based on the recent *Glencore*-judgment I conclude that setting a time limit can also be justified if the secured creditor is not wavering in the execution of its rights. In this case a large part of the unencumbered assets of the debtor had already been sold. Even so, the Dutch Supreme Court ruled that if a creditor with a right of summary execution does not enforce this right within the timeframe set by the trustee – *inter alia* in a situation in which the secured creditor cannot be blamed for failure to timely enforce his rights or in which enforcement turns out to be reasonably not possible – the trustee can extend the time limit for enforcement, but is not obligated to do so.[120] It then dismisses the appeal. And, although this judgment has been made in the context in the extension of a time limit, I argue that the same rule applies in the setting of the original time limit.[121] Meaning that the setting of a time limit by a trustee is allowed, even if the secured creditor has not been negligent in the enforcement of its rights.

I am critical of the possibility of setting a time limit as provided for in Section 58 DBC. The possibilities of Section 58 DBC and the Supreme Court judgment in *Glencore* do not solve the problem of suboptimal value realization because a creditor uses its right of summary execution too expedient. It also does not provide the trustee with an option to sell the encumbered asset in a quick going-concern sale free and clear of encumberments during the time frame set under Section 58 DBC. Furthermore, under *Glencore* the right of summary execution can simply be made unenforceable by setting a time limit. This is in conflict with the creditors' bargain theory, which provides that making a right of summary execution unenforceable is only warranted in case this provides for value maximization. This is not necessarily the case, because a set time limit expires.[122] Finally, after the time limit of Section 58 DBC has expired, a secured creditor will have to contribute towards the costs of bankruptcy.[123] However, it does not have to pay such costs outside of

118 See: C.E. Goosmann and R.A. Couperus, 'Misbruik van art. 58 lid 1 FW; een redelijke termijn voor de separatist', *TvI* 2012, no. 12 and D. Winkel and S.A.H.J. Warringa, 'De termijnstelling van art. 58 Fw', *FIP* 2013, no. 1, p. 19.

119 Rb. Amsterdam, 16 May 2012, *JOR* 2013, 119 (*Zetteler q.q./ING Bank*), r.o. 4.2.

120 HR 20 December 2013, *RvdW* 2014, 131 (*Glencore*), r.o. 4.6.2.

121 A trustee will, however, not be able to set a valid time limit, if it is impossible for the secured creditor to exercise its rights within this timeframe. See: HR 3 June 1994, *NJ* 1995, 340 (*Antillen/Komdeur q.q.*). This judgment regarded the Antilles version of Section 58 DBC as it applied until 1992. See for a judgment under current law with the same conclusion: Court of Appeals 's-Hertogenbosch, 28 June 1995, *NJ* 1996, 208 (*Generali/Niederer q.q.*).

122 This is especially true in light of the *Glencore* judgment, as the setting of the time limit does not have to have a relation with a decline of value or a wavering secured creditor.

123 Section 182 DBC.

bankruptcy. This can provide for an incentive for the secured creditor to execute on the assets too soon to prevent incurring these costs.[124] Which results in a suboptimal value for the assets.

4.2.2 Cooling-off period of Section 63a DBC

Another tool that the trustee has under Dutch law is Section 63a DBC. Section 63a DBC provides for the possibility of the promulgation of a cooling-off period (*afkoelingsperiode*) for a period of two months by the Supervisory Judge.[125] Such a promulgation can be done *ex officio* or on the request of a party in interest.[126] The consequence of such a promulgation is that the right of third parties – which includes secured creditors – to seek recourse against assets of the estate or against assets which are under the control of the debtor or trustee is stayed.[127] So, a secured creditor temporarily cannot execute its right of summary execution.

The goal of a cooling-off period is to provide the trustee with time. Time to survey the assets of the debtor and time to research the possibilities of a going-concern sale.[128] As such, the cooling-off period prevents – according to the Parliamentary History – that third parties remove assets from the debtor's estate immediately after the declaration of bankruptcy, because of fear that others will also do this.[129]

The stay of a secured creditor seems to be in accordance with the creditors' bargain theory. The stay is limited to situations in which there is a possibility of a non-piecemeal – and thus value adding – sale of assets. However, if a right of summary execution needs to be stayed for a period longer than four months in order to provide value maximization, the possibilities that Section 63a DBC offers are insufficient.

Furthermore, because Section 63a DBC is only applicable in bankruptcy, an incentive can exist for a secured creditor to execute its right prior to the declaration of bankruptcy. For example, because of an increased risk of value decline of the secured asset during the cooling-off period. This incentive and the resulting execution may prevent value maximiza-

124 Hoekstra 2007, p. 83.

125 The period can be extended once for another two months. Section 63a(1) DBC.

126 Section 63a(1) DBC. The cooling-off period can also be promulgated on the request of a creditor or the debtor by the District Court at the time the debtor is declared bankrupt. Section 63a(4) DBC.

127 Section 63a(1) DBC. Third parties includes *inter alia* secured creditors, parties with a retention of title and the fisc. See: Groene Serie Faillissementswet, Section 63a DBC, Comment 4. Excluded from the cooling-off period are creditors with an estate claim (*boedelschuldeisers*) and assets which are pledged under a financial collateral agreement. See: Section 63a(1) and 63d DBC.

128 Parliamentary History Wijziging Rv e.a.w. (Inv. 3,5, 6), p. 414. See, for example, also: District Court Almelo, 27 June 2001, *JOR* 2001, 219 (*Fleuregio Bloemen en Planten*), in which it was held that the cooling-off period does not only serve to take stock of which assets belong to the debtor.

129 Parliamentary History Wijziging Rv e.a.w. (Inv. 3,5, 6), p. 414.

tion. In order to off-set this incentive, the creditors' bargain theory prescribes that the value of the right of the secured creditor whose right of summary execution is stayed has to be respected.[130] This can be done by giving the secured creditor a compensation for costs of delayed payout on his claim and a risk premium for the risks incurred in a deferred sale.[131] Such compensation is currently not provided for in the Dutch Bankruptcy Code.[132]

Finally, the prevailing opinion in the literature is that during a cooling-off period a trustee is, in principle, not entitled to use or sell assets which are encumbered with a security interest.[133] This opinion seems to be confirmed by the Dutch Supreme Court judgment in *Van der Hel q.q./Edon*.[134] In this judgment the Supreme Court held that cooled-off assets in principle are not lost, so the rightful claimant can exercise its powers after the cooling-off period has ended.[135] In any event, Section 63a DBC does not make it possible that a secured creditor is forced to consent to a value maximizing sales method.

4.2.3 Abuse of power

Another relevant provision for the discussion regarding creditors with a right of summary execution is Section 3:13 DCC. Paragraph 1 of Section 3:13 DCC provides that a person who has a certain right may not invoke that right if this means an abuse of power (*misbruik van bevoegdheid*). Such abuse can *inter alia* be present if: i) it is exercised with no other purpose than to damage another or with another purpose than for which it is granted; or ii) when a party, given the disparity between the interests served in using the right and the interests that are damaged, could not have reasonably made use of its right.[136]

In the context of creditors with a right of summary execution abuse of power is usually invoked in the context of the second ground. This entails that a secured creditor is entitled to execute its rights in case of default, unless there is such a disproportion between the

130 Jackson 1986B, p. 59.

131 See further about ways to respect the value of the right of the secured creditor: Hoekstra 2007, p. 85–90.

132 Except for the time value costs of oversecured claims. See: Section 128 DBC.

133 See *inter alia*: Van der Aa 2007, p. 40 and F.M.J. Verstijlen, *De faillissementscurator*, Deventer: Kluwer 1998, p. 195. See different: S.C.J.J. Kortmann, 'De afkoelingsperiode van artikel 63a Fw: ondoordachte wetgeving', in: Financiering en aansprakelijkheid, Zwolle: W.E.J. Tjeenk Willink 1994, p. 152–154; A.L. Leuftink, *Surseance van betaling*, Deventer: Kluwer 1995, p. 118 and J.J. van Hees, *Leasing*, Zwolle: W.E.J. Tjeenk Willink, p. 179.

134 HR 16 October 1998, NJ 1998, 986 (*Van der Hel q.q./Edon*).

135 *Id.*, r.o. 3.7. '*De hiervoor bedoelde goederen gaan in beginsel niet verloren, zodat de rechthebbenden hun bevoegdheden na het verstrijken van de afkoelingsperiode alsnog kunnen uitoefenen*.' It has been defended that circumstances can make that there are exceptions to this rule. See *inter alia*: W.J.M. van Andel, 'Afkoelen en warmhouden', WPNR 2008 (6760), p. 506–511 with reference to HR 19 December 2003, *NJ* 2004, 293 (*Mobell/Interplan*). Insofar as this is the case, such an exception should not be based on 'new' societal interests, as these interests are not to be taken into account under the third principle of the creditors' bargain theory. See: Baird and Jackson 1984, p. 103.

136 Section 3:13(2) DCC.

interests of the secured creditor and the debtor that the secured creditor cannot reasonably execute its rights.[137]

It follows from Parliamentary History that there is an abuse of power if no right-minded person could have reasonably exercised its powers.[138] Abuse of power is therefore only present in special circumstances.[139]

Case law provides both examples of success and failure in invoking Section 3:13 DCC in respect of preventing summary execution. In a case from the District Court in Amsterdam from 2009, for example, the judge ruled that in light of the circumstances that the debt of the debtor would further increase and that it was uncertain when the real estate market would recover, the secured creditor could exercise its rights.[140] Despite the fact that the debtor would be left with a residual debt from the secured loan. In 2013, however, the same District Court ruled that the secured creditor could not exercise its rights. In this case the debtor would be left with a sizeable residual debt after execution, while its total outstanding amount of debt was manageable. In light of this and the economic crisis, the judge ruled that a secured creditor has to go to the extreme to prevent a public auction of the secured property.[141]

As such, Section 3:13 DCC – which is also applicable in bankruptcy – provides a judge with the opportunity to curtail secured creditors in situations in which summary execution would prevent value maximization. However, I would not deem Section 3:13 DCC a suitable tool to 'override' a secured creditor in the exercise of its rights, if this interferes with value maximization for the investors as a group. I see Section 3:13 DCC as providing the judge with the opportunity to correct unacceptable behavior. A secured creditor that acts in its own interests, tries to exercise its rights and in the course prevents value maximization does not qualify, in my opinion, as behavior that no right-minded person would display. Furthermore, as with the cooling-off period, the value of the right of the secured creditor whose right of summary execution is stayed has to be respected and the secured creditor

137 I. Visser, 'Uitstel van executie', *MvV* 2009, no. 7/8, p. 179. See also, for example: Vzr. Rb. Adam, 13 May 2013, *JOR* 2013, 227 (*X/Sparck Hypotheken*), r.o. 4.1.

138 PG Inv. Boek 3 BW, p. 1040. See also: Conclusion of the Advocate-General before HR 20 December 2013, *RvdW* 2014, 79 at 2.19.

139 Conclusion of the Advocate-General before HR 20 December 2013, *RvdW* 2014, 79 at 2.20.

140 Vzr. Rb. Adam, 8 October 2009, ECLI: NL:RBAMS:2009:BK1877.

141 Vzr. Rb. Adam, 13 May 2013, *JOR* 2013, 227 (*X/Sparck Hypotheken*). See, however: District Court Gelderland, 2 October 2013, case number C/05/251268 KG ZA 13-539 (unpublished) as quoted in: S.E. Bartels, 'Crisis, huis onder water en coulance', NTBR 2014, 6, in which the District Court held that an economic crisis is no reason for more clemency.

will have to be compensated.[142] This compensation, as stated, however, is currently not provided for in the Dutch Bankruptcy Code.

4.3 *Overriding the secured creditor*

A security right has two functions: i) giving the secured creditor special powers for recovery of its claim and; ii) a preferential status.[143] The question is if and to what extent the special powers for recovery of the secured creditor – i.e. the right of summary execution – should be altered.[144]

A secured creditor – as a rational actor – will act in its own interests and may execute its right of summary execution. This is logical and, in principle, allowed. However, such use of the right of summary execution may prevent value maximization. Piecemeal sale of an asset may, for example, prevent the debtor from continuing production of certain goods or services.[145] Furthermore, the secured creditor can negotiate a compensation for its consent to allow the trustee to sell the encumbered asset in a going-concern sale. The secured creditor is, however, not entitled to part of the surplus of a going-concern sale over a piecemeal sale, as it could only sell the assets piecemeal had it made use of its rights of summary execution.[146]

Under the creditors' bargain theory substantive 'non-bankruptcy' rights should be respected as much as possible in bankruptcy.[147] Abolishing the right of summary execution should therefore be seen as a final resort. In this respect I have assessed three options that a trustee currently has under in Dutch law. As set out in § 4.2, however, these tools are insufficient to 'override' a secured creditor in all situations in which such an override is warranted under the creditors' bargain theory.

I propose the following. The secured creditor keeps its right of summary execution in bankruptcy. However, a safeguard is introduced to ensure that the encumbered assets are

142 Jackson 1986B, p. 59.
143 See: Van den Heuvel 2004, p. 55.
144 The justification for secured credit and its preferred status are not relevant for bankruptcy law. This matter (as well as the efficiency of secured credit) are to be dealt with in non-bankruptcy law. Baird and Jackson 1984, p. 110–111.
145 Compare: F.M.J. Verstijlen, 'Stelling: de separatistenpositie voor zekerheidsgerechtigden moet worden afgeschaft', *TvI* 2005, 14.
146 Verstijlen 2005.
147 Baird and Jackson 1984, p. 100. See also: Jackson 1986B, p. 152, which states: "*Respecting the rights themselves is the most accurate way of respecting the underlying value (…).*"

deployed in a value maximizing way and the secured creditor is not able to extract 'compensations' to which it is not entitled.

The safeguard would be that both the secured creditor and the trustee are given the power and duty to request prior approval of an auction or sale of an encumbered asset from the Supervisory Judge under Section 101 DBC.[148] As such, both the secured creditor and the trustee can try and close the sale they deem the best sale possible. The Supervisory Judge can then assess the sale under Section 101 DBC in light of the framework set out in § 3.3 and approve or disapprove of the sale, after which it would be able to instruct a secured creditor or trustee to consent to a certain method of sale.[149] As such, the Supervisory Judge would be able to see to value maximization for the investors as a group.

If the outcome of the procedure before the Supervisory Judge is that the secured creditor cannot exercise its right of summary execution, the value of the right of the secured creditor should be respected. This entails that the secured creditor receives the value of the encumbered asset would it have been sold piecemeal minus the costs of the sale that the secured creditor does not have to conduct increased with a reimbursement of time value costs, a risk premium and if applicable costs incurred for preserving the asset.[150] The secured creditor would not have to share in the costs of bankruptcy, as it would not have to pay those costs if it had executed its right of summary execution.

5 Method of sale

5.1 Statutory framework for the method of sale

Under Section 101 and 176 DBC the trustee can sell assets both by means of a public auction and a private sale. Explicit approval from the Supervisory Judge for a sale is only required in case of a private sale.[151] The Parliamentary History provides that approval in case of a

148 The need for approval would be mandatory and contractual exclusion impossible. This is a deviation from Section 3:251(1) DBC. I deem the procedural change – Supervisory Judge instead of Judge for Preliminary Relief – justified in light of the fact that the Supervisory Judge also makes an assessment of sales of unencumbered assets under Section 101 DBC.

149 See § 5 for the choice made by the trustee between a public auction and a private sale. This paragraph also applies to the choice made by the secured creditor.

150 I realize that it would be costly to calculate the time value costs and risk premium on a case-by-case basis. However, a tool can probably be developed that can calculate the amount of these reimbursements based on metadata about the value of money and risk assessments.

151 Section 176(1) DBC. See also above in § 3.1.

public auction was deemed unnecessary, because 'a disadvantage is not to be expected'.[152] If the trustee is not able to sell the assets quickly or the assets cannot be sold at all, the trustee can dispose of the assets in a way that is to be approved by the Supervisory Judge.[153] This entails, for example, giving the assets to a local thrift store or disposing of them as waste.[154]

The Dutch Bankruptcy Code nor case law contains further rules regarding the structure of the bid process or the sale method that is to be used.[155] Neither are such rules laid down in the Parliamentary History of the Dutch Bankruptcy Code. The Parliamentary History merely seems to imply that, in order for a sale to qualify as a public auction, it needs to be conducted by a public servant (*ambtenaar*).[156] In the literature such a requirement is also generally accepted.[157] In the context of the creditors' bargain theory the freedom given to the trustee to choose for a certain method of auctioning should be regarded as positive. It gives the the trustee the flexibility to chose that method that is able to generate the highest yield.[158]

The Dutch Bankruptcy Code does provide in Section 94 that the trustee is obligated to provide for an inventory of the estate.[159] The general rule – laid down in the Dutch Code of Civil Procedure – is that such an inventory is drawn up by a civil law notary and that the assets are valued by 'estimators' (*schatters*).[160] However, the Dutch Bankruptcy Code allows the trustee to draw up an inventory and estimate the value of the assets himself with approval of the Supervisory Judge.[161] The law further prescribes that the trustee is obligated to lay down the inventory list at the relevant District Court, where it can be viewed by

152 Van der Feltz II 1897, p. 64–65: '*moeilijk nadeel is te duchten*'. In a public auction the supervision is given shape by means of the general, continuing supervision that a Supervisory Judge exercises. The Parliamentary History also states that it is to be expected of a trustee that he confers with the Supervisory Judge in case of a public auction.

153 Section 176(2) DBC.

154 This, of course, will only happen if the assets have no or very limited value.

155 Compare: Van Daal 2011, p. 208 and 211.

156 Van der Feltz II 1897, p. 231. The Parliamentary History refers to Section 853 and 857 Code of Commerce 1838 (old), which Sections provided that a public servant was a requirement for a public auction. See for a discussion regarding the question what constitutes a public auction from before the date of the entry into force of the Dutch Bankruptcy Code between F. and Cd. Reeling Knap: WPNR 1249 (1893); 1250 (1893); 1253 (1893); 1255 (1894); 1257 (1894) and 1259 (1894). Examples of a public servant are a bailiff (*deurwaarder*) and civil law notary (*notaris*)., H.F.A. Völlmar, *Het Nederlandse handels- en faillissementsrecht*, Haarlem: H.D. Tjeenk Willink & Zoon 1961, p. 825.

157 See: Groene Serie Faillissementswet, Section 176 DBC, comment 3. See also: W.L.PA. Molengraaff, *De Faillissementswet*, Zwolle: W.E.J. Tjeenk Willink 1951, p. 547 and Völlmar 1961, p. 825.

158 Compare: Visser 2013, p. 92–93.

159 Section 94(1) DBC.

160 Section 671–675 Dutch Code of Civil Procedure.

161 Section 94(2) DBC.

everyone.[162] Third parties can receive a copy of the inventory list from the District Court against payment.[163]

In practice the trustee will only submit quarterly public reports with the District Court, a copy of which can be requested by third parties free of cost.[164] Usually the reports will also be published on the website of the trustee. Although these reports only contain a very global overview of the assets of the estate, they are held to satisfy the requirement of an inventory list.[165] The requirement of a separate inventory list made up following the rules of the Dutch Code of Civil Procedure is generally considered a hollow provision.[166]

5.2 Public auctions in the context of a summary execution

The choice between a private sale and a public auction is also relevant in case of a foreclosure sale in the context of a summary execution.[167] And although the guidance regarding the way a choice needs to be made in case of such a sale is also limited, there is more research on this subject. As set out in § 4.1 The default rule – as in bankruptcy – is a public auction with the option of a private sale.[168] This latter option was introduced in 1992, because a public auction was in practice not deemed the most suitable way of selling an asset.[169]

An advantage of the public auction is that it takes place in public and that everyone can enter an offer. This reduces the risk of price manipulation and should ensure that the asset ends up with the party that assigns it the highest value.[170] However, a summary execution by means of a private sale is by far more popular than a public auction. There are at least

162 Section 97 DBC.
163 Section 107 DBC.
164 Section 73a DBC.
165 See: Dutch Supreme Court 21 January 2005, *RvdW* 2005, 13 (*Jomed I*), in which it was held by the Supreme Court that the District Court had correctly ruled that a requirement of more detail existed than the details as provided for in the published public report existed. It is interesting in this respect that the District Court held that public reports serve only to give a global insight in the development and state of the estate. See also: District Court of Leeuwarden, 9 August 2006, *JOR* 2007, 57 (*Trost Group*), r.o. 4.
166 Compare: R.J. van Galen, 'Het belang van een gemotiveerde taxatie', in: J.G. Princen and A. van der Schee, *De ondernemende curator*, Deventer: Kluwer 2011, p. 232. But see: A.J. Marx, 'De taak van den rechter-commissaris in het faillissement', *RM Themis* 1938, p. 20–21, who argues that the Supervisory Judge should require periodical reports from the trustee in addition to the list of Section 94 DBC.
167 See for the right of summary execution and the creditors' bargain theory § 4 above.
168 With regard to the summary execution Section 519 Code of Civil Procedure, however, determines that a public auction can only take the form of a Dutch auction. The Parliamentary History does not provide for commentary explaining this choice. Compare: Visser 2013, p. 90.
169 Parliamentary History Book 3 DCC, MvA II, p. 824.
170 See: Visser 2013, p. 24 and 91–92.

two reasons for this: i) public auctions often generate a lower yield than the market value and; ii) the high costs of a public auction.

With regard to the lower yield, empirical research has shown that on average a public auction generates a substantially lower yield than the market value of the asset with regard to real estate.[171] In 2007 Ferwerda et al. reported a yield of 70% of the market value of the asset.[172] In 2008 Brounen reported a value of real estate in case of public auction that is 37% lower than the market value.[173]

Ferwerda et al. argue that the difference they found can be attributed to *inter alia* the fact that a buyer in a public foreclosure sale assumes more risk than a buyer in a regular sale, the absence of private individuals, the exploitation of illegal activities and tenant protections.[174] Interestingly enough, they note that the difference can also be attributed to the fact that the system of public auction is sensitive to price manipulation.[175] That a risk of price manipulation exists, is also shown by research on this subject by the Dutch competition authority. The NMa, as it was then called, fined 14 real estate traders for violating cartel restrictions in 2011.[176] In 2013 they fined another 65 traders for violation of cartel restrictions.[177]

The Dutch Minister for Safety and Justice has acknowledged that a private sale usually generates a higher yield than a public foreclosure sale.[178] It is in light of this that he has submitted the Bill Foreclosure Sales (*Wetsvoorstel Executieveilingen*) to Parliament.[179] This Bill aims to make public foreclosure sales of real estate more transparent and more accessible for a broader public, as to generate higher yield in such sales.[180] The Bill Foreclosure sale provides *inter alia* that the announcement of the auction and the conditions of the auction need to be published on a publicly accessible website.[181] It further provides that a

171 See for an extensive discussion of this empirical research: Visser 2013, p. 39–46.
172 H. Ferwerda et al., *Malafide activiteiten in de vastgoedsector. Een exploratief onderzoek naar aard, actoren en aanpak*, WODC 2007, p. 100. Although not stated explicitly, I deduce from the wording of the report that only public auctions were assessed.
173 D. Brounen, 'The boom and gloom of real estate markets', Inaugural address Erasmus University 2008, p. 26.
174 Ferwerda et al. 2007, p. 100, 102 and 107.
175 *Id*, p. 100.
176 See: https://www.acm.nl/nl/publicaties/publicatie/4649/Executieveilingen/
177 https://www.acm.nl/nl/publicaties/publicatie/11025/NMa-beboet-opnieuw-handelaren-voor-manipuleren-executieveilingen/
178 Kamerstukken 33484, no. 3, p. 3.
179 Kamerstukken 33484, no. 3, p. 1. See for the Bill itself: Kamerstukken 33484, no. 2.
180 Kamerstukken 33484, no. 3, p. 1.
181 Section 516 and 517 Code of Dutch Civil Procedure (new).

public auction can – besides the current option of a physical auction – be conducted via the internet and both on the internet and physically.[182]

Besides a lower yield another reason for a preference for private sales in foreclosure sales is that the costs of a private sale are generally lower than that of a public auction.[183] There are costs involved for a civil law notary, an auctioneer, but also for renting an auction venue and advertising costs. With a private sale such costs need not be made. There are some costs involved in obtaining permission from the Judge for Preliminary Relief for a private sale and costs to find a buyer for the asset, but these costs will generally be of a limited amount. As such, the private sale generally provides for a higher net yield of the asset. This gives a seller an incentive to sell the asset by means of a private sale.

5.3 Public auctions and the creditors' bargain theory

Generally, in a bankruptcy asset sale a public auction is to be preferred over a private sale, because this best represents the market value of assets.[184] So, in principle, the trustee should use this method of sale to achieve value maximization. However, the process of the public auction is subject to a lack of independent bidders and relatively high costs, which can prevent value maximization.

With regard to the lack of independent bidders, the trustee should ensure that there are as many prospective bidders as possible. In this respect, a first step would be to inform third parties about the assets that are for sale. The internet seems the right place to do so.[185] I would therefore argue that the duty to draw up an inventory list under Section 94 DBC is 'reinvented', in the sense that the trustee would be obligated to lay down an inventory list or information memorandum – in case of a going-concern sale – regarding the assets of the estate at the District Court.[186] In case of a limited amount of assets, the trustee can attach pictures of the assets to the list. This list can then be published on the Central Insolvency Register, where it is accessible for everyone. Such a publication can entice third

182 Section 519 Rv Code of Dutch Civil Procedure (new).

183 See about the importance of costs also: Visser 2013, p. 79–83. See also: Brounen 2008, p. 28.

184 Compare in the context of U.S. bankruptcy law: *In re Lahijani*, 325 B.R. 282, 289 (9th Cir. B.A.P. 2005). See also: J. Bulow and p. Klemperer, 'Auctions versus negotiations', *American Economic Review* 1996, p. 180–194, in which it was shown that a public auction is to be preferred over a private sale if there is one more bidder involved in the public auction.

185 Compare: B.P.A. Santen and Th. Buchmann, 'Waardemaximalisatie van de boedel', in: J.G. Princen and A. van der Schee, *De ondernemende curator*, Deventer: Kluwer 2011, p. 252.

186 Compare: Santen and Buchmann 2011, p. 253. The information memorandum can contain a global overview of the debtor's business that is to be sold. A more detailed information memorandum can then be made available after interested parties sign an confidentiality agreement.

parties both to bid a public auction or submit a private bid and help achieve value maximization.

The costs of a public auction are also important in achieving value maximization. However, because there are barely any formalities the costs of a public auctions are relatively low.

The costs of a civil law notary can already be evaded by organizing a public auction in the form of a private sale.[187] The auction itself can be held via the internet and, in principle, can be performed by the trustee himself. If an auctioneer is used, costs can also be brought down by organizing regional auctions where multiple asset sales are held at once.[188]

5.4 Private sales and insiders

Sometimes a private sale of assets may be more suitable than a public auction. The majority of the asset sales presently concluded in Dutch bankruptcies take the form of a private sale. It is not uncommon, in this respect, that the assets are sold to director and/or shareholder of the debtor, who continues the activities of the debtor in a new legal entity.[189] The advantage of such an asset sale for the director/shareholder is that it is a relatively simple way of relaunching the enterprise and capturing the going-concern value of the assets, while being able to leave employees and debts in the bankrupt legal entity.[190]

Dutch bankruptcy law, in principle, allows for a sale to the director and/or shareholder of a debtor.[191] Often the director/shareholder has inside knowledge on how assets can best be used and he is the highest bidder for the assets.[192] If the bid is obtained in a level playing field and this 'insider' truly has the highest bid, there is no objection to such a sale, as it provides for value maximization.

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187 The trustee will need approval of the Supervisory Judge in this case, as such a sale qualifies as a private sale. Section 176 DBC.

188 This practice has already developed over the last few years with regard to foreclosure sales. See: F.J. Vonck, 'Executoriale verkoop van registergoederen via internet', WPNR 2011 (6882), p. 302.

189 The Hugo Sinzheimer institute reports in this respect that in a set of 181 going-concern asset sales insiders were the buyer of the assets in more than 50% of the cases. See: Knegt 1996, p. 19–20.

190 The employees are left behind, because the rules for transition of enterprise (*overdracht van onderneming*) are not applicable in bankruptcy. See: Section 7:666 DCC.

191 According to Scheurs Supervisory Judges do not have any protocols, working agreements or standard procedures with regard to insider transactions. See: Ph. W. Schreurs, 'A Corporate Cloak', in: J.G. Princen and A. van der Schee, *De ondernemende curator*, Deventer: Kluwer 2011, p. 227.

192 It is also possible that the trustee has an incentive to sell assets to the first bidder – usually the former director or shareholder – because the trustee expects that the higher yield of a further sale efforts is not so much that it will be enough to pay for the trustees' salary. See: F.H.E. Boersma, 'De doorstart vanuit het perspectief van de rechter-commissaris', in: A.A.M. Deterink et al., *Doorstart*, Deventer: Kluwer 2008, p. 189.

However, problems arise if the insider uses the bankruptcy forum to divert value to himself. An example of this can be found in the *Ontvanger/Wesselman* judgment of the Dutch Supreme Court.[193] In this case a legal entity controlled by the indirect majority shareholder/director of the bankrupt debtor bought the inventory for an amount of NLG 250,000 (€ 113,000) and then immediately sold the inventory to a third party for an amount of NLG 850,000 (€ 385,000).[194]

The Supreme Court held that in such a case the special quality of shareholder/director is still vested in the insider, even if the insider was only approached as a possible buyer of assets by the trustee.[195] It further held that this quality can lead to an extra duty of care (*zorgplicht*) for the insider.[196] The extent of this duty of care, however, is unclear, as there was no objection raised against the standard set by the District Court.[197] It is furthermore unclear whether the insider has been held liable by the Court of Appeals to which the Dutch Supreme Court referred the case.

But, while the judgment of the Supreme Court in *Ontvanger/Wesselman* leaves some questions unanswered, it is clear that the trustee failed to capture the going-concern value of the assets which could have been realized. The insider – using its inside knowledge – did realize this value. In this respect, insider sales warrant extra scrutiny.[198] Failure to realize the risk of an insider sale and simply selling the assets to the insider without consideration for other parties, is inefficient.[199]

Also interesting in respect of insider sales, are the sale of 'earmarked assets' to an insider.[200] These are assets of which the value is depressed if they are not used by the insider. Examples of such assets are pizza boxes which carry the logo of a pizza chain or clothes which have the print of the designer's logo all over them. The purchase value of such assets may be high, but without the pizza chain or designer's cooperation these assets have limited value.

Generally, the trustee is then left with the choice to either sell the earmarked assets to a third party for fire sale prices or to sell the assets to the insider for the fire sale price with

193 HR 11 February 2011, *NJ* 2011, 305 (*Ontvanger/Wesselman*).
194 The inventory was appraised at NLG 150,000 in a forced sale and NLG 700,000 in a private sale.
195 HR 11 February 2011, *NJ* 2011, 305 (*Ontvanger/Wesselman*), r.o. 3.5.3.
196 *Id.*
197 Compare: B.F. Assink, 'Hoedanigheden en zorg(vuldigheids-)plichten in het ondernemingsrecht', Ars Aequi, 2012, p. 280.
198 Compare under U.S. law: *In re Bidermann*, 203 B.R. 547 (U.S. Bankr. S.D.N.Y. 1997).
199 See for an example of a case where the trustee was held liable, because he had sold the assets to the first bidder, without giving a third party – of who the trustee knew he was interested – an opportunity to bid: Court of Appeals Arnhem, 6 February 2007, *JOR* 2007, 106 (*Feenstra/Schouten & Van Muiswinkel Holding*).
200 I thank Rolef de Weijs for coming up with the term 'earmarked assets'.

a small premium. The bid of the insider is higher, but at the same time this allows him to continue his business quite cheaply in a different legal entity, while the creditors of the debtor are left with their claims. Should the trustee sell these assets to the insider?

The answer to the trustee's choice is found by acknowledging the relative value of the insider's need for cooperation. In this respect, a comparison can be made to the supplier who refuses to deliver any goods after bankruptcy, until his pre-bankruptcy debt has been paid in full. This right to refuse to deliver goods has value, because its goods are necessary for the continuance of the debtor's business.[201] As this right could also be invoked before the declaration in bankruptcy, its value should be respected in bankruptcy.[202]

As such, the insider's right to refuse cooperation also has a relative value. As he is not obligated to continue cooperating outside of bankruptcy or provide a capital contribution, he also cannot be obligated to do so inside of bankruptcy. The relative value of this right to refuse translates in the possibility to acquire assets for a depressed value. As this still provides the investors as a group, with the highest yield for the assets, no problem exists in acknowledging this relative value. An exception to this is the situation in which the acquiring of the assets for a depressed price was a predesigned scheme.[203] Such behavior is not allowed outside of bankruptcy and should therefore also not be allowed inside bankruptcy.[204]

6 Conclusion

The goal of bankruptcy law should be to ensure that the assets of the debtor can be deployed in a way that provides the group of people with a right against the debtor's assets with the most value. In this respect, allowing new substantive policies to be introduced during bankruptcy leads to undesirable forum shopping and should not be allowed. However, the societal interests that are to be taken into account outside of bankruptcy, should also be taken into account during the bankruptcy. As such, Dutch bankruptcy law does not seem to deviate from the creditors' bargain theory.

201 As such, the supplier's right only has value, if it concerns goods that cannot be obtained elsewhere. See: Jackson 1986B, p. 159.

202 Jackson 1986B, p. 159.

203 Such behavior may be assumed earlier in case of repeat players. For example, the pizza chain that continuously lets a franchisee set up a pizza shop, lets it go bankrupt and then buys the assets for a depressed price.

204 Under Dutch law, it is unlawful to stop entrepreneurial activities in one legal entity and then continue them in another, if the only objective is to prejudice creditors and prevent further possibilities of recourse against the debtor. HR 13 October 2000, *NJ* 2000, 698 (*Rainbow Products*).

A more pressing point is that secured creditors can interfere in an optimal asset deployment by exercising their right of summary execution. The current tools that Dutch law currently offers in this respect are insufficient to effectively override the secured creditor. I therefore propose that both the secured creditor and the trustee are given the power and duty to request prior approval of an auction or sale of an encumbered asset from the Supervisory Judge.

Another important aspect of asset sales is the sale process. Both a public auction and a private sale should be carried out in a way which allows for obtaining the highest bid possible. In this respect, minimizing costs and obtaining as many bids as possible are a concern.

Asset sales occur in almost every Dutch bankruptcy. However, the statutory guidance in this respect is very limited. Furthermore, there has been very little attention for this form of asset deployment in literature or case law. This Article aims to bring asset sales into the spotlight and help shape the law in this respect.

5 The sale process in a pre-packaged asset sale*

1 Introduction

One of the elements of the legislative program 'Recalibration of Bankruptcy Law' is the Continuity of Enterprises Act I (*Wet Continuiteit Ondernemingen I*; hereafter: CEA 1).[1] The primary aim of the CEA 1 is to introduce a legal basis for assets sales in bankruptcy which have been prepared prior to the declaration of bankruptcy (i.e. the pre-pack).[2]

At the time this article was written a bill for the CEA 1 was not available.[3] The Minister had, however, published a draft bill for consultation.[4] This article aims to assess the pre-pack and specifically the sale process in a pre-packaged transaction as laid down in the draft-bill from a normative point of view. More specifically the question is how to maximize the value in a pre-pack transaction by structuring the sale process in the right way.

In this article the creditors' bargain theory is used as assessment framework.[5] This theory states that the goal of bankruptcy law is to maximize the value of the pool of assets for the investors as a group.[6]

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* This chapter was published as an article in Dutch in Tijdschrift voor Insolventierecht 2015, 2, p. 5–16.

1 The legislative program was announced by letter of the Minister of Safety and Justice of November 26, 2012. See Parliamentary Papers 29 911, no. 74. Subsequently the Minister has sent a letter to the House of Representatives every six months, in which he reported on the progress of the legislative program. See: Parliamentary Papers 33 695, no. 1, 3, 5 and 7.

2 Draft Explanatory Memorandum CEA I, p. 2.

3 In his most recent letter of December 10, 2014 the Minister announced that the submission of a bill can be expected in the beginning of 2015. See: Parliamentary Papers 33 695, no. 7, p. 3.

4 See: http://www.internetconsultatie.nl/wet_continuiteit_ondernemingen_i. The consultation period ended on January 21, 2014 and resulted in 15 reactions. See for the announcement regarding the bill: Parliamentary Papers 33 695, no. 7, p. 3.

5 The creditors' bargain theory was developed in the eighties of the last century by D.G. Baird and T.H. Jackson. See: T.H. Jackson, 'Bankruptcy, non-entitlements, and the creditors' bargain', *Yale Law Journal* (91) 1982, p. 857–907, D.G. Baird and T.H. Jackson, 'Corporate reorganizations and the treatment of diverse ownership interests: a comment on adequate protection of secured creditors in bankruptcy', *University of Chicago Law Review* (51) 1984, p. 97–130, T.H. Jackson, 'Of liquidation, continuation and delay: an analysis of bankruptcy policy and nonbankruptcy rules, *American Bankruptcy Law* Journal (60) 1986(B), p. 399–428. and T.H. Jackson, *The logic and limits of bankruptcy law*, Cambridge: Harvard University Press 1986(B) See about the choice for the creditors' bargain theory as assessment framework: J.M. Hummelen, 'Efficient bankruptcy law in the U.S. and the Netherlands', *EJCLG* 2014A, no. 2, p. 148–211.

6 See about the terms 'pool of assets' and 'investors as a group' – also in relation to current Dutch law – extensively: J.M. Hummelen, 'An assessment of Dutch bankruptcy assets sales', *IILR* 2014B, no. 3, p. 276–278.

Hereafter attention will first be devoted to the phenomenon of the 'melting ice cube' (§ 2) and the role that a pre-pack can play in preserving value (§ 3). Next attention the risk that the price in a pre-pack transaction is formed in a faulty way will be addressed (§ 4). In the context of this risk attention is given to the question whether or not the intended trustee lacks certain powers to guarantee the integrity of the sale process (§ 5 and 6). In particular attention is devoted to the question to what extent the use of the concept of the stalking horse can have a value maximizing effect (§ 6.2.3). This article ends with a conclusion (§ 7).

2 The problem of the 'melting ice cube'

The suggested changes to the Dutch Bankruptcy Code on the basis of CEA 1 intend to create a legal basis for the appointment of an 'intended trustee' (*beoogd curator*) and an 'intended supervisory judge' (*beoogd rechter-commissaris*) prior to the opening of a formal bankruptcy procedure.[7] Starting point is that this intended trustee and intended supervisory judge are appointed as respectively trustee and supervisory judge in a subsequent bankruptcy.[8] This way an asset sale can be prepared and coordinated with the intended trustee prior to the declaration of bankruptcy of the debtor. This asset sale can then be effectuated shortly after the opening of the bankruptcy by the – then – trustee.[9]

At this time there is not yet a legal basis in the Netherlands for the appointment of an intended trustee and intended supervisory judge. Nonetheless eight of the eleven district courts have been willing to appoint an intended trustee prior to the declaration of bankruptcy of a debtor, thus facilitating pre-packs.[10]

So, how can appointing an intended trustee and the subsequent preparation of an asset sale prior to a bankruptcy contribute to value maximization? To answer this question it is

7 Section 363 DBC (draft). Based on this provision it also possible to name more than one person as intended trustee. Although naming an intended trustee and intended supervisory judge can be relevant in relation to multiple solutions for a debtor in trouble, this article is limited to the role of the aforementioned figures in the context of a pre-pack aimed at an asset sale.

8 Deviation from this starting point is justified solely in the event of 'pressing circumstances'. See Section 14a DBC (draft). Such circumstances may be present if there is, for example, a breach of trust between the intended trustee and the debtor. See: Draft Explanatory Memorandum CEA 1, p. 15. Based on Section 363 DBC (draft) a person can also be named 'intended administrator'. This article is limited to the situation that an intended trustee has been named in view of an asset sale in bankruptcy.

9 Draft Explanatory Memorandum CEA I, p. 1–2.

10 Because of a lack of a statutory framework the District Court of Limburg, Overijssel en Midden-Nederland do not yet name intended trustees. See: http://www.rechtspraak.nl/Actualiteiten/Nieuws/Pages/Vier-vragen-over-de-stille-bewindvoerder.aspx

important to examine the role of bankruptcy law in maximizing value and to what extent the law succeeds in doing this.

2.1 *Bankruptcy law as solution for a common pool problem*

Under the creditors' bargain theory bankruptcy law is seen as a solution to eliminate a common pool problem that would otherwise occur.[11] Without a collective way of recourse creditors can only seek recourse on an individual basis against a debtor for their claims. Payment then takes place on a 'first come, first serve' basis. This means that if a debtor has insufficient funds to pay all his creditors, only the creditors that come early will be repaid. This way an incentive is created for creditors to seek individual recourse and to be the first to do so, because only the first ones that seek recourse will be fully paid.

The assumption under the creditors' bargain theory is therefore that creditors prefer a collective way of seeking recourse – i.e. bankruptcy – if this leads to a higher value of the pool of assets for the investors as a group. This value can *inter alia* be realized because imposing a collective way of recourse prevents assets from being sold piecemeal by individual creditors seeking recourse.[12]

Bankruptcy law should, according to the creditors' bargain theory, be shaped on the basis of the following three principles:[13]

1. '[B]ankruptcy law at its core should be designed to keep individual actions against assets, taken to preserve the position of one investor or another, from interfering with the use of those assets favored by the investors as a group.
2. Bankruptcy law should change a substantive nonbankruptcy rule only when doing so preserves the value of assets from the group of investors holding rights in them.
3. [B]ankruptcy (…) should be (…) concerned with the interests of those (…) who have property rights in the assets of the firm (…).'

2.2 *Blocking of individual recourse does not prevent value decrease*

The first principle of the creditors' bargain theory implies that recourse by an individual creditor which is not in the interest of the investors as a group is blocked. Such a blocking of individual recourse can be found in Dutch law in Section 33 DBC. It follows from this

11 Jackson 1982, p. 860–865 and Jackson 1986A, p. 402–403.

12 Jackson 1982, p. 861–868. Besides keeping the assets together, administrative efficiencies and the decreased need for monitoring are also mentioned as ways to maximize the value of the pool of assets.

13 Baird and Jackson 1984, p. 100 and 103.

provision that individual recourse is no longer possible after a debtor is declared bankrupt and that all individual attachments end.[14] Furthermore, Section 26 DBC states that legal claims that result in rights or obligations that belong to the bankruptcy estate, cannot be instituted in any other ways than by filing them for admission.

The problem is that bankruptcies take time.[15] And that, despite Section 26 and 33 DBC, the assets of a debtor can still decrease in value during a bankruptcy. In this respect it can be said that a declaration of bankruptcy generally has a negative effect on the business operations of the debtor and, as such, on the value of the assets.

The draft Explanatory Memorandum to CEA 1 states in the context of the consequences of a declaration of bankruptcy that: "*a declaration of bankruptcy in many cases leads to the situation that a company will find itself in an uncontrolled process.*" And that: "*the company will generally lose much of her value in a short amount of time.*"[16] In this respect the negative publicity that is generally associated with bankruptcy is mentioned explicitly.[17]

The fact is that, although the possibilities for individual recourse are (largely) blocked, this does not mean that therefore the assets of the debtor can be sold going-concern with the connected surplus value above a piecemeal sale. Section 26 DBC is confined to claims against the debtor that arose before the declaration of bankruptcy or can be otherwise be submitted for admission.[18] Third parties are not obligated to participate in the continuity of the operations of the debtor.[19] In practice it therefore regularly occurs that suppliers no longer deliver or only against unfavorable conditions. Customers and employees walk away and ipso facto clauses come into effect.[20] This leads to a noticeable decrease in value of the assets of the debtor.

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14 Groene Serie Faillissementswet, Section 33, comment 4.

15 Jackson 1986A, p. 404.

16 Draft Explanatory Memorandum CEA 1, p. 7. "*[e]en faillietverklaring er in veel gevallen echter toe [leidt] dat de onderneming in een ongecontroleerd proces komt (…).*" and "*[D]e onderneming doorgaans in korte tijd veel van haar waarde [zal] verliezen.*".

17 Draft Explanatory Memorandum CEA 1, p. 2.

18 Groene Serie Faillissementswet, Section 26, comment 5. An example of a claim that can otherwise be submitted for admission, is a claim based on Section 37a DBC.

19 An exception is Section 37b DBC. In his letter of July 16, 2014 the Minister further mentioned the possibility of the introduction of an obligation to continue delivery of essential services and goods.

20 See for other authors that mention such kind of behavior by third parties: J.I.R.A. Huydecoper, 'Pre-pack liquidatie: wat vindt een betrekkelijke buitenstaander daar op het eerste gezicht van?', *TvI* 2013, 5; M.R. van Zanten, 'Aan het werk met de pre-pack!', *ArbeidsRecht* 2013, 47 and O. Tacoma en C. Weebers-Vrenken, 'The b(l)ack side van een pre-pack faillissement', *Vastgoedrecht* 2013, no. 6, p. 171

Furthermore, the blockade of Section 26 DBC is not absolute. For example, creditors with a right of summary execution can keep exercising their rights as if there was no bankruptcy.[21] Also, creditors can invoke a retention of tile, exercise a right of retention and rely on a right of recovery.[22] Because of all these circumstances it is often difficult to keep a company running during bankruptcy.

In the Dutch literature the decrease in value as a consequence of the negative effects that usually follow from a declaration of bankruptcy are referred to as 'desintegration losses'.[23] In the American literature the more vivid comparison with a 'melting ice cube' has been made.[24] The company is as an ice cube, of which the value melts away after the declaration of bankruptcy.

The trustee that is confronted with a melting ice cube is under great pressure to effectuate an asset sale as soon as possible and fix the yield of the assets. The problem, however, is not only that the value of the company decreases rapidly, but also that the freshly appointed trustee usually has a great information backlog and that, for that reason, it is difficult for him to correctly assess the value of the assets.[25] A potential buyer may also be confronted with uncertainties regarding the value of the assets and will adjust his price accordingly. At the same time certain parties – for example: current management – may have an information advantage, which creates possibilities for opportunistic behavior.[26] The trustee is confronted with a prearranged transaction and the request to simply sign it.[27] It is also because of these circumstances that it is possible that the assets are sold against a suboptimal price.

3 The pre-pack as solution

So, in what way does the pre-pack help to maximize the value of the assets of the debtor? In essence by – for lack of a way to manipulate time itself – by changing the *timing* of relevant events.

21 Section 57 DBC.

22 Compare for the right of retention, however, Section 60(2) DBC. Based on this section the trustee can sell the relevant asset.

23 See for example: Ph. W. Schreurs, 'Hoe stil is de stille bewindvoerder eigenlijk?', *FIP* 2013, no. 8, p. 271.

24 See for example:. Melissa B. Jacoby en Edward J. Janger, 'Ice Cube Bonds: allocating the price of process in Chapter 11 bankruptcy', *Yale Law Journal*, januari 2014, p. 865. "*Financially distressed companies can melt like ice cubes: every day that a company burns through more cash than it earns, it loses value.*"

25 See: J.J. van Hees, 'Stille bewindvoering:pre-packen en wegwezen?', *OR* 2014, 79 and Jacoby en Janger 2014, p. 895.

26 See: Jacoby en Janger 2014, p. 895.

27 N.W.A. Tollenaar, 'Faillissementsrechters van Nederland: geef ons de pre-pack!', *TvI* 2011, 23.

On the one hand, the amount of time between the moment of the declaration of bankruptcy and the signing of the asset sale can be shortened considerably by already preparing the asset sale before the opening of the bankruptcy.[28] In principle the sale can be signed by the trustee directly after the proceeding is opened.[29] Of course the sale will have to be in accordance with legal requirements. This means *inter alia* that, based on Section 176 DBC, the supervisory judge will have to give permission for the sale. After all, as a result of the necessary private nature the sale will be a private sale and, as such, permission is required.[30] Furthermore, the sale will have to meet the requirements of Section 101 DBC, as the debtor will not yet have entered the state of insolvency.[31] This means that the trustee is only allowed to sell assets of the estate: i) if and to the extent that this is necessary to cover the costs of bankruptcy or ii) if and to the extent that assets could not be preserved without loss to the estate.

On the other hand, the trustee can, because he is already involved before the opening of the bankruptcy, inform himself better with regard to both the debtor as with regard to an intended sale.[32] He can, in relative peace, get an overview in the period preceding the bankruptcy and form an opinion as to whether or not he will consent to a certain transaction after the declaration of bankruptcy.[33]

In essence the appointment of a intended trustee – and that pre-pack sale that is facilitated with that appointment – is therefore related to a change in the process that precedes an asset sale in bankruptcy. The goal, however, that is to be achieved – under the creditors' bargain theory value maximization of the pool of assets for the investors as a group – does

28 See: draft Explanatory Mermorandum CEA 1, p. 7–8.

29 According to the Dutch Supreme Court Section 101 DBC gives the trustee the power to sell all assets prior to the state of insolvency (*staat van insolventie*), which enables a going-concern sale right after the opening of bankruptcy procedings. See: Dutch Supreme Court 27 August 1937, *NJ* 1938, 9 (*Nieuw Plancius*). In this sense the Dutch Supreme Court deviated from the reticent attitude that was recommended by the legislator. See: G.W. van der Feltz, *Geschiedenis van de wet op het faillissement en de surseance van betaling*, bewerkt door G.W. baron van der Feltz deel II (1897); Heruitgave bewerkt door S.C.J.J. Kortmann en N.E.D. Faber, Serie Onderneming en Recht, Deel II, Zwolle: W.E.J. Tjeenk Willink 1994, p. 63–64.

30 The legislator has expressed his expectation in the Parliamentary History that the trustee will also confer with the supervisory judge in the context of a public sale. See: Van der Feltz II 1897, p. 64–65.

31 The state of insolvency is entered, according to Section 173 DBC, if on the claims admission meeting no reorganization plan was adopted, an offered reorganization plan was rejected or the confirmation of an adopted plan was denied and this denial has become final. Contrary to previously applicable law – specifically Section 851 Code of Commerce – the state of insolvency is not merely entered after a judgment ordering so has been given. In Section 101(2) DBC Section 176 DBC is made applicable to asset sales that take place before the state of insolvency is entered. As a pre-pack transaction will be effectuated shortly after bankruptcy proceedings are opened, it may be assumed that the state of insolvency will not yet be entered.

32 See: Tollenaar 2011 and F.M.J. Verstijlen, 'Pre-packing in the Netherlands. De beoogde 'beoogd curator'', *NJB* 2014A, no. 16, p. 1099.

33 See the letter of the Minister of July 15, 2014. Parliamentary Papers 33 695, no. 5.

not change.[34] In light of this the question arises what the best way is to structure a sale process as to achieve the aforementioned value maximization. The question is, after all, not if a certain amount offered is the highest offer that has been received, but if the offer is the best possible offer that can be obtained.[35]

4 The risk of the pre-pack: faulty pricing

It follows from the draft Explanatory Memorandum that the appointment of an intended trustee does in principle not affect the powers of the debtor. The debtor retains complete power of disposition. This entails that the board takes the decisions and represents the legal entity.[36] The primacy of the debtor can also be seen in the position of the intended trustee under the proposal for the CEA 1. The intended trustee is not an advisor of the debtor, holds no position at the debtor's company and is also not a supervisor of the debtor.[37] He is bound by a duty of confidentiality and cannot approach any parties in the context a possible asset sale without permission from the debtor.[38] The draft Explanatory Memorandum states in the context of the powers of the intended trustee that his task is merely "*to watch, to inform himself and be informed and to form himself an opinion about the way the company is run*".[39] The thoughts of the Minister seem to be that it is the debtor that structures and leads the sale process. The intended trustee, in principle, just looks over the debtor's shoulder. This primacy of the debtor is suppose to serve as an incentive for the debtor to timely undertake action and request the appointment of an intended trustee.[40]

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34 See: Section 365(1) DBC (draft), which provides that the intended trustee has to take the duties of the trustee as guiding principle. See for an assessment of the Dutch framework for asset sales during bankruptcy in relation to the creditors' bargain theory: Hummelen 2014B.

35 Compare in this context the judgment of the Dutch Supreme Court about the term 'sale value' in the sense of Section 21 Inheritance Tax Act 1956 (old). In this judgment the Dutch Supreme Court quoted the Court of Appeals, which had stated that sale value is: "*The price that would be offered by the highest bidder when the [asset] was offered in the most suitable way after the best possible preparation.*" ("*de prijs die bij aanbieding ten verkoop op de voor het [activum] meest geschikte wijze na de beste voorbereiding (…) door de meestbiedende gegadigde besteed zou zijn.*").

36 Draft Explanatory Memorandum CEA 1, p. 4 and 21.

37 Draft Explanatory Memorandum CEA 1, p. 4.

38 Section 365(3) DBC (draft) and draft EM CEA 1, p. 21 and 27.

39 Draft Explanatory Memorandum CEA 1, p. 21. "*om mee te kijken, zich te (laten) informeren en zich een oordeel te vormen over de gang van zaken binnen de onderneming*"

40 See: O. Couwenberg, 'reorganisatie-obstakels in faillissement', *OR* 2004, 223 about losing the 'private benefits of control' as an explanation for the fact that many debtors request bankruptcy too late and as a result strongly impede a reorganization. See also: Parliamentary Papers 33 695, no. 1, p. 4. See for a comparable argument in the context of the American Chapter 11: H.R. Rep. No. 595, 95th Cong., 1st sess. 231 (1978), p. 6191. However, another argument that is mentioned there for the concept of the debtor-in-possession is the saving of costs because of the lack of a trustee and the fact that the debtor-in-possession is already familiar with the business and a trustee not. See extensively about the concept of the debtor-in-possession: H.R. Miller, 'The

The debtor-led sale process will in principle be conducted behind closed doors. For that is where the advantage lies in preparing an asset sale prior to bankruptcy.[41] However, this private nature also bears a risk, i.e. that the price is formed in a faulty way because of the lack of market forces.[42] In the words of the U.S. Supreme Court : "*[T]he best way to determine value is exposure to a market.*"[43] A risk therefore exists that due to a lack of market forces certain interested parties are not approached and that, as a result, the highest possible price is not achieved.[44] In that context the first disappointed parties have come forward in the media.[45]

5 Information rights of trustee

The question at hand is what powers an intended trustee should have to guarantee the integrity of the sale process in a pre-packaged transaction.[46] After all, although the primacy of the sale process in the period preceding the declaration of bankruptcy lies with the debtor, the intended trustee has to take the duties of a trustee as guiding principle.[47] According to the draft Explanatory Memorandum this means that the intended trustee performs his duties for the benefit of the joint creditors. From the viewpoint of the creditors' bargain theory this means that the intended trustee should safeguard that the value of the available assets is maximized.[48]

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changing face of Chapter 11: a reemergence of the bankruptcy judge as producer, director, and sometimes star of the reorganization passion play', *Am. Bankr. L. J.*, Fall 1995, p. 440–448.

41 See above in § 3.

42 See for comparable criticism in the context of the English pre-pack: Graham Review into Pre-pack administration, June 2014, p. 20.

43 *Bank of Am. Nat'l Trust & Sav. Ass'n v. 203 N. LaSalle St. P'ship*, 526 U.S. 434, 457 (1999).

44 See: B.J. Tideman, 'Kritische kanttekeningen bij de pre-pack', *FIP* 2013, no. 6, p. 191; E. Loesberg, 'Pre-pack in het Nederlandse faillissementsrecht', *FIP* 2013, no. 1, p. 31 and G. Gispen, 'De "pre-pack" is ondeugdelijk en niet goed voor de gezamenlijke schuldeisers', in: Liber Amicorum Mart Franken 2013, p. 86 and 89. See also paragraph 4.13 of the reaction of the Orde van Advocaton regarding the consultation document.

45 See the Financieele Dagblad article of February 5, 2014 'Verkoop boedel is delicaat spel' regarding the bankruptcy of Corso B.V. and the article of July 9, 2014 'Estro hield deur dicht voor Nederlandse kandidaatkopers' on the website of BNR. See for the last article: http://www.bnr.nl/nieuws/beurs/255157-1407/estro-hield-deur-dicht-voor-nederlandse-kandidaat-kopers.

46 See: J. Wind, 'Wetsvoorstel Continuïteit Ondernemingen I overbodig: het kan eenvoudiger en beter', *TvI* 2014, 22, who contends that is very well arguable that a debtor hands in part of his powers in the interest of an effective representation of interests of the interests of the joint creditors by the intended trustee.

47 Section 365(1) DBC (draft), which provides that the intended trustee has to take the duties of a trustee as guiding principle. See for an assessment of the Dutch framework for asset sales during bankruptcy in relation to the creditors' bargain theory: Hummelen 2014B.

48 See for the goal that a trustee should pursue in the context of an asset sale in bankruptcy in relation to positive law and the creditors' bargain theory and discrepancies between them: Hummelen 2014B.

This paragraph concerns the information rights of the intended trustee. Because the first thing that matters for an effective performance of the intended trustee in a sale process is that he has all relevant information at his disposal.[49] The pre-pack period intends to offer a period of relative peace in which the intended trustee can form an opinion about the envisaged sale of the relevant assets after the declaration of bankruptcy. The risk is, however, that the intended trustee only possesses insufficient or selected information, as a result of which the intended trustee cannot reach an informed conclusion during the pre-pack period.[50] This can lead to a suboptimal yield of the assets.

5.1 Need for free access to complete books and records

It is of importance that the intended trustee obtains insight into the financial and operational situation of the debtor. This ensures that the informational advantage that insiders – like current management – have on the intended trustee is decreased, which results in decreased possibilities for opportunistic behavior.[51] In this context it is important that it is the intended trustee himself that makes the selection of relevant information in the books and records of the debtor and that it is not the debtor himself that does this.[52] This prevents that the intended trustee is not given insight into certain information that is relevant for him.[53]

However, in the proposal for the CEA 1 the information rights of the intended trustee are limited. Section 365(3) DBC (draft) states that the debtor has to provide the intended trustee with information in view of an intended asset sale. This way the intended trustee could get insight into the situation of the debtor.[54] At the same time, however, the draft Explanatory Memorandum makes it clear that it is not the intention of Section 365(3)

49 See: J.V. Maduro, 'Het wetsvoorstel Continuiteit Ondernemingen I: de rechtszekerheid gediend?', *FIP* 2013, no. 8, p. 281.

50 Although the intended trustee will have extensive powers as a trustee to obtain information, the character of the pre-pack process implies that it is specifically the trustee that will not have the time to enforce these powers in an effective way.

51 See: Jacoby and Janger 2014, p. 895. See also: F.M.J. Verstijlen, Reorganisatie van ondernemingen en pre-pack, Preadvies Vereeniging Handelsrecht 2014B, p. 27–28. It follows from a report of the Hugo Sinzheimer Institute that in a set of 181 going-concern sale in bankruptcy, insiders were the purchasers of the assets in over 50% of the cases. See: R. Knegt, *Faillissementen en selectief ontslag: een onderzoek naar 'oneigenlijk gebruik van de Faillissementswet*, Hugo Sinzheimer Instituut 1996, p. 19–20. In the context of the English pre-pack the Graham Report notes that in a set of 499 pre-packs 316 (63.3%) could be qualified as a 'connected sale'. See: Graham Report, p. 37.

52 Compare paragraph 12 of the proposal by Gispen. See: Gispen 2013, p. 92. See different: rule 4 of the draft best practice rules intended trustee of INSOLAD.

53 See: paragraph 9.31 of the comments of the Orde van Advocaten on the consultation document.

54 Draft Explanatory Memorandum CEA 1, p. 26.

DBC (draft) to introduce an all-encompassing duty for the debtor to provide information.[55] Because of this there is a risk that the intended trustee is selectively provided with information, which is beneficial for insiders as potential buyers.

5.2 Need for possibility of free access to third parties

Besides access to existing information it is also of importance that the intended trustee can obtain additional information. For example, for an informed decision about whether or not a certain transaction is opportune the intended trustee – because of lack of market forces – will have to consult with an expert about the value of the assets. This can be done by having an independent third party perform a valuation of the assets of the debtor on a going-concern basis as a benchmark for a transaction based on piecemeal sale, to see what will happen if no turn around of the company can be realized.

However, under the proposal for the CEA 1 the obtaining of information from third parties by the intended trustee is also controlled by the debtor. Based on Section 363(3) DBC (draft) the intended trustee can obtain information from third parties or hire an expert. This enables the intended trustee to obtain an independent valuation from third parties.[56] However, obtaining such information by the intended trustee is only possible with the consent of the debtor. As such, there is a risk that insiders will act in an opportunistic way in this regard.[57]

6 Control of the sale process by the intended trustee

Besides the amount of information that an intended trustee has access to, it is also of importance to what extent he can steer the sale process. The sole possession and study of information by the intended trustee has, in principle, no influence on the position of the debtor in the sale process. It leaves the leading role of the latter unaffected. The question is, however, if the intended trustee should be given powers to actively steer the sale process.

Under current law the intended trustee – by lack of any statutory framework – has, in principle, no formal power to steer the sale process. The draft Explanatory Memorandum

55 Draft Explanatory Memorandum CEA 1, p. 26.

56 See: draft Explanatory Memorandum CEA 1, p. 27.

57 In the context of the English pre-pack the Graham report, notes, for example that: "*The researchers (…) found it was common, where there had been a connected sale, for the purchase price to exactly match the valuation figure. This could lead to a suspicion on the part of the creditors that a purchaser had set a valuation as an indicator of how much it was prepared to pay, rather than the market value of the assets in question.*" Graham Report, p. 48.

for the CEA 1 also clearly states that the installation of an intended trustee does not lead to a change in the debtor's power of disposal.[58] It is the debtor that remains in control of the sale of the company.[59] For this reason the intended trustee is not authorized – other than with permission of the debtor – to, for example, approach third parties to see if they are interested in acquiring assets of the debtor.[60]

If the sale process is conducted in a correct and professional manner by the debtor and the trustee has sufficient information, there is, in principle, no reason to let the intended trustee influence the sale process. However, a lack of powers for the intended trustee to influence the sale process has at least two significant risks: the risk that the debtor continues for too long (§ 6.1) and the risk that the debtor falls short in approaching potential buyers (§ 6.2).

6.1 Risk that debtor continues for too long

A first risk is that the debtor tries to stall the sale process in the pre-bankruptcy phase as to keep in control for as long as possible and force a rescue in which current management continues to play a role. This despite the conclusion of the intended trustee that a direct filing for bankruptcy and, for example, executing a piecemeal sale would be better.[61] In this context it is important that the debtor has an incentive to take excessive risks in an attempt to get the company 'on the right track'.[62] However, neither current law nor the consultation proposal of the CEA 1 provides the intended trustee with the power to intervene and request the bankruptcy of the debtor. Creditors are aware of this lack of powers. For this reason they have an incentive to monitor the debtor and request bankruptcy sooner than if they could rely on the intended trustee as party that can intervene in case of irresponsible behavior.[63] The aforementioned risk may, however, be limited in a relatively easy way by giving the intended trustee the power to request the bankruptcy of the debtor or at least by giving the intended trustee the power to request that the supervisory judge orders him to do so.[64]

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58 Draft Explanatory Memorandum CEA 1, p. 4 and 21.

59 See: paragraph 4.4 of the comments of the Orde van Advocaten.

60 Draft Explanatory Memorandum CEA 1, p. 4.

61 An example is the situation that the intended trustee concludes that the business of the debtor is not viable and the assets can best be sold piecemeal, but the debtor refuses to accept this en undertakes (costly) attempts to restructure the funding of the business by means of an informal reorganization plan or tries to attract additional funding by issuing high yield bonds.

62 See in the context of the American debtor in possession: M. Bradley and M. Rosenzweig, 'The untenable case for Chapter 11', *Yale L.J.* 1992, p. 1047.

63 See: Bradley and Rosenzweig 1992, p. 1045.

64 See: Verstijlen 2014A, p. 1103, who argues for the inclusion of a provision in CEA 1 under which the intended trustee can or has to request the opening of a bankruptcy procedure, can request an order from the supervisory

6.2 *Risk that debtor fails to approach potential buyers*

A second risk is that the debtor falls short in the approaching of and negotiating with potential buyers, as a result of which a suboptimal price is realized.[65] Of particular importance in this context is the risk of opportunistic behavior by insiders, who perhaps rather sell the assets for a suboptimal price to themselves or to a party that commits itself to keeping on current management.[66] In the context of an English pre-pack attention has been drawn to the situation in which insolvency practitioners believed current management on their word when they indicated that there was no other interested party other than them.[67]

6.2.1 Accountability obligations insufficient

Under current law the intended trustee holds no formal position at the debtor. He will generally act on the basis of a contract for services (*overeenkomst van opdracht*), under which he does not have the power to explore the market and approach potential buyers or impose conditions on interested parties in the context of a specific transaction.[68] Such powers are also not attributed to the intended trustee under the consultation proposal for the CEA 1. Section 364(3) DBC (draft) does provide for an obligation for the intended trustee to draft and deposit a publicly available report promptly after he is discharged. The intention of this is to let the intended trustee provide insight into the – soundness of the – sale process.[69] However, under the current proposal the intended trustee only knows what is provided to him by the debtor. He will therefore, for example, not be able to report on interested parties that have been dismissed by the debtor if the debtor has not told him about this. In this sense the proposed accountability obligations fall short in safeguarding the integrity of the sale process.

judge and/or has to file a report with the police of a criminal offense. See also paragraph 9.16 of the comments of the Orde van Advocaten.

65 See in the English context: Graham Report, p. 8.

66 See: Gispen 2013, p. 86. See in the American context for the identification of this risk: Jacob A. Kling, 'Rethinking 363 sales, *Stanf. J of L. Buss. & Fin.*, Spring 2012, p. 266 and Elizabeth B. Rose, 'Chocolate, flowers, and § 363(b): the opportunity for sweetheart deals without Chapter 11 protections', *Emory. Bankr. Dev. J.*, Fall 2006, p. 277.

67 Graham Report, p. 47.

68 See for example the 'Modelovereenkomst stille bewindvoering' by Tollenaar. See: N.W.A. Tollenaar, 'Van pre-pack naar stille bewindvoering', *FIP* 2013, no. 6, p. 212–213.

69 See: draft Explanatory Memorandum CEA 1, p. 11.

6.2.2 Informal powers of intended trustee insufficient

In practice the intended trustee will have some powers to steer the sale process.[70] For, the intended trustee will, in principle, become the trustee in the subsequent bankruptcy.[71] And this trustee will have formal powers. Anticipating on his appointment as trustee the intended trustee can therefore already indicate which transaction and which conditions he deems acceptable or not acceptable. In this context reference should be made to Section 365(2) DBC (draft) of the consultation proposal. Based on this section the debtor can request an opinion from the intended trustee about a particular transaction that is being prepared and ask the intended trustee to indicate whether he would sell the assets of the debtor under the conditions negotiated by the debtor and the potential buyer in a bankruptcy proceeding.[72] The intended trustee could possibly specify in this preliminary statement that he would consent to a certain deal as a trustee if certain conditions are met.

What the intended trustee, however, cannot do, is force the debtor to approach other parties or impose certain conditions. A negative opinion by the intended trustee does not mean that the debtor has to stop preparing an intended transaction. For, the intended trustee cannot force the debtor to perform or not perform certain acts.[73]

The idea is, as it follows from the draft Explanatory Memorandum, that the intended trustee will request the district court to release him from his duties if he has stated that he cannot consent to a certain transaction and the debtor keeps acting contrary to the view of the intended trustee.[74] Firstly, this is an incentive for the intended trustee to consent to a suboptimal transaction, because he will otherwise not be appointed as trustee and will miss out on revenue.[75] Secondly, it is conceivable that the intended trustee is confronted with the situation that he can chose between a suboptimal transaction prepared by the debtor or a piecemeal sale against an even lower price. It will then be difficult for the trustee not to choose for the suboptimal deal that was prepared by the debtor.[76] In that sense the informal powers under the proposal for the CEA 1 are of a limited scope.

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70 See also: Verstijlen 2014A, p. 1102 and Schreurs 2013, no. 8, p. 270–271.

71 Cf. Section 14a DBC (draft).

72 The debtor can also request the intended trustee to give his opinion regarding the question to what extent intended legal acts in the ordinary course of business or intended to diminish debts, are contestable on the basis of transactional avoidance and which preparations could be made to expedite the conclusion of a bankruptcy procedure. Section 365(2)(a)(c) DBC (draft). The text of the proposed Section 365 DBC contains the words '*inter alia*' (*onder meer*) and the enumeration does not seem to be exhaustive. See:. Van Hees 2014.

73 Draft Explanatory Memorandum CEA 1, p. 22.

74 Draft Explanatory Memorandum CEA 1, p. 22. See also: Gispen 2013, p. 84.

75 See: Tideman 2013, p. 192.

76 See in the context of an American asset sale the judge's lamentation that: "*The problem with the "melting ice cube" argument is that it is easy enough for the debtor to unplug the freezer prior to bankruptcy. (…) Unless the bankruptcy judge is willing to show exceptional judicial courage, he or she must approve the sale. While*

In the context of informal powers of the intended trustee it is noted, however, that the intended trustee does have some power by threatening to hold the debtor liable if he either does or does not perform certain acts. In this context the judgment *Ontvanger/Wesselman* can be referred to.[77] In this judgment the Supreme Court assumed that the special quality of shareholder/director remains with an insider, even if he only buys assets from the bankrupt debtor for which he acted as shareholder/director. This special capacity can lead to an extra duty of care (*zorgplicht*) for the insider.[78] The scope of this duty of care, however, is unclear, now that no objection was raised against the standard set by the district court.[79] It is therefore unclear whether a director can be held liable for the fact that he prematurely 'unplugs the freezer' to effectively force the trustee to consent to a certain transaction desired by the director.

6.2.3 The added value of a public sale process for pricing

The problem is that the private nature that is required for a successful pre-pack has an inherent disadvantage: its private nature. It is this private nature that creates a risk that too few parties are approached. In the American restructuring practice a concept has been developed, which tries to combine the advantages of a privately prepared asset sale with the advantages of a public sale process. This concept is called the 'stalking horse procedure'.

6.2.3.1 The American 363-sale and the concept of the stalking horse

The stalking horse procedure is a well known phenomenon in pre-packaged asset sales in the United States.[80] Such transactions find their foundation in Section 363 of the U.S. Bankruptcy Code. Section 363 offers the possibility to sell assets 'outside the ordinary course of business' during the course of a bankruptcy – after notice to certain parties and a hearing – to third parties.[81] Such a sale can be prepared by the debtor prior to the opening

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nominally "presiding" over the case, the judge is reduced to a figurehead without any meaningful discretion and might as well leave his or her signature stamp with the debtor's counsel and go on vacation or shift attention to consumer cases where the law may still mean something." *In re Humboldt Creamery*, 2009 WL 2820610 at 2 (Bankr. N.D. Cal.)

77 Dutch Supreme Court 11 February 2011, *NJ* 2011, 305 (*Ontvanger/Wesselman*).

78 Dutch Supreme Court 11 February 2011, *NJ* 2011, 305 (*Ontvanger/Wesselman*), r.o. 3.5.3.

79 See: B.F. Assink, 'Hoedanigheden en zorg(vuldigheids)plichten in het ondernemingsrecht', *Ars Aequi* 2012, no. 4, p. 280.

80 See for a recent example: 'Bidders are looking to gobble up cupcake retailer Crumbs' via https://www.youtube.com/watch?v=fiNsVG8Fxt8. Since the large bankruptcies in the United States are often conducted in the Southern District of New York, I follow the Local Rules of this District. For this article Rule 6004-1(j) of the Local Rules is of particular importance. This rule refers to the 'Guidelines for the Conduct of Asset Sales' of the Southern District of June 17, 2013. These Guidelines can be found via: http://www.nysb.uscourts.gov/sites/default/files/6004-1-j-Guidelines.pdf. A substantial part of the rules laid down in the Guidelines concern the stalking horse procedure, which fact is indication for the extent of the stalking horse sale procedure. As far as I am aware there is no empirical data concerning this particular practice.

81 11 U.S.C. § 363(b)(1). See for procedural rules also Federal Rule of Bankruptcy Procedure 6004.

of a bankruptcy procedure. The debtor can then close the sale as debtor-in-possession after the opening of a Chapter 11 procedure on the basis of Section 363.[82] After obtaining judicial permission the pre-packaged asset sale will then be realized. In this context Section 363(f) provides that the assets can be sold 'free and clear' – that is: free from claims of third parties such as secured creditors – under certain conditions.[83]

Since a 363-sale in Chapter 11 does not take place on the basis of a reorganization plan that is adopted by creditors and confirmed by a judge with all the attached safeguards that go with it, American judges in the Second Circuit generally require that the sale meets the threshold of the 'business justification test'.[84] This test entails that "*there must be some articulated business justification, other than appeasement of major creditors, for using, selling or leasing of property outside the ordinary course of business, before the judge may order such disposition under section 363(b).*"[85] As this test is easily met, the threshold for it is relatively low. Generally speaking it will suffice that the transaction is under time pressure to meet the test.[86]

In larger bankruptcies it is common that the pre-pack is executed in the form of a stalking horse procedure. In a stalking horse procedure the debtor negotiates a sale purchase agreement preceding to the declaration of bankruptcy with a third party – the stalking horse –, which agreement is subject to the condition that no better price is obtained in a public sale held after the debtor is declared bankrupt.[87] After the debtor and the stalking horse agree upon a sale purchase agreement – including the bidding procedures –, the debtor will request the opening of a bankruptcy procedure.

82 11 U.S.C. § 1107.

83 11 U.S.C. § 363(f) states: "*the trustee [or debtor-in-possession] may sell property under subsection (b) or (c) of this section free and clear of any interest in such property of an entity other than the estate, only if– (1) applicable nonbankruptcy law permits sale of such property free and clear of such interest; (2) such entity consents; (3) such interest is a lien and the price at which such property is to be sold is greater than the aggregate value of all liens on such property; (4) such interest is in bona fide dispute; or (5) such entity could be compelled, in a legal or equitable proceeding, to accept a money satisfaction of such interest.*" See about this: Brad B. Erens and David A. Hall, 'Secured lender rights in 363 sales and related issues of lender consent', *Am. Bankr. Inst. L. Rev*, Winter 2010, p. 535–568.

84 The asset sale can also form part of the reorganization plan. See: 11 U.S.C. § 1123(a)(5)(D) and 1123(b)(4). This is not, however, a pre-packaged asset sale. It is also possible that the reorganization plan is a pre-packaged plan. This form of the pre-pack falls outside the scope of this article. The Second Circuit also includes the Southern District of New York, in which generally the largest bankruptcies are handled.

85 *In re Lionel Corp.* 722 F.2d 1063, 1070 (2nd Cir. 1983).

86 See: Jacoby and Janger 2014, p. 868 and Tollenaar 2011.

87 See: J. Sarra, 'Financing insolvency restructurings in the wake of the financial crisis: stalking horses, rogue white knights and circling vultures', *Penn State International Law Review*, winter 2011, p. 593.

The debtor then files a request for both a 'Sale Procedures Order' and a 'Sale Order'. The first order seeks approval from the judge for the sale process; the second order seeks approval for the sale of the relevant assets to the winning bidder in the public sale that is to be held.[88] The judge will then hold a hearing and set the bidding procedures in the requested Sale Procedures Order. After the bidding procedures have been established, interested parties can execute a due diligence and submit a bid during a certain period. After this period has ended an auction will be held, during which parties can bid against each other and where the debtor selects the winning bid.[89] Then the sale hearing will be held during which the judge will confirm the sale of the assets to the winner of the auction in the previously requested Sale Order.[90] Effectively, this procedure achieves that the debtor auctions off his assets with the certainty that he will at least receive the amount agreed upon with the stalking horse and the possibility that the assets will yield even more.

In the Dutch context the stalking horse is a phenomenon that is practically non-existent.[91] However, in principle there don't seem to be any objections against using a stalking horse procedure for pre-pack sales in the Netherlands.[92] The debtor can negotiate a conditional sale purchase agreement preceding to the bankruptcy, after the opening of which the trustee can organize a public sale to see if a better result can be achieved. The great advantage of this is that the advantage of the private nature of the pre-pack is combined with the forming of a price in an open market. At the moment the bankruptcy procedure is opened the trustee – like in a regular pre-pack – has a sale purchase agreement in his pocket. He is, however, offered an extra chance to sell the assets for a higher price.[93] The stalking horse procedure therefore seems *the* right way to maximize the value of the assets in the context of a pre-pack sale. The question is, however, whether this is really true in a Dutch context.

88 § I.A of the Guidelines for the Conduct of Asset Sales.

89 Generally speaking, judges will not be present at this auction. See: Jonathan Friedland e.a., 'The dealmaker's guide to buying distressed assets-section 363 sales and alternatives', *Norton Annual Survey of Bankruptcy Law* 2008.

90 See: § III of the Guidelines for the Conduct of Asset Sales. See also: Strategic Alternatives For and Against Distressed Business Database, § 16.8: sequence of events for bankruptcy acquisitions.

91 As far as I am aware there has been one bankruptcy in which a sale purchase agreement has been negotiated under the condition subsequent that no 'overall better deal' would be reached with a different party than the original purchaser of the assets. See the first public report in the bankruptcy of Pelican Magazines B.V. (13/13/227F). For Dutch literature regarding this subject reference can be made to: Tollenaar 2011 and 2013; Gispen 2013 and Verstijlen 2014B, p. 49.

92 Tollenaar seems to argue the same. See: Tollenaar 2013, p. 210.

93 In this context, the Guidelines for the Conduct of Asset Sales offer the possibility that the bid procedures determine that the bidder with the second highest bid is obligated to enter into a sale purchase agreement if the highest bidder is unable to fulfill his obligations under the sale purchase agreement in a set amount of time. See: § I.B.3 of the Guidelines.

6.2.3.2 (Un)certainty for stalking horse: bid procedures

A possible objection that could be raised in the context of the stalking horse procedure, is that during some time there will be uncertainty about the question whether or not the stalking horse bidder will indeed obtain the assets, as a result of which other investment possibilities are being forfeited.[94] The idea is that this uncertainty is factored into the bid which results in a stalking horse bid that is lower than it would have been in a naked pre-pack. If there is a lack of interest at the public sale the assets will yield a suboptimal price.

The aforementioned objection can, however, be obviated by offering the stalking horse bidder a form of compensation for the uncertainty. This compensation can be offered in the form of certain bidding procedures.

The most common protection that is included in bidding procedures in the United States is that in which certain fees are awarded to the stalking horse. A common fee in this respect is the break-up fee.[95] Such a break-up fee is a compensation that is paid to the stalking horse if he is not the winning bidder after the public sale or if the debtor is unable to fulfill his obligations under the sale purchase agreement.[96] Often the break-up fee is a certain percentage of the sale price that was agreed upon by the debtor and the stalking horse.[97]

In the context of offering the stalking horse protections it is of importance that the advantages that the protection offer do not lead to a situation in which other bidders are discouraged (*bidding chill*). For this reason the bidding procedures are – as set out in § 6.1 – subject to judicial confirmation to safeguard a competitive bidding process.

The standard that the judge in the Southern District of New York sets in this respect, is that the bidding procedures "*are, as a matter of reasonable business judgment, likely to maximize the sale price. Such procedures must not chill the receipt of higher and better offers and must be consistent with the seller's fiduciary duties*".[98] Three elements are of particular importance for the break-up fee in the context of the business judgment standard: i) is the transaction with an insider or is there manipulation by the bidder; ii) does the break-up fee hinder the bidding by other parties; and iii) is the amount of the break-up fee dispro-

94 See: *In re App Plus*, 223 B.R. 870, 874 (Bankr. EDNY 1998).

95 See in the Dutch context: Gispen 2013, p. 90.

96 *In re Integrated Resources*, 147 B.R. 650, 653 (Bankr. SDNY 1992).

97 Another, relatively common compensation is the topping fee. This fee is only paid if another party than the stalking horse bidder turns out to be the winner of the auction. The topping fee is usually a percentage of the difference between the winning bid and the bid of the stalking horse. See: *In re App Plus*, 223 B.R. 870, 874 (Bankr. EDNY 1998). Furthermore, it is possible that the bidding procedures provide for expense reimbursements, that regard a direct reimbursement of costs made by the stalking horse.

98 § I.B. of the Guidelines for the Conduct of Asset Sales.

portionate in relation to the sale price?[99] It will also be of importance that, in order for the break-up fee to be acceptable, the first bidding increment will have to exceed the maximum amount of the break-up fee.[100]

A certain amount of protection can also be offered in the Dutch context to the stalking horse in the conditions of the sale purchase agreement, as to diminish uncertainty. This may be done in the form of a break-up fee.[101] Such a fee shall be subject to review by the judge, as it forms a part of the sale purchase agreement. In this respect uncertainty is not a convincing obstacle for using a stalking horse procedure.

6.2.3.3 Dutch market too small for public sale process

Another objection that can be raised against the stalking horse procedure in the Dutch context is that the Dutch market is too small to successfully use this procedure. In assessing this objection the starting point should be that a public sale process is to be preferred over (only) a private sale. A public sale, after all, is the best way to establish the market value of the assets.[102]

However, a condition is that there are sufficient bidders.[103] For, without sufficient bidders there will still be a faulty pricing, while costs are attached to the public sale process and the offering of protections to the stalking horse. In such a case the public sale process has no added value over a naked pre-pack. Using the stalking horse procedure with the corresponding costs, such as reimbursement of costs made, would then be considered to be inefficient.

In relation to the above, particular reference should be made to the situation in which the bankruptcy finds its roots in external circumstances. It is very well possible that these external circumstances have an industry wide effect. Because of this it will be (more) difficult for competitors from the same industry as the debtor – the most obvious buyers of the assets – to obtain the necessary financing for the purchase of the assets. Something that

99 *In re Integrated Resources*, 147 B.R. 650, 657 (Bankr. SDNY 1992): "*These decisions suggest three questions for courts to consider in assessing break-up fees: (1) is the relationship of the parties who negotiated the break-up fee tainted by self-dealing or manipulation; (2) does the fee hamper, rather than encourage, bidding; (3) is the amount of the fee unreasonable relative to the proposed purchase price?*" Furthermore, the bidding procedures will have to provide whether the stalking horse will be entitled to a break-up fee if he overbids the overbidder. § I.B.4 Guidelines for the Conduct of Asset Sales.

100 § I.B.4(c) Guidelines for the Conduct of Asset Sales. In dictating the size of further increments, it has to be taken into account that they may not be so large as to chill the bidding, but also not so small that a new bid has no material surplus value.

101 See: Gispen 2013, p. 90.

102 See in the American context: *In re Lahijani*, 325 B.R. 282, 289 (9th Cir. B.A.P. 2005).

103 See: *In re Lahijani*, 325 B.R. 282, 289 (9th Cir. B.A.P. 2005).

will lead, in turn, to a lack of competition in the bidding process.[104] Especially in the Dutch context – with its relatively small market – such a lack of competition is not unrealistic.[105]

It should be noted that a lack of bidders is also relevant in relation to the initial offer made by the stalking horse. For, if there is a lack of bids during the public sale, the trustee will fall back on the bid of the stalking horse. If this bid was the result of opportunistic self dealing, however, the trustee can be forced to enter into a suboptimal transaction. Consequently, despite the addition of a public sale process in a stalking horse procedure, the intended trustee will have to ensure that the bid of the stalking horse is the best achievable result in the pre-bankruptcy stage of the pre-pack.

6.2.3.4 Funding structure of companies impediment to stalking horse

Finally, besides the uncertainty for the stalking horse and the scope of the market, the problem of the funding structure of many Dutch corporations in relation to the stalking horse procedure should be addressed. In this context both the problems surrounding existing funding of the debtor and the need for additional funding during the public sale process are a factor.

The creditor with a right of summary execution as a party at the table

If a pre-pack – either naked or stalking horse – is being prepared, the debtor and intended trustee will generally have to let a third party join the table: the creditor with a right of summary execution. For, the debtor will often have encumbered a large part of his assets with a security interest, without which assets the business of the debtor cannot be continued on a going-concern basis. The creditor with a right of summary execution can execute this security right – if the debtor defaults on his obligation – during both the stage preceding the opening of bankruptcy proceedings and during the bankruptcy.[106]

The secured creditor, however, can prevent a going-concern sale by exercising his rights and in this way prevent value maximization. For example, this way it could be made impossible for the debtor to keep producing certain goods or delivering certain services.[107]

104 See: A. Shleifer en R.W. Vishny, 'Liquidation values and debt capacity: a market equilibrium approach', *J. of Fin.* 1992, nr. 4, p. 1343–1366.

105 The perception is that business in bankruptcy are generally sold to domestic buyers. The 'market' is therefore limited to the Netherlands. Furthermore, the Netherlands – in contrast to the United States – has fewer (large) corporations that can buy business of some size out of bankruptcy.

106 See for the right of summary execution: Section 3:248 DCC for holders of a right of pledge; Section 3:268 DCC for holders of a right of mortgage and Section 7:54 DCC for the financial collateral arrangement. Section 57 DBC states that this right can be exercised during bankruptcy as if there was no bankruptcy.

107 See: F.M.J. Verstijlen, 'Stelling: de separatistenpositie voor zekerheidsgerechtigden moet worden afgeschaft', *TvI* 2005, 14.

Furthermore, the secured creditor can extract compensation from the debtor for his cooperation to a going-concern sale in a pre-pack transaction. Such a compensation is unjustified, now that the secured creditor, after exercising his rights, would not have obtained more than the value in a piecemeal sale.[108] There can also be an incentive for the secured creditor to induce the debtor to enter into a suboptimal transaction, because the yield of this transaction covers the amount of the outstanding secured debt and there is no reason for the secured creditor to maximize the value of the assets for the unsecured creditors.[109]

In an earlier article I have argued that a safeguard should be introduced in the Dutch Bankruptcy Code to ensure that encumbered assets are deployed in a value maximizing way.[110] This safeguard entails that both the trustee and the secured creditor have the right and the duty to obtain permission as meant in Section 101 DBC from the supervisory judge for an intended sale or exercise of rights. If such a safeguard is included, the necessity for the intended trustee and debtor to include the secured creditor in the sale process is eliminated. They can privately prepare a transaction and show to the supervisory judge after the bankruptcy procedure is opened that the transaction is value maximizing. In this context it is of importance, however, that the secured creditor receives the value of his right.[111]

Need for additional funding during public sale process

Keeping existing lenders at bay, however, will generally not be sufficient in a stalking horse procedure. For, the public sale process will take time. During this time the business has to be kept running by the debtor. Something that requires money.

Under existing law an existing lender or third party can, however, not be forced to continue a lending facility.[112] A necessary loan will therefore only be obtainable if both the trustee and the lender approve and reach consent on all relevant aspects of the loan.[113] In practice

108 Verstijlen 2005.

109 See: J. Brege, 'An efficiency model of Section 363(b) sales', *Va. L. Rev.*, November 2006, p. 1669.

110 See: Hummelen 2014B, p. 290–291. See p. 283–290 for my argument that the current possibilities that are available for the trustee to ensure value maximization are insufficient.

111 See about the size of this value: Hummelen 2014B, p. 291.

112 See: J.H.S.G.K. Timmermans, 'De curator en het boedelkrediet', in: J.G. Princen and A. van der Schee (red.), *De ondernemende curator*, Deventer: Kluwer 2011, p. 61. In his letter of July 16, 2014 the Minister writes about the possibility of the inclusion of a duty to continue delivery of essential goods and services in the Continuity Enterprises Act 3. It is unclear whether this would also include funding. See: Parliamentary Papers 33 695, no. 5, p. 5.

113 See: Timmermans 2011, p. 61.

this means that the trustee will soon turn to the existing lender of the debtor, because generally all relevant assets will already have been encumbered.[114]

Even if business is done with the existing lender the room for obtaining an additional loan is limited. Generally speaking, the lender will require that (additional) security is provided for the new loan. Otherwise his claim will only qualify as a general unsecured estate claim.[115] However, under Dutch law it is impossible to infringe on existing security interests in favor of a lender willing to provide the estate with a loan.[116] The room for providing security interest in exchange for additional funds is therefore limited. Although unencumbered assets or a lower ranked security right might serve as collateral. Furthermore, a right of pledge may be given in relation to expected revenue.[117]

In practice, therefore, there will not be room in every pre-pack for a public sale process after a bankruptcy procedure has been opened. This mainly concerns cases in which the 'ice cube' melts so fast that immediate action is required after the opening of bankruptcy proceedings and no additional loans can be obtained. In these cases the stalking horse will not be a viable alternative for the naked pre-pack.

6.2.4 Safeguarding the approach of potential buyers by the debtor: how to do it?

Now, how can we safeguard that the debtor does not fall short in approaching potential buyers of the assets of the debtor? In this context I refer to 'debtor', because it does not seem efficient to provide that the intended trustee is given the power to approach potentially interested buyers on his own accord. The introduction of such power leads to a strong decrease in the incentive for the debtor to act in time. Because, the debtor may eventually find another way out of difficulties than by means of a pre-pack transaction. If the intended trustee nevertheless starts to approach parties independently, this may lead to unwanted interference with an alternative solution.[118]

During the sale process it may be that the assets are best sold to insiders. Such self dealing is not necessarily inefficient. The insider that is familiar with the business may be willing

114 P.J.M. Declerq, 'Rechten van schuldeisers in andere stelsels: hoe kijkt men in het buitenland naar Nederland?', *TvI* 2010 and Timmermans 2011, p. 68.

115 Timmermans 2011, p. 69.

116 See: L.W. Mooij e.a., 'Van boedelkrediet tot noodkrediet', in: N.E.D. Faber e.a. (red.), *Overeenkomsten en insolventie*, Deventer: Kluwer 2012, p. 293. In the United States it is, under circumstances, possible to extend a secured claim that impairs existing security interests based on 11 U.S.C. § 364 (priming lien).

117 See: T.T. van Zanten, *De overeenkomst in het insolventierecht*, Deventer: Kluwer 2012, p. 369.

118 See: Tollenaar 2013, p. 205. Tollenaar states that the process that is started with the appointment of an intended trustee should be reversible. This does not alter the conclusion in § 6.1 above that the intended trustee should be able to intervene if the debtor continues for too long and that he has to have the power to request the opening of bankruptcy proceedings.

to pay more for it than third parties, because he – in contrast to the outsider – knows both the business and its risks and can better value them. It can also be that an insider better knows how to make use of the investment possibilities that the business offers and for that reason is willing to pay more.[119] The difficulty therefore does not necessarily lie in the fact that it is possible to sell the assets to an insider, but rather the possibility that an insider abuses this fact and benefits himself by keeping the price for the assets artificially low.

As set out above, it does not seem efficient to dictate that a stalking horse procedure is to be followed in every case to solve the problem of faulty marketing and opportunistic self dealing by insiders.[120] It seems better to ensure that the (intended) trustee is not put in a hold by the debtor. This can be achieved by not stepping down as intended trustee if he does not agree with a proposed deal. The draft Explanatory Memorandum should be changed in this regard.[121] The intended trustee can, by staying on, have the debtor redo his homework in the event of a bad deal instead of having to let a new, not-informed intended trustee start from scratch again. After all, the debtor is free to choose a pre-pack transaction, but only if this is the best transaction possible. An additional effect of the aforementioned proposed solution is that this also eliminates the incentive for the trustee to consent to a suboptimal transaction in the interest of his own salary.

Additionally a duty of care for the debtor will help to prevent manipulation by the debtor to push through a suboptimal transaction. This is in particular related to liability for opportunistic self dealing and prematurely 'disconnecting the freezer' to put pressure on the intended trustee. This combination of measures gives the debtor the freedom to act, but does ensure that the intended trustee has a real influence on the organization of competition in the sale process in case of a pre-pack transaction.

7 Conclusion

In the preceding paragraphs I have set out how the pre-pack can prevent value loss by reducing the amount of time between the moment bankruptcy proceedings are opened and the closing of an asset sale. The appointment of an intended trustee provides the future trustee with the possibility to better inform himself about the debtor and the intended transaction. This also contributes to preserving value.

119 See: L. Enriques e.a., 'Related-Party Transactions' in: R. Kraakman e.a., *The anatomy of corporate law. A comparative and functional approach*, Oxford: Oxford University Press 2009, p. 154.
120 Although nothing stands in the way of following this sale procedure if there is a reason to do so.
121 See: draft Explanatory Memorandum CEA 1, p. 22.

The great risk of the pre-pack is that the private nature that is required for a successful pre-pack leads to faulty pricing. In this context it is recommended that the intended trustee has wide informational powers to prevent information asymmetry. It is further recommended that the intended trustee should have the power to request bankruptcy proceedings to be opened. Regarding the risk that the debtor falls short in approaching potential buyers the stalking horse procedure – in which a public sale takes place after the private preliminary stage – will increase value in certain cases. There are, however, a number of obstacles that come into play in the Dutch context, which makes that this procedure will not always be suitable. It seems better to provide that the intended trustee can stay on if he disapproves of an intended transaction and to impose a duty of care on the debtor, to prevent opportunistic behavior.

In short, the pre-pack is a useful and good instrument, provided that sufficient safeguards are built in. I hope that the legislator will take this into account in the final bill.

6 The Dutch reorganization plan. An assessment of the efficiency of the legal framework from the perspective of the creditors' bargain theory*

1 Introduction

The Dutch provisions for the reorganization plan (*faillissementsakkoord*), regulated by part 6 of title 1 of the Dutch Bankruptcy Code, can prevent that potentially successful businesses collapse because of a concurrence of circumstances.[1] Despite the fact that a business cannot pay his debt, it may still be wiser not to liquidate a business. An example of this, is a business with a large future earning capacity, whose bankruptcy was caused by non-structural circumstances. In such a case the reorganization plan enables the thorough restructuring of the business and the possibility to continue it with a reduced debt burden.[2]

In practice, few Dutch bankruptcies end by way of a reorganization plan. Over the years 2000 to 2004 the percentage of bankruptcies that ended with a reorganization plan was 3.9% on average. In the years after that (2005 to 2009) the percentage declined to 2.4% on average.[3] The cause for this decline is unclear, but the fact is that the use of a reorganization plan is not very common.

The figures above give reason to research to what extent the legal framework of the reorganization plan functions. 'Functions', in this context, means that the framework is eco-

* This chapter was published as an article in Dutch in Tijdschrift voor Insolventierecht 2010, 26, p. 162–171.

1 Where the term 'reorganization plan' is used, I refer to the Dutch reorganization plan in bankruptcy (*faillissementsakkoord*), unless explicitly stated otherwise.

2 An alternative for a restructuring based on a reorganization plan is a going-concern sale. However, it can occur that in such a sale the interests of the creditors may not be sufficiently taken into account and the checks and balances of the Dutch Bankruptcy Code are evaded. For this reason the reorganization plan as a restructuring mechanism is to be preferred over a going-concern sale.

3 www.cbs.nl > cijfers > kerncijfers > faillissementen. Last checked on July 23, 2010.

nomically efficient.[4] The assessment framework for this efficiency is the creditors' bargain theory.[5]

Law and Economics is aimed at the question how human behavior is influenced by legal provisions.[6] In this context it is interesting to see how efficient the legal provisions regarding the reorganization plan are and how they can be changed to increase efficiency. This is what the aim is of assessing the legal framework of the reorganization plan in light of the creditors' bargain theory. The consequence of value maximization is that a maximum amount of money is realized for the investors as a group and that the debts due to them can be paid as much as possible.[7]

Before the efficiency of the legal framework is considered, first the creditors' bargain theory will be discussed. Next, an overview is given of the legal framework of the reorganization plan. After this, the efficiency of the legal framework is assessed. In this assessment, specific attention is given to cramming down a reorganization plan, binding preferred creditors and confirmation of a reorganization plan. This article ends with a conclusion.

2 The creditors' bargain theory

The creditors' bargain theory gives an explanation for the existence of bankruptcy law and gives an assessment framework that enables the assessment of the efficiency of specific legal provisions. The ultimate goal of bankruptcy law, according to this theory, is value maximization of the pool of assets for the investors as a group.[8]

4 Efficiency means value maximization of all the assets of the estate, while taking into account the costs that are involved in the bankruptcy.

5 The creditors' bargain theory was developed in the 1980s by D.G. Baird and T.H. Jackson. See: T.H. Jackson, 'Bankruptcy, non-entitlements, and the creditors bargain', *Yale Law Journal* (91) 1982, p. 857–907, D.G. Baird and T.H. Jackson, 'Corporate reorganizations and the treatment of diverse ownership interests: a comment on adequate protection of secured creditors in bankruptcy', *University of Chicago Law Review* (51) 1984, p. 97–130, T.H. Jackson, *The logic and limits of bankruptcy law*, Cambridge: Harvard University Press 1986(A) and T.H. Jackson, 'Of liquidation, continuation and delay: an analysis of bankruptcy policy and nonbankruptcy rules, American Bankruptcy Law Journal (60) 1986(B), p. 399–428. The creditors' bargain theory is not the only theory for assessing bankruptcy law. See for an explanation of the creditors' bargain theory and several other theories: G.D. Hoekstra, *De positie van de pandhouder in het faillissementsrecht*, Den Haag: Boom Juridische uitgevers 2007. Hoekstra also discusses why this theory is to be preferred over the other theories. Specifically: Hoekstra 2007, p. 49–52.

6 Compare: S. Franken, 'Onderzoek naar de effectiviteit van faillissementswetgeving', *Tijdschrift voor Insolventierecht* 2000, 6, p. 175–176.

7 See below for the term 'investors as a group'.

8 Jackson 1986A, p. 5. The terms 'pool of assets' and 'investors as a group' differ from the terms 'estate' and 'joint creditors'. See about this: Hoekstra 2007, p. 71–72. 'Investors as a group' refers to anyone with a property right, i.e. a right against the debtor. See: Baird and Jackson 1984, p. 100 (fn. 15). The term 'investor'

A creditor can, theoretically, seek recourse in two ways: individually or collectively. According to the creditors' bargain theory a creditor will choose collective recourse if this leads to a higher total yield for the investors as a group.[9] The higher yield compared to individual recourse can then be distributed among the various creditors.[10]

However, the assumption is that creditors, without a framework for collective recourse, will act in their individual interests and not in the collective interest.[11] This is called the collective action problem. Before the declaration of bankruptcy the collective of creditors will not come to a framework for collective recourse, because of the costs that are attached to bringing this about and because of the uncertainty about the question who belongs to the collective of creditors.[12] After the declaration of bankruptcy the main problem is that, because of a lack of a collective framework, creditors will want to put their individual interest first. This leads to the situation that each creditor wants to secure his claim and will seek recourse for his claim as soon as possible.[13] If this recourse takes the form of a sale of the assets on an individual basis, it is possible that a part of the value of the business will be lost.[14] Because it is in the interest of the creditors to seek recourse as soon as possible after the declaration of bankruptcy, they will incur many costs to monitor other creditors.[15]

According to the creditors' bargain theory – now that the creditors will not come to a framework for collective recourse on their own – bankruptcy law is the designated way to provide for collective recourse. According to the creditors' bargain theory bankruptcy law has to prescribe creditors a binding agreement that they would have entered into before the declaration of bankruptcy, if they had been able to agree upon an agreement. As such, bankruptcy law can be seen as a hypothetical bargain. This hypothetical bargain has to meet three principles:[16]

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is broader than 'creditor'. I have, however, chosen to mainly use the term 'creditors', because this article mainly focuses on the position of this group. The term 'pool of assets' means all assets of the debtor.

9 See: Jackson 1982, p. 860–865.

10 Hoekstra 2007, p. 14. Distributing the higher yield among the individual creditors is a requirement for an investor to chose for collective recourse.

11 See: Jackson 1982, p. 862.

12 Hoekstra 2007, p. 13 and Jackson 1982, p. 866. The free rider problem can also come into play. See: Jackson 1982, p. 865.

13 Jackson 1982, p. 865.

14 Because a sale of the assets in larger parts generally generates a higher yield than a piecemeal sale. The problem referred to here is called the 'common pool problem'. See about the undesirability of this situation: Jackson 1986B, p. 402.

15 These are the so-called 'monitoring costs'.

16 Baird and Jackson 1984, p. 100 and 103.

1. '[B]ankruptcy law at its core should be designed to keep individual actions against assets, taken to preserve the position of one investor or another, from interfering with the use of those assets favored by the investors as a group.
2. Bankruptcy law should change a substantive nonbankruptcy rule only when doing so preserves the value of assets from the group of investors holding rights in them.
3. [B]ankruptcy (…) should be (…) concerned with the interests of those (…) who have property rights in the assets of the firm (…).'

The first principle entails that the purpose of bankruptcy law is to let the investors as a group act collectively and to prevent an individual creditor from seeking recourse in a way that is not in the best interest of the collective.[17] This principle only concerns the question how the assets should be deployed to realize a maximum yield for the investors as a group (the deployment question). This question differs from the question how the yield should be distributed (the distribution question).[18]

To answer the question how the pool of assets can best be deployed to generate the highest possible yield for the investors as a group, the deployment question should be answered in the way a sole owner would.[19] Because, if a business has only one creditor (or owner), he will deploy these assets in a way that promotes maximization of the yield. By pretending there is a sole owner in the context of decision-making in bankruptcy, the assets will be deployed in a way that maximizes the yield for the investors as a group. If multiple creditors are taken into account, it is possible that they answer the deployment question differently. This may lead to a race for recourse with the goal of seeking recourse as soon as possible which prevents a restructuring with a higher yield for all creditors.

The second principle regards the changing of substantive rights in bankruptcy. A justification for changing a substantive right in bankruptcy only exists if this relates to the maximization of the value of the pool of assets for the investors as a group. This is related to the following. By changing substantive rights in bankruptcy a creditor may obtain an advantage in bankruptcy (for example a right of preference) that he does not have outside of bankruptcy. This advantage gives a creditor an incentive to prefer his own interest above the interest of the investors as a group.[20] For this reason, it is preferable to look for a situa-

17 Baird and Jackson 1984, p. 106. In the Netherlands this goal can be found in Section 33 DBC.
18 Jackson 1986B, p. 404.
19 Baird and Jackson 1984, p. 108.
20 Baird and Jackson 1984, p. 104. Hoekstra 2007, p. 15.

tion that resembles the situation outside of bankruptcy as much as possible instead of changing substantive rights.[21]

The third principle entails that bankruptcy law should only deal with the interests of holders of a property right.[22] Other interests, such as preserving employment or societal interests, should not be solved by bankruptcy law, but by non-bankruptcy law.[23] For example, a special position for employees should be provided for in labor law. Bankruptcy law should then respect this position as provided for by labor law.[24]

3 The legal framework of the Dutch reorganization plan

3.1 Bringing about the reorganization plan

The bringing about of a reorganization plan starts with the offering of a draft plan by the debtor to the joint creditors.[25] Instead of the debtor it is also possible that a third party with a power of attorney offers a plan.[26] A plan can only be offered once.[27] It is, however, possible to change a plan during the period in which creditors are consulted.[28]

The actual offering of the plan takes place by filing a draft plan with the registry of the District Court. If the plan is filed with the registry at least eight days before the claims admission meeting, it is considered to be filed on time.[29] A copy of the plan has to be sent

21 This entails that substantive rights outside of bankruptcy remain intact as much as possible. See: Jackson 1986A, p. 22; Jackson 1986B, p. 339 and Hoekstra 2007, p. 16.

22 As stated in footnote 8, a property right is a right that can be enforced against the debtor. The term cannot be limited to 'right of ownership' or 'property law related right'.

23 Baird and Jackson 1984, p. 103 and Hoekstra 2007, p. 16. See about the creditors' bargain theory and 'other interests': G.D. Hoekstra, 'de spanning tussen het maatschappelijk belang en het gezamenlijk belang bezien in het licht van de creditors' bargain', *Tijdschrift voor Insolventierecht* 2005, 12.

24 A.P.K. Luttikhuis, 'Onderneming insolvent: arbeidsrecht in solvent en insolvent recht noodzakelijk!', *Tijdschrift voor Insolventierecht* 2005, 21, p. 77. With a reference to: Jackson 1986A, p. 31–32. The question can be posed to what extent labor law is designed to regulate the position of the employee in bankruptcy. This subject falls outside the scope of this article, but reference is made to the article by Luttikhuis.

25 Section 138 DBC.

26 It is possible that the trustee acts as the one with the power of attorney, but restraint should be exercised in this respect. See: G.W. van der Feltz, *Geschiedenis van de Wet op het faillissement en de surseance van betaling*, bewerkt door G.W. baron van der Feltz, deel II (1897); Heruitgave bewerkt door S.C.J.J. Kortmann en N.E.D. Faber, serie Onderneming en Recht, Deel 2-II, Zwolle: W.E.J. Tjeenk Willink 1994, p. 151–152.

27 Section 158 DBC.

28 Section 144 DBC.

29 Section 139(1) DBC.

to the trustee and all members of the creditors committee.[30] Directly after the claims admission meeting the creditors will discuss and vote on the plan.

Acknowledged and provisionally admitted ordinary creditors are entitled to vote on the plan. Not entitled to vote are the creditors with a right of preference, unless they give up their right of preference.[31]

Despite the fact that creditors with a security interest are not entitled to vote, in practice they have a huge influence on the plan. This is mainly due to the fact that their cooperation is necessary to achieve value maximization by means of a reorganization plan.

The fact is that for a reorganization plan that maximizes the value of the pool of assets certain assets will often be necessary that are encumbered by a security right. Think, for example, of a printing business whose printing presses are encumbered by a right of pledge. If value maximization is achieved by continuing the printing business, the printing presses are essential in realizing a reorganization plan under which the printing business will be continued. If the secured creditors exercise their right of summary execution, it will no longer be possible to reorganize the value maximizing reorganization plan.[32]

In practice, it seems wise for a creditor to confer with secured creditors in the period preceding the offering of a reorganization plan and to secure their support. This way the offering of a reorganization plan that is bound to fail can be prevented.

Besides conferring with secured creditors the debtor can request the judge or supervisory judge to promulgate a cooling-off period.[33] Such a cooling-off period prevents secured creditors from exercising their rights. The duration of the cooling-off period is two months and can be extended once. This way the debtor has extra time to bring about a reorganization plan. However, the cooling-off period in itself does not lead to an increased chance of success of a reorganization plan. For, after the cooling-off period secured creditors can still exercise their rights with regard to the encumbered assets. For this reason the cooling-off period has to be viewed in the context of binding preferential creditors to a reorganization plan.[34]

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30 Section 139(2) DBC. Not complying with this provision does not mean that creditors cannot adopt the plan. See: M. Ph. van Sint Truiden & F.M.J. Verstijlen (red.), *Insolventierecht: de tekst van de Faillissementswet en de EU Insolventieverordening voorzien van commentaar*, Deventer: Kluwer 2008 at Section 139 DBC.

31 Examples of rights that result in a preference are the right of mortgage, the right of pledge and the rights of privilege.

32 Perhaps another plan can be agreed upon, but that is not a value maximizing plan.

33 Section 63a DBC.

34 See paragraph 4.2.

A reorganization plan will have been adopted if it has been approved by the majority of the acknowledged and provisionally admitted ordinary creditors that have appeared, that represent at least half of the total debt.[35] Since January 15, 2005 the judge can cram down a plan as if it was adopted.[36] For such a cram down to be possible two requirements have to be met. Firstly, two thirds of the acknowledged and provisionally admitted ordinary creditors that have appeared have to approve of the plan. Secondly, the rejection of the plan has to be the consequence of one or more creditors whose decision to vote against the plan could not reasonably have been made. If the reorganization plan is not adopted, the estate enters the state of insolvency.[37]

3.2 Confirmation of the reorganization plan

If the plan is approved or crammed down, it has to be confirmed.[38] To this end the District Court will schedule a public hearing within eight to fourteen days after the meeting of creditors.[39] Refusal of confirmation of a reorganization plan will be based on statutory grounds. Several of these grounds are imperative. The District Court also has discretionary power to refuse confirmation ex officio.[40]

Parties can appeal the decision of the District Court regarding the confirmation at the Court of Appeals. If the confirmation was refused, this appeal exists for the debtor and creditors that consented to the proposed plan. If the plan was confirmed, appeal is possible by creditors that voted against the plan or that did not participate in the vote.[41] After the appeal at the Court of Appeals, parties can appeal to the Dutch Supreme Court.[42]

If the District Court confirms the plan it is binding on all creditors without preference.[43] The plan also applies to creditors that have not submitted their claim for admittance, did not participate in the vote or voted against the plan.[44]

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35 Section 145 DBC.
36 Section 146 DBC, introduced by law of November 24, 2004, Dutch Bulletin of Acts and Decrees. 2004, 615.
37 Section 173 DBC.
38 Confirmation means judicial approval of the plan.
39 If Section 150(3) DBC is applicable, the confirmation hearing will take place eight to fourteen days after the altered judicial records are confirmed.
40 Section 153 DBC.
41 Section 154 DBC. Only creditors that are entitled to vote can appeal. See: Dutch Supreme Court, September 24, 1993, *NJ* 1993, 759.
42 Section 156 DBC.
43 Section 157 DBC.
44 Van der Feltz II 1897, p. 184–185.

When the confirmed plan becomes non-appealable the bankruptcy ends and the debtor regains control over the assets of the estate.[45] If the plan is not confirmed, the estate enters the state of insolvency.[46]

3.3 *Dissolution of the reorganization plan*

If the debtor does not meet his obligations under the reorganization plan, every creditor can request that the plan be dissolved.[47] The judge can not only grant a request for dissolution, but can also give the debtor one month extra time to meet his obligations and, as such, prevent the dissolution of the plan. If the reorganization plan is dissolved, the bankruptcy is reopened and the trustee will liquidate the estate.[48]

4 Assessing the legal framework in light of the creditors' bargain theory

4.1 *Cramming down a reorganization plan in light of the creditors' bargain theory*

It follows from Section 146 DBC that the supervisory judge can cram down a reorganization plan that has not been adopted by a vote of the creditors. This gives the supervisory judge the power to push a reorganization plan through against the will of the creditors. The cram down is possible at the request of the trustee or debtor and the supervisory judge cannot change the contents of the reorganization plan.[49]

Section 146 DBC lists two requirements for a cram down. First of all, three quarter of the admitted and provisionally admitted ordinary creditors that have appeared have to have approved of the plan. Secondly, the rejection of the plan has to be the consequence of one or more creditors that could not have reasonably voted against the plan. In this respect all circumstances have to be taken into account and in particular the expected payout in case of a liquidation of the estate.

45 Section 161 DBC.
46 Section 173 DBC.
47 Section 165 DBC. This concerns every creditor that is bound by the plan.
48 Section 167 DBC.
49 Parliamentary History, 22 969, no. 3, p. 55.

The second requirement is closely related to the doctrine of forcing a creditor to consent to an out-of-court reorganization plan.[50] Many judgments can be found in case law about the circumstances under which voting behavior can be prescribed and on what grounds. Three grounds that are mentioned, are the acting of a creditor contrary to the principle of reasonableness and fairness, abuse of power and acting contrary to what is befitting in society according to unwritten law (i.e. an unlawful act).[51]

In 2005, however, the Dutch Supreme Court gave a guiding judgment concerning the prescription of voting behavior. This is the judgment *Groenemeijer/Payroll*.[52] In this judgment the Dutch Supreme Court gave a ruling on when a creditor can be forced to consent to an out-of-court reorganization plan. In the judgment the Dutch Supreme Court rules that a creditor first and foremost has the freedom not to consent to a proposed plan. However, the creditor does not have this freedom if he abuses his powers and the creditor could therefore not have reasonably refused the proposed plan.[53]

In paragraph 3.5.3 of *Groenemeijer/Payroll* the Dutch Supreme Court addresses the weighing of interests required in order to assess whether or not it is a matter of abuse of power. According to the Dutch Supreme Court it is insufficient to establish abuse of power based on the fact that the creditor knows or should have known the bad financial situation of the debtor. The interest for a creditor in being able to refuse a proposed plan lies in the possibility of recourse against all assets of the debtors for payment of a debt. The interest of the debtor in preventing a bankruptcy does not, in principle, outweigh that interest. Nor does the creditor have to put the interest of the debtor – the possibility for the debtor to reduce its liabilities faster – before its own interests.[54]

Groenemeijer/Payroll clearly shows that restraint should be leading for a judge.[55] The basic principle is that an individual creditor is free to choose whether or not he consent to a

50 Compare: Losbladige Faillissementswet, commentary 2 at Section 146 (F.M.J. Verstijlen) and A.DW. Soedira, 'Het akkoord', in: L.I. Couwenberg et al., *De afwikkeling van het faillissement*, Deventer: Kluwer 2008, p. 123.

51 District Court Haarlem, 3 August 1993, *Prg.* 1993, 3993 (with note A.J.J. van der Heijden) lists all three. For an example of an assessment in light of the principle of reasonableness and fairness see: District Court Almelo, 4 February 1998, *JOR* 1998, 66. Abuse of power as a basis is assumed in inter alia President District Court Utrecht, 20 June 1995, *KG* 1995, 293 and President District Court Zwolle, 26 April 1996, *KG* 1996, 192. In this last judgment the court uses the doctrine of unlawful act as a test in relation to the question whether the creditor is allowed to reject a proposed plan.

52 Dutch Supreme Court, 12 August 2005, *NJ* 2006, 230.

53 3.5.2 of Groenemeijer/Payroll.

54 The Advocate-General has a different opinion in his conclusion.

55 3.5.4 of Groenemeijer/Payroll. Approving: Spanjaard in his note under Dutch Supreme Court, August 12, 2005, Ondernemingsrecht 2005, p. 257. A.D.W. Soedira, 'Gedwongen medewerking aan een buitengerechtelijk akkoord. (HR 12 augustus 2005, *RvdW* 2005, 92)', *Nieuwsbrief Bedrijfsjuridische Berichten* 2005, p. 235 and Hoge Raad 12 augustus 2005, *Tijdschrift voor Insolventierecht* 2006, 22 (with note C.M. Harmsen), p. 106.

proposed plan. It is subsequently the debtor's responsibility, according to the Dutch Supreme Court, to bring forward specific facts and circumstances that show that a creditor could not have reasonably withheld his consent to the proposed plan.[56]

In my view the test applied in *Groenemeijer/Payroll* in the context of the out-of-court reorganization plan can also be used for the reorganization plan in bankruptcy. An indication for this conclusion can be found in the Dutch Court of Appeals judgment *De Nederlanden van 1870/Dil.*[57] In this judgment the standard for prescribing voting behavior is also abuse of power and interests are also weighed. It should, however, be noted that in the context of a bankruptcy other interest might play a role in determining whether there is abuse of power than in the context of an out-of-court restructuring. For example, the interest of preventing a bankruptcy will no longer play a role in the context of a bankruptcy. The interest of the debtor is rather the bringing about a successful restructuring with the goal of preserving the business.

When assessing the power of a judge to cram down a reorganization plan in light of the creditors' bargain theory, this power seems to be in accordance with the rationale of the first principle. Cramming down a reorganization plan does not directly prevent individual recourse by a creditor, but it does prevent an individual creditor from blocking the realization of a reorganization plan that is in the interest of the investors as a group. This is achieved by cramming down the reorganization plan. As a result of this cram down the bankruptcy is conducted in a way that is in the interest of the investors as a group and therefore in line with the creditors' bargain theory.

It is noted that it is remarkable that a reorganization plan can be crammed down if less than a quarter of the creditors abuses their powers, but not if more than a quarter abuses their powers. This difference is the consequence of the first requirement of Section 146 DBC.[58] As a result, a reorganization plan that is in the interest of the investors as a group may not be realized, solely because more than a quarter of the creditors abuses their powers. It is unclear to me why this – arbitrary – majority requirement is necessary. Unreasonable voting behavior is unreasonable voting behavior.[59]

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56 3.5.4 of Groenemeijer/Payroll.

57 Court of Appeals Amsterdam, 7 March 1991, *NJ* 1992, 77.

58 Compare: Losbladige Faillissementswet, commentary 2 at Section 146 (redacted by F.M.J. Verstijlen).

59 Compare: F.M.J. Verstijlen, 'Het insolventieakkoord' in: J.A. van de Hel, M.C.A. van den Nieuwenhuizen & J.H. Verdonschot (red.), *Het Voorontwerp Insolventiewet nader beschouwd*, Nijmegen: Ars Aequi Libri 2008, p. 140.

Testing of Section 146 DBC against the second principle of the creditors' bargain theory results in the following. Cramming down a reorganization plan results in a limitation of the freedom of contract of a creditor. Someone that disapproves of a reorganization plan is still bound by it. The second principle of the creditors' bargain theory prescribes that a substantive right may only be changed in bankruptcy if the costs of altering the right are smaller than the gained benefits for the investors as a group. This assessment of costs and benefits can be a factor for the judge in his decision whether or not to cram down a reorganization plan. After all, value maximization of the estate leads to a higher (chance of a) payout to the creditors, while the expected payout to the disapproving creditors is explicitly mentioned in Section 146 DBC as relevant factor. In a correct assessment – under the creditors' bargain theory – the judge will not cram down a reorganization plan if it is not value maximizing, but will cram it down, and limit the freedom of contract of creditors, if the reorganization plan maximizes the value of the pool of assets for the investors as a group. In this respect the judge can take the interests of the creditors that did not appear at the vote into account.

In this respect the question can be posed whether or not the judge should have the power to cram down a reorganization plan at all. For, according to the creditors' bargain theory this reorganization plan would have been adopted anyway, because this plan offers the creditors the most value.[60] Why should the judge then have the authority to cram down a plan? At this point the difference between the legal and economic approach becomes visible. In practice creditors do not always act in the most efficient way. In this respect the most predominant situation that can be thought of is the situation that creditors reject a proposed plan for non-economic reasons.[61] The judge can then correct this with his authority to cram down a plan and ensure that the bankruptcy is conducted in a value maximizing way. This does limit the freedom of contract of creditors, but at the same time the other creditors will receive the biggest repayment possible on their claim. A desirable scenario for this latter group of creditors.

4.2 Binding creditors with a right of preference in light of the creditors' bargain theory

It follows from the Dutch Bankruptcy Code that creditors with a right of preference are not bound by a reorganization plan.[62] Nor is there a possibility for the judge to bind cred-

60 This follows from the assumption in law & economics that people behave in a value maximizing way. See: C.J. van Velthoven en P.W. van Wijck, *Recht en efficientie*, Deventer: Kluwer 2001, p. 3.

61 Houben argues that this regularly occurs. See: I.S.J. Houben, 'Het onderhands dwangakkoord, *Tijdschrift voor Insolventierecht* 2006, 21, p. 101.

62 Section 157 DBC.

itors with a right of preference to a reorganization plan against their will. The supervisory judge can, however, promulgate a cooling-off period. A cooling-off period prevents secured creditors from exercising their right of summary execution.[63] This way the possibility is created to realize a reorganization plan, without the possibility of frustration by a creditor who exercises his right of summary execution. After this realization of a plan, attention will have to be devoted to creditors with a right of preference.

In assessing whether or not creditors with a right of preference should be bound to a reorganization plan, the starting point is the existence of a right of summary execution for secured creditors and the existence of a right of preference for preferred creditors.[64] It follows from this starting point that the impossibility to bind secured creditors to a reorganization plan can conflict with the first principle of the creditors' bargain theory. For, despite the fact that a reorganization plan is in the interest of the investors as a group, a secured creditor can still interfere with this interest.[65] He is not bound by a reorganization plan and can still seek recourse on an individual basis.

The same goes for a preferred creditor. Without a binding force a preferred creditor will always have to be paid in full. The amount of the claim of such a creditor can be such, that nothing remains for ordinary creditors and a reorganization plan no longer has any use. If preferred creditors are bound by a reorganization plan they can relinquish part of their claim and a reorganization plan might still be realized.[66]

As stated above, by promulgating a cooling-off period the judge can prevent a secured creditor from seeking individual recourse before a reorganization plan enters into force. The question is to what extent a creditor should have a right of summary execution after the reorganization plan enters into force. Based on the second principle of the creditors' bargain theory rights of recourse that a creditor had before a bankruptcy have to be respected in bankruptcy. This is different if these rights prevent value maximization for

63 Section 63a DBC. The starting point is that the cooling-off period lasts for two months. The supervisory judge can extend this period once by two months.

64 See regarding the question to what extent the position of creditors with a right of summary execution is in line with the creditors' bargain theory: Hoekstra 2007, p. 79 et seq. The reason for this starting point is that the right of summary execution and the right of preference originate in non-bankruptcy law. Compare: Baird and Jackson 1984, p. 111.

65 Compare: Hoekstra 2007, p. 85.

66 It is noted here that for binding secured creditors and preferred creditors a significant change in the voting procedure is necessary. See for an example of how the procedure can be changed: F.M.J. Verstijlen, 'Het insolventieakkoord' in: J.A. van de Hel, M.C.A. van den Nieuwenhuizen & J.H. Verdonschot (red.), *Het Voorontwerp Insolventiewet nader beschouwd*, Nijmegen: Ars Aequi Libri 2008, p. 134 et seq.

the investors as a group. In such a case the rights of creditors may be violated, but only under the condition that the value of the right is respected.[67]

The aforementioned situation occurs in at least three instances.[68] The first is that the assets are more valuable together than on an individual basis. In such a case the liquidation of a certain asset can make a restructuring more difficult. The second situation is when there is no incentive for a secured creditor to realize the highest possible yield for a certain asset. This occurs *inter alia* when a higher ranked creditor has such a claim that the secured creditor will not receive any of the proceeds of the assets.[69] Thirdly, this situation occurs if the asset that is encumbered is worth more than the claim that it aims to secure. Then there is also no incentive for the secured creditor to realize the highest possible price for an asset. The secured creditor, after all, will have to pay the surplus value to the trustee.

At least in these three situations it is justified that the secured creditor is deprived of his right of summary execution. However, as stated before, the value of his right has to respected. This can be done by paying the secured creditor the realizable value of the asset at the moment the secured creditor would have been able to exercise his right of summary execution.[70] There is also a certain amount of delay costs that should be paid. These costs consist of the interest between the moment when the secured creditor would have been able to exercise his right of summary execution and the moment that the realizable value is paid out. In the Netherlands, such a compensation does not exist, except for oversecured claims.[71] Furthermore, the secured creditor should receive a risk premium for the extra risks such a creditor incurs by the deferment of the payment of his claim.[72] Dutch law does not provide for such premium.

In other cases, where there is a sufficient incentive for the secured creditor to generate the highest yield, nothing stands in the way of leaving the secured creditor his right of summary execution. This is also in line with the second principle of the creditors' bargain theory, which states that pre-bankruptcy rights should be respected as much as possible.

67 Jackson 1986A, p. 29.
68 A.P.K. Luttikhuis, 'De relatieve betekenis van toezicht', *Tijdschrift voor Insolventierecht* 2004, 56, p. 282.
69 An example of such a higher ranking creditor are the tax authorities pursuant to Section 21(2) of the Collection of State Taxes Act 1990.
70 Jackson 1986A, p. 183–189 and Luttikhuis in *Tijdschrift voor Insolventierecht* 2004, 56, p. 282.
71 Section 128 DBC.
72 See about the determination of this premium: Jackson 1986A, p. 188 et seq.

4.3 *Confirmation of the reorganization plan in light of the creditors' bargain theory*

In order for a reorganization plan to be binding, the judge has to confirm the plan.[73] The judge can, despite objections by creditors, bind ordinary creditors against their will by confirming the plan. During the hearing every creditor is given the opportunity to argue why the proposed plan should or should not be confirmed.[74] Creditors that are not bound by the reorganization plan can also advance their arguments.[75]

When looking at the creditors' bargain theory, confirmation can be seen as a useful testing instrument. The goal of confirmation can be seen as giving a guarantee that the proposed way of ending the bankruptcy is feasible and more efficient than liquidation. Or so it follows from the analysis of the conditions for confirmation that are discussed below. This testing is performed in the interest of the creditors.[76] Confirmation enables the judge to test whether a certain number of conditions that apply to an efficient plan are met. This way the judge can guarantee that the proposed plan is in the interest of the investors as a group.

Section 153 DBC contains several grounds on the basis of which confirmation of a reorganization plan can be withheld. These grounds were introduced because of 'case law that was slacking in morality' that dated from before the introduction of the current Dutch Bankruptcy Code.[77] The grounds contained in paragraph 2 are imperative and non-exhaustive. For example, the judge also has to deny confirmation if the reorganization plan interferes with a certain statute.[78] Furthermore, paragraph 3 contains a discretionary ground for denial. The grounds for denial listed in paragraph 2 are the following:

1. The assets of the estate considerably exceed the sum under the reorganization plan[79] This ground concerns all assets of the estate, also assets that are to be expected.[80] The provision does not prescribe which value the Dutch judge should take as a starting

73 Section 157 DBC.
74 Section 151 and 152 DBC.
75 Losbladige Faillissementswet at Section 152 DBC (redacted by R.J. van Galen). An example of such creditors are those who are excluded from voting.
76 B. Wessels, *Het akkoord*, Deventer: Kluwer 2010 (Insolventierecht deel VI), § 6099.
77 Van der Feltz II 1897, p. 177. Confirmation was almost never denied under this case law.
78 Wessels 2010, §6115. For example if the supervisory judge wrongfully crammed down the plan. Different: District Court Rotterdam, 2 December 2008, *RI* 2009, 23.
79 In the provisions regarding the plan during a suspension of payments procedure the word 'considerably' is not included. See: Section 272 DBC. This appears to be a mistake of the legislator. The lack of the word 'considerably' does not lead to a substantive difference. See: C.M. Harmsen, '2002: de comeback van de surseance van betaling', *Tijdschrift voor Insolventierecht* 2003, p. 281 and Court of Appeals Amsterdam, 5 November 2005, *JOR* 2007, 51.
80 Dutch Supreme Court, 14 December 2001, *NJ* 2002, 39. This was a plan in the context of Debt Restructuring Natural Persons procedure.

point in determining the value of the assets of the estate. The rationale of Section 153(2)(1) DBC is that the debtor cannot be better off in comparison with the situation that no reorganization plan was offered.[81] In other words, the assets of the estate are, insofar as they do not exceed the total amount of liabilities, to be distributed to the creditors.

This rationale does not correspond to the creditors' bargain theory. This theory prescribes that questions with regard to distribution, such as the question whether or not the debtor is permitted to retain a part of the business, should not be answered by the judge during the bankruptcy. It should be left to the creditors to express their opinion about such a course of action.

It is therefore recommended that the first criterion of Section 153(2) DBC be altered. The criterion should test whether the reorganization plan realizes a value maximization of the pool of assets.

A simple example shows why the alteration proposed above is efficient. Suppose that business X BV goes bankrupt. The total shortfall of the estate is 110 and a liquidation of the assets would generate 80, which yield would go completely to the creditors. In case a reorganization plan were realized, a yield of 100 would be possible. If the reorganization plan entailed that the creditors would get 85 and the debtor would retain 15, then this reorganization plan would not be realized under current law. Even though the creditors would have an extra 5 to distribute in comparison to the situation that the estate would be liquidated. If the criterion I proposed by were used, the – efficient – reorganization plan would be realized.

Based on the above it seems justified to argue that the judge should also be able to take into account the going-concern value of the business.[82] For, the assets of the estate can also consist of the joint sale of the assets. A reorganization plan which then realizes a yield that is lower than the going-concern value, is thus not value maximizing and should not be pursued.[83]

In determining the value under the reorganization plan the judge will also have to take into account the (extra) time it takes until the creditors will be paid and the extra risk they incur because they have to wait longer before their claim is satisfied.[84] This way

81 Harmsen 2003, p. 281.

82 Compare: Court of Appeals Leeuwarden, 21 July 2006, *LJN* AY 4796. This judgment uses the words 'joint value or yield of the unencumbered assets of the business'. The judgment concerns a reorganization plan following a suspension of payments procedure. See further: Harmsen 2003, p. 281. Harmsen argues that the piecemeal value should be taken as a starting point in light of the aforementioned rationale of the criterion. In my view Harmsen does not take the possibility of a going-concern sale into account and the rationale of this criterion leads to the aforementioned conclusion.

83 Jackson 1986A, p. 211. This does not alter the fact that restructuring by means of reorganization plan is to be preferred based on legal grounds. See footnote 2.

84 Jackson 1986A, p. 181 et seq.

the value of the rights of the creditors is respected and the judge will act in line with the creditors' bargain theory. As a starting point the law does not provide for the extra time it takes during a bankruptcy until a creditor gets paid for the extra risk he incurs.[85] The law should also be changed on this point.

Incidentally, for both the current criterion as well as the criterion proposed by me, the debtor will be required to give insight into his financial position. For the judge has to make the best possible assessment of the value of the estate.[86] Unclear is to what extent debtors are required to give insight into their financial position. Insight into the financial position of the debtor is to be applauded. By giving creditors insight into financial information with regard to a business, they can take a well considered decision whether or not to consent to or reject the reorganization plan. In any event the creditors can obtain financial information from the advise of the trustee and committee of creditors mentioned in Section 140 DBC.

2. The fulfillment of the reorganization plan is insufficiently warranted
   If the fulfillment of the reorganization plan is sufficiently warranted, depends on the circumstances of the case. It is up to the judge to have an opinion about this. However, the fulfillment is not sufficiently warranted by a mere promise of payment.[87] Examples of ways that do offer a sufficient warranty are a contract of surety or payment of the payout mentioned in the plan out of the cash present in the estate.[88]
   This criterion safeguards that after the realization of the reorganization plan it turns out that the requirements of the plan cannot be met. Such a criterion is justified. The debtor can, for example, offer his creditors a plan that promises a very high payout percentage, which in reality cannot be paid. It can be assumed that such plans are not efficient, because there will be costs involved in the realization of the plan that is – at least that is the expectation – destined to fail. Furthermore, the value of the business can decline in the period between the realization of the plan and the failure to fulfill the relevant obligations under the plan. As such, the pool of assets is not used in the most efficient way. This criterion prevents that such a reorganization plan is realized and, as such, contributes to the realization of an efficient reorganization plan.
3. The reorganization plan is realized by means of deceit, beneficial entitlement of one or more creditors, or realized by other dishonest means
   This criterion includes the plan that secretly favors a creditor.[89] Such a plan is a plan in which one or more creditors are promised more benefits than they are entitled to

85 An exception is made in Section 128 DBC for oversecured claims.
86 Wessels 2010, § 6116 and Soedira 2008, p. 131. See also: District Court Amsterdam, 6 April 1914, *W* 9663 and Court of Appeals Leeuwarden, 22 February 1922, *W* 10861.
87 Van der Feltz II 1897, p. 180.
88 Leuftink 1995, p. 313.
89 Van der Feltz II 1897, p. 177.

under the reorganization plan.[90] The plan will be confirmed, however, if all creditors get more than what they are entitled to under the plan.[91]

There has to be a causal connection between the deceitful means of paragraph 3 and the realization of the plan. The deceitful means must have led to a majority in favor of the reorganization plan and the adoption of the plan.[92]

In testing this criterion against the creditors' bargain theory, it becomes apparent that the criterion prevents that a reorganization plan is realized that does not have the form of the agreement that the creditors would have entered into, if they had been able to do so.

The fact is that in the situation of beneficial entitlement certain assets are distributed to certain creditors, while it would also have been possible to distribute these assets among all creditors. Regarding deceit and other dishonest means, it is improbable that creditors would approve of a framework that allows a plan to enter into effect if a debtor uses such means.

In the case of deceit and other dishonest means the plan will set forth a higher distribution to creditors than the one that can actually be realized. However, in such a case the plan can still be value maximizing. It can be argued that the plan is then still efficient and should have effect. For, creditors will favor that way of conducting the bankruptcy which realizes the most value. Would creditors still stipulate in their hypothetical bargain that such a plan is blocked from entering into effect? In my view, this question has to be answered affirmatively. The reason for this is that such a plan is only efficient in the strictest sense of the word.

For, by allowing the plan, the mala fide debtor would remain in control of the business. Besides the fact that such a situation is not desirable from a societal point of view, it increases the chance that, even if the plan is executed successfully, the business will go bankrupt again. For, why would a debtor not continue to deceive, now that he has saved his business successfully with this at least once before. A new bankruptcy means new costs for society and for creditors that continued to do business with the debtor. This last group of creditors may, as a result, be left worse off than in the situation in which the creditors would not have chosen the plan that was realized by deceit or other dishonest means, but would have chosen for liquidation. Even though this was not value maximizing in the first bankruptcy. Furthermore, because the mala fide debtor remains in control of the business, the creditor remains connected with the debtor, even though the creditor has no desire to be connected (e.g. from a PR perspective).

90 C.M. Hilverda, *Faillissementsfraude. Een studie naar de strafrechtelijke handhaving van faillissementsrechtelijke normen*, Zwolle: W.E.J. Tjeenk Willink 1999, p. 431. Such a plan is punishable under criminal law under Section 345 Dutch Penal Code.

91 Court of Appeals Amsterdam, 23 August 1905, *W* 8270.

92 Dutch Supreme Court, 26 June 1908, *W* 8715.

Because the creditor did not know about the deceit at the vote and could therefore not vote against the plan, such a creditor cannot evade such a situation. The criterion of Section 153(2)(3) DBC prevents such a situation.
In view of the above, it can be assumed that a reorganization plan that is realized by means of beneficial entitlement or other dishonest means, is not efficient. As such, the criterion of paragraph 3 of Section 153(2) DBC is useful in light of the creditors' bargain theory.

4. The trustee in a main proceeding under the EU Insolvency Regulation has withheld his approval of the plan
If the trustee in a cross-border bankruptcy did not approve of the proposed plan in the main proceeding, the judge has to deny confirmation in the context of a secondary proceeding. The exception to this is if the plan in the secondary proceeding does not affect the financial interests of the creditors in the main proceeding.
With this criterion the judge has an instrument to decide whether or not a plan can go ahead in a secondary proceeding. The starting point is that the trustee has the power to decide whether he consents to this or not. It is correct that the judge can give the plan the go-ahead if the financial interests of the creditors in the main proceeding are not affected. As there is no objection to a plan if it respects the value of the right of the creditors.

Besides the imperative grounds for refusal of paragraph 2 a discretion ground for refusal is provided for in paragraph 3 of Section 153 DBC. The judge can refuse confirmation on other grounds and *ex officio*. This grounds comes, for example, into play if the causal connection between dishonest means and the realization of the plan cannot be proven.[93] Another example is the situation that payment of preferred creditors and administrative expenses are not warranted.[94] The judge has full discretion, by means of paragraph 3, to test whether or not there are circumstances that result in the plan is not being value maximizing, or –, which as stated before, usually comes down to the same – prevent it from being effectuated.

5 Conclusion

In the preceding paragraphs I have assessed the efficiency of the legal framework of the Dutch reorganization plan in view of the creditors' bargain theory. It follows from this assessment that several aspects of the Dutch Bankruptcy Code have to be amended to increase the efficiency.

93 Dutch Supreme Court, 10 March 1916, *NJ* 1916, 727.
94 Losbladige Faillissementswet commentary 7 at Section 153 DBC (redacted by F.M.J. Verstijlen).

For example, it is unclear why a plan can only be crammed down if less than a quarter of the creditors objects to the plan on the basis of unreasonable grounds. Furthermore, preferred creditors should be bound to a reorganization plan. This way these creditors are prevented from blocking the realization of a plan. The right of summary execution for secured creditors should also be abolished in cases where there is no incentive for the secured creditor to realize the highest possible yield or if the assets are worth more together than if sold piecemeal. In this context the value of the creditor should be respected. Dutch law does not provide for the necessary compensation in this respect. Regarding the confirmation grounds of Section 153 DBC subparagraph 1 of paragraph 2 should be altered and should test whether or not the plan realizes the maximum value of the pool of assets. In performing this test, the judge has to take into account the yield of a possible going-concern sale and costs that are involved in respecting the rights of creditors. The other grounds do not have to be altered.

Implementing these proposed alterations would benefit the efficiency of the legal framework for the reorganization plan and ensure that the value of the pool of assets can be maximized for the investors as a group.

7 The cram down plan outside of bankruptcy: CEA 2 and conflicts of interest assessed

1 Introduction

The legislative program 'Recalibration of Bankruptcy Law' intends to be one of the most far-reaching reforms of bankruptcy law since the enactment of the Dutch Bankruptcy Code in 1896.[1] Part of this legislative program is the Continuity of Enterprises Act 2 (CEA 2). This concerns the introduction of a statutory framework for a cram down plan outside of the 'bankruptcy' procedure.[2]

Under current law a debtor can offer his creditors an out-of-court reorganization plan outside the context of bankruptcy. Starting point is that such a plan cannot bind creditors against their will. Only creditors that consent to the plan are bound. A creditor can only be bound against his will to an out-of-court reorganization plan in exceptional cases.[3]

The CEA 2 intends to change the above stated situation. The published consultation proposal for the CEA 2 contains sweeping changes from the current situation for both creditors and shareholders.[4] The CEA 2 aims to provide a legal basis to enable the binding of creditors

1 The legislative program was announced by letter of the Minister of Safety and Justice of November 26, 2012. See: Parliamentary Papers 29 911, no. 74. Subsequently the Minister has sent a letter to the House of Representatives every six months, in which he reported on the progress of the legislative program. See: Parliamentary Papers 33 695, no. 1, 3, 5 and 7.

2 Hereafter, where I use the term 'cram down plan' I mean the reorganization plan outside of the bankruptcy procedure (*dwangakkoord buiten faillissement*). A cram down plan during bankruptcy is denoted as 'bankruptcy reorganization plan' (*faillissementsakkoord*). This is not the first attempt to implement a framework for a cram down plan. During the parliamentary hearings regarding the Dutch Bankruptcy Code in 1893, the Member of Parliament I.A. Levy submitted an amendment aiming to include a framework for a cram down plan in the Code. The Lower House rejected the amendment after debate with 41 against 27 votes. See: G.W. van der Feltz, *Geschiedenis van de wet op het faillissement en de surseance van betaling*, bewerkt door G.W. baron van der Feltz deel II (1897); Heruitgave bewerkt door S.C.J.J. Kortmann en N.E.D. Faber, Serie Onderneming en Recht, Deel II, Zwolle: W.E.J. Tjeenk Willink 1994, p. 417–443.

3 See: Dutch Supreme Court 12 August 2005, *NJ* 2006, 230 (*Groenemeijer/Payroll*). See specifically r.o. 3.5.2.-3.5.4.

4 The consultation documents can be found at http://www.internetconsultatie.nl/wco2. The consultation ended on December 15, 2014 and resulted in sixteen reactions. The aim of the Minister is to send a bill to the Council of State in the spring of 2015 for advisement. See: Parliamentary Papers 33 695, no. 7, p. 3.

and shareholders against their will to a reorganization plan under certain circumstances.[5] In this context, especially the possibility to bind shareholders against their will is a big step relative to the bankruptcy and suspension of payments reorganization plan, under which plans such a possibility does not exist.

The question is, however, if a justification exists for the introduction of a statutory framework for a cram down plan under which creditors are collectively treated and, if so, which one (§ 2 and 3). In that context, attention is also devoted to the position of individual creditors during the bringing about of a cram down plan. In particular, this concerns the possibility for an individual creditor to seek recourse during the adoption process of a plan. (§ 4). Attention is further devoted to certain groups of creditors that can evade the regime of a cram down plan (§ 5) and the position of shareholders under a cram down plan (§ 6).

The starting point in this Article is the consultation proposal for the CEA 2, but where relevant attention is also given to the recommendation of the European Commission of March 12, 2014 regarding '*a new approach to business failure and insolvency*'.[6]

2 The CEA 2: bankruptcy law or not?

In discussing the above mentioned topics, I use the creditors' bargain theory as theoretical framework. The creditors' bargain theory is a leading theory in the area of normative bankruptcy law. It gives both a justification for the existence of bankruptcy law as well as three principles which bankruptcy law has to meet in order to be efficient.[7] In this context

5 Such a statutory basis can also be found in Section 287a DBC. This article is, however, limited to the bringing about of a reorganization plan outside of the context of the Debt Restructuring Natural Persons. For that reason Section 287a DBC falls outside the scope of this article.

6 C (2014) 1500 final. Available via: ec.europa.eu/justice/newsroom/civil/news/140312_en.htm.

7 The creditors' bargain theory was developed in the eighties of the last century by D.G. Baird and T.H. Jackson. See: T.H. Jackson, 'Bankruptcy, non-entitlements, and the creditors bargain', *Yale Law Journal* (91) 1982, p. 857–907, D.G. Baird and T.H. Jackson, 'Corporate reorganizations and the treatment of diverse ownership interests: a comment on adequate protection of secured creditors in bankruptcy', *University of Chicago Law Review* (51) 1984, p. 97–130, T.H. Jackson, 'Of liquidation, continuation and delay: an analysis of bankruptcy policy and nonbankruptcy rules, *American Bankruptcy Law* Journal (60) 1986(A), p. 399–428 and T.H. Jackson, *The logic and limits of bankruptcy law*, Cambridge: Harvard University Press 1986(B). See about the choice for the creditors' bargain theory as assessment framework: J.M. Hummelen, 'Efficient bankruptcy law in the U.S. and the Netherlands', *European Journal of Comparative Law and Governance* 2014A, no. 2, p. 148–211.

'efficient' means that the value of the pool of assets is maximized for the investors as a group.[8]

The question, however, that first has to be answered is if this bankruptcy theory can be applied to the CEA 2. One can see this in the draft Explanatory Memorandum, where a clear choice is made for the context in which a cram down plan under the CEA 2 is realized: such a restructuring takes place outside a bankruptcy procedure.[9] At the same time the intention is to include the provisions of the CEA 2 in the Dutch Bankruptcy Code. Apparently the legislator sees the provisions of the cram down plan as bankruptcy law. The question is whether or not this is justified and, if so, why.

2.1 Why a collective recourse method I: common pool

According to the creditors' bargain theory bankruptcy law is the reproduction of the hypothetical agreement that creditors would have concluded if they had been able to do so.[10] In this context, the creditors' theory states that in such a hypothetical bargain the creditors would chose a collective method of treatment of claims if this would provide for higher value of the pool of assets for the investors as a group. They would do this, because this surplus value can then be divided among the different claimants of the debtor.

The traditional justification from the perspective of the creditors' bargain theory for the choice to treat claims collectively – and thus apply bankruptcy law – is formed by the desire to prevent a 'common pool problem'.[11] A common pool problem occurs if creditors are paid on a 'first come, first serve' basis and there is the idea that the debtor might not be able to pay the last in line in full. An incentive then arises for the creditors to seek recourse as soon as possible and in this way outsmart other creditors.[12] This leads to a piecemeal sale of the assets of the debtor, as a result of which the surplus value is lost that would be

8 Jackson 1986B, p. 5. See about the terms 'pool of assets' and 'investors as a group' – also in relation to current Dutch law – extensively: J.M. Hummelen, 'An assessment of Dutch bankruptcy assets sales', *International Insolvency Law Review* 2014B, no. 3, p. 276–278.

9 Draft Explanatory Memorandum CEA 2, p. 1. The recommendation of the European Commission recommends in this context 'a restructuring framework' that offers the possibility to restructure with the aim of *preventing* insolvency. See: EC Recommendation, recommendation 6.

10 Jackson 1982, p. 860.

11 Jackson 1986A, p. 402–403. See extensively about the common pool problem: Hummelen 2014A, p. 162–166.

12 Jackson 1986A, p. 402–403 and Jackson 1986B, p. 10–11. This phenomenon is also described as the '*race to the courthouse*'.

realized in case of a sale of the assets as a whole.[13] To prevent this destruction of value, a collective recourse mechanism is justified.[14]

2.2 *Why a collective recourse method II: anticommons*

The framework for the cram down plan can also be seen as collective recourse system as meant under the creditors' bargain theory. In case of a cram down plan the creditors bargain in a manner that is structured by law over a 'hypothetical sale' of the debtor.[15] The outcome of this bargaining is laid down in an agreement, in which existing claimants collectively sell the claims against the debtor to the debtor and in exchange for this receive a claim for a lower amount than the claim that they handed in.[16]

However, the question then arises why statutory provisions for this collective recourse are necessary. Creditors and a debtor are in principle free to enter into an agreement containing a hypothetical sale – i.e. an out-of-court reorganization plan – at any time. This does not require a statutory framework.[17] It is in this respect that the common pool problem falls short as justification for a statutory framework for a cram down plan.[18]

The individual 'recourse' of creditors under a cram down plan consist of their consent to the proposed restructuring and the acceptance of an adjusted claim in return. The problem with this does not arise if the individual creditor acts, but if the creditor does not act. That is to say: if he does not consent to the proposed restructuring. An individual creditor can have an incentive to do so, in the hope that such hold-out behavior leads to the payment of a premium over the amount to which he is actually entitled. Such premium would ensure that the creditor consents to the proposed restructuring and, in effect, enable that a value

13 Jackson 1986A, p. 402. In this context the comparison to an oil well is made. Without rules for collective extraction every party that drills for oil in the well will have an incentive to bring up as much oil as possible and as soon as possible, even if much more oil could be brought up if the extraction would be done in a coordinated manner.

14 Besides the possibility to keep assets together, the administrative benefits and the decreased need for monitoring are mentioned as ways to maximize the value of the pool of assets.

15 See *inter alia*: R.C. Clark, 'The interdisciplinary study of legal evolution', *Yale Law Journal* 1981, p. 1252–1253 and D.G. Baird, 'The uneasy case for corporate reorganizations', *Journal of Legal Studies* 1986, p. 127.

16 Under positive law, for example, the bankruptcy reorganization plan can also be qualified as an agreement. See: A.D.W. Soedira, *Het akkoord*, Deventer: Kluwer 2011, p. 19.

17 Compare: M.A. Heller, 'The tragedy of the anticommons: property in the transition from Marx to markets', *Harvard Law Review* 1998, p. 673–674.

18 See hereafter further in § 4 about the role of the common pool problem in relation to the cram down plan.

maximizing restructuring can come about. This issue is also denoted as an anticommons problem.[19]

It is for this reason that a statutory framework for collective recourse in the context of a cram down plan is necessary. It should be possible to force creditors to consent to a value maximizing cram down plan. The CEA 2 provides for this.[20] For this reason the CEA 2 should, in my opinion, be qualified as bankruptcy law.

3 The added value of the CEA 2

Important to note is that creditors in the hypothetical creditors bargain would only chose the collective recourse method as set out above if this leads to the realization of surplus value over individual recourse. The question is what the added value of a cram down plan is over a – individual or collective – sale of the assets of the debtor.

The draft Explanatory Memorandum of the CEA 2 merely states about the added value of having a framework for a cram down plan: "*It can be beneficial to the continuation of economic recovery that an enterprise that is confronted with problematic or possibly problematic debt, but is on its own viable according to stakeholders, can restructure this debt and bring it back to controllable proportions.*"[21]

The recommendation of the European Commission also pays little attention to the question why having a plan procedure has added value. The recommendation states: "*The objective of this Recommendation is to ensure that viable enterprises in financial difficulties (…) have access to national insolvency frameworks which enable them to restructure at an early stage with a view to preventing their insolvency, and therefore maximise the total value to creditors, employees, owners and the economy as a whole.*"[22]

Although the cited quotes are not very explicit, it seems to be suggested that the added value of having a framework for a cram down plan should be sought in the possibility to

19 See also about anticommons in the context of a cram down plan: D.G. Baird and R.K. Rasmussen, 'Antibankruptcy', *Yale Law Journal* 2010, p. 648–699 and R.J. de Weijs, 'Harmonisation of European insolvency law and the need to tackle two common problems: common pool and anticommons', *International Insolvency Review* 2012, p. 67–83.

20 Section 381 DBC (draft).

21 Draft Explanatory Memorandum CEA 2, p. 2. "*[Aan een bestendiging van het economisch herstel] kan bijdragen dat onderneming (sic) die zich geconfronteerd zien met problematische of mogelijk problematische schulden, maar volgens betrokken stakeholders op zichzelf economisch levensvatbaar zijn, deze schulden kunnen saneren en terugbrengen tot beheersbare proporties.*"

22 EC Recommendation, preamble (1).

preserve the relevant legal entity and continue the enterprise in this entity. In this respect, in the literature – in the context of the bankruptcy reorganization plan – the term 'survival of capital' as goal of plan procedure is used.[23]

However, in my view, the survival of capital is not the goal of a plan procedure, but more the means to realize the goal: value maximization. The point is that the preservation of the legal entity can lead to the preservation of 'going-concern value' of the business.[24] The thought behind this is that the assets are worth more if they are kept together as a whole and the business can be kept running than if the assets are sold.[25]

In view of the above, it is important to realize that the term 'going-concern value' is used in multiple ways. The term is used to denote the value that is being preserved by a collective sale of the assets of the debtor instead of a piecemeal sale. However, the term is also used to denote the surplus value that is realized by bringing about a cram down plan under which the relevant legal entity is preserved.[26]

It is the latter form of going-concern value that forms the justification for having a plan procedure and that makes that a cram down plan can have an added value.[27] In this context, one can think of fiscally compensable losses, a certain write-down basis or having certain non-transferable and hard to obtain licenses.[28] Such going-concern value does not have to be present in every business.[29] Therefore, a cram down plan shall not be the appropriate way for every business for it can very well be that preserving the legal entity is not necessary to achieve value maximization. It can also be that a business is simply no longer economically viable and should be cleaned up.[30]

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23 See: Soedira 2011, p. 16. See also: B. Wessels, Insolventierecht VI. *Het akkoord*, Deventer: Kluwer 2013, p. 6.

24 Baird and Jackson 1984, p. 118–119. See also: R.V. Butler and S.M. Gilpatric, 'A re-examination of the purposes and goals of bankruptcy', *American Bankruptcy Institute Law Review* (2) 1994, p. 278.

25 Compare: Jackson 1986B, p. 14.

26 See for this distinction: E. Warren, 'Bankruptcy policy making in an imperfect world', *Michigan Law Review* (92) 1993, p. 350.

27 See also the remarks on p 3,4 and 10 of the Dutch Associations of Banks regarding the consultation proposal. In answering the question whether or not the going-concern value under a cram down plan is higher than under an asset sale a correct valuation is of great importance. See more about this problem: J.M Hummelen, 'Shaping bankruptcy law. What form should it take?' *Norton Journal of Bankruptcy Law and Practice* 2015, nr. 1, p. 52–106 and S.W. van den Berg, 'WCO II: de *cram down* beschouwd vanuit waarderingsperspectief', *FIP* 2014, p. 237–246.

28 Compare: N.W.A. Tollenaar, 'Faillissementsrechters van Nederland: geef ons de pre-pack', *TvI* 2011, 23.

29 Compare: D.G. Baird and R.K. Rasmussen, 'The end of bankruptcy', *Stanford Law Review* 2002, p. 751–789 who are critical regarding the term 'going-concern value'. See as an answer to this critique: L.M. LoPucki, 'The nature of the bankrupt firm: A response to Baird and Rasmussen's the end of bankruptcy', *Stanford Law Review* 2003, p. 645–671.

30 Compare: A.M. van Amsterdam, *Insolventie in economisch perspectief*, Den Haag: Boom Juridische uitgevers 2004, p. 7.

The recommendation of the European Commission seems to acknowledge the presence of going-concern value, by stating in recommendation 22 that the confirmation requirements for a cram down plan should in any event provide that: "*the restructuring plan does not reduce the rights of dissenting creditors below what they would reasonably be expected to receive in the absence of the restructuring, if the debtor was liquidated or sold as a going-concern (…)*".

The consultation proposal for the CEA 2 also provides in Section 373(2) DBC (draft) a comparison of capital. Interesting in this respect is that, in the context of preferred and ordinary creditors and shareholders, the comparison is to be made between the situation that a cram down plan is realized and a liquidation in bankruptcy.[31] Firstly this is interesting, because it is ambiguous if 'liquidation' also envelops a going-concern asset sale. However, from the wording of the draft Explanatory Memorandum – "*which amount is available in case of bankruptcy for distribution*"- it seems possible to derive that the term 'liquidation' is to be conceived in a broad manner.[32]

The wording of the consultation proposal is, however, more striking, because the draft bill – unlike the recommendation – speaks about a comparison with the situation of a bankruptcy. That bar is, however, lower, than the bar that the European Commission sets. At the time of the cram down plan there is no bankruptcy. It is therefore possible that the assets are sold as a going-concern outside the context of a bankruptcy procedure for a considerably larger amount than such a sale would have yielded in bankruptcy.[33] A cram down plan should then not be on the agenda.

4 The cram down plan outside of bankruptcy: bankruptcy or not?

As set out above in § 2, the justification for the possibility to bind creditors to a cram down plan against their will lies in the concept of the anticommons: what now should be the position of an individual creditor during the (twilight) period that a cram down plan has been offered, but has not been finally approved or denied. For as soon as creditors are offered a cram down plan, they know that the debtor has (or expects) financial problems. This gives creditors an incentive to seek recourse as soon as possible, to safeguard payment

31 Section 373(2)(c) and (d) DBC (draft).

32 Draft Explanatory Memorandum, p. 68. "*welk bedrag er in geval van faillissement voor uitkering beschikbaar zou zijn*"

33 Compare: Van den Berg 2014, p. 243–244. This seems – in slightly different words – to be acknowledged by INSOLAD in no. 5 of its reaction on the consultation proposal. See hereafter § 4 for the question whether or not it is correct that the cram down plan is realized outside the context of a bankruptcy procedure.

of their claim.[34] Should this lead to a situation in which creditors are collectively denied their possibility of individual recourse and there is effectively a bankruptcy in place? Or should creditors simply be able to keep seeking individual recourse and should the value of the pool of assets be protected in a different way? That is the subject of this paragraph.

4.1 The twilight period before the cram down plan is adopted and CEA 2

Under the consultation proposal for the CEA 2 a cram down plan, as stated above, comes about outside the context of a bankruptcy. The choice of the Minister in the proposal for the CEA 2 finds its basis in the argument that the opening of a bankruptcy by means of a public judgment leads to an uncontrollable process, through which value is lost. For after opening a bankruptcy, so the argument goes, suppliers will no longer continue to deliver or only against lesser conditions, customers and employees will walk away and secured creditors will execute their rights.[35] This despite the fact that Section 26 and 33 DBC ensure that individual attachments expire and creditors cannot enforce their existing claims in an individual manner.

4.1.1 Individual recourse possible under CEA 2

The fact that the bringing about of a cram down plan takes place outside the context of a formal bankruptcy procedure means that the possibilities for creditors to seek individual recourse during the adoption process are in principle not limited.[36] A creditor can still attach goods, enforce an executory attachment or enforce security interests.

The draft Explanatory Memorandum of the CEA 2 confirms this starting point, but adds that the judge for preliminary relief can be requested to lift an attachment or halt its execution. Such a halting shall – now the draft proposal does not state otherwise – only be in order if there is abuse of power (Section 3:13 DCC).[37] The element of 'abuse' would then be in the undertaking of execution measures, while the cram down plan has a reasonable chance of success.[38]

In this respect, it is questionable whether invoking abuse of power in the context of a cram down plan will be effective. The bar that needs to be met to assume abuse of power is high.

34 Compare: Jackson 1986B, p. 122.
35 Compare: Draft Explanatory Memorandum CEA 2, p. 2. See also about this problem: J.M. Hummelen, 'Het verkoopproces in een pre-packaged activatransactie', *Tijdschrift voor Insolventierecht* 2015, 2.
36 See: draft Explanatory Memorandum CEA 2, p. 26. The basis for this recourse can be found in Section 3:276 in conjunction with Section 277 DCC.
37 Compare: Groene Serie Privaatrecht, comment 17.11 and 17.12 with Section 3:13 DCC.
38 Compare: Draft Explanatory Memorandum CEA 2, p. 26.

It follows from the parliamentary history that abuse of power is only present if no right-minded person could have reasonably exercised his powers.[39] It is questionable to what extent such a situation occurs in the event that a creditor simply tries to safeguard payment of his claim.

4.1.2 Possibility of suspending handling of bankruptcy filing under CEA 2

The proposal for the CEA 2 does introduce a specific possibility for the judge to suspend the handling of a request for bankruptcy if a cram down plan has been offered or if a declaration of collective binding of a – possibly rejected – cram down plan has been requested.[40] The possibility of such a suspension should prevent that a creditor could use a request for bankruptcy as leverage.[41]

The suspension is, however, restricted, by stating that a suspension is not possible if there are valid reasons to assume that a cram down plan will not come about or if there are compelling reasons not to suspend the handling of a request.[42] The District Court will also have to lift the suspension if – *inter alia* – a claim that is due and payable and has arisen during the suspension is not paid.[43]

4.1.3 European Commission does recommend general moratorium

In the recommendation of the European Commission the possibilities to prevent individual recourse by creditors are more comprehensive. It is recommended that it should be possible for a debtor to request that individual recourse by creditors is not possible for a period of up to four months.[44] During this 'stay' the handling of requests for bankruptcy are also to be suspended.[45] The debtor, however, does have to comply with his obligations under continuing contracts during the stay.[46]

Member States can make the stay conditional, but the stay should in any event be promulgated if: i) creditors that represent a considerable part of the claims that are to be included

39 PG Inv. Boek 3 BW, p. 1040. See also: 2.19 of the conclusion of Advocate General Wesseling-van Gent before Dutch Supreme Court 20 December 2013, *RvdW* 2014, 79.
40 Section 3c(1) and (2) DBC (draft).
41 Draft Explanatory Memorandum CEA 2, p. 26.
42 Section 3c(1)(2) and (3) DBC (draft).
43 Section 3c(6) DBC (draft).
44 EC Recommendation, recommendation 10 in conjunction with 13. The period can be renewed for up to a maximum of twelve months, if it turns out that there is progress in the negotiations about a cram down plan.
45 EC Recommendation, recommendation 12.
46 EC Recommendation, recommendation 10.

in a cram down plan support negotiations over a plan; and ii) there is a reasonable prospect that a cram down plan is adopted.[47]

The recommendation of the European Commission goes considerably further than the proposal of the CEA 2 in the context of the rights of creditors. Where the CEA 2 merely gives the possibility of suspending the handling of a request for bankruptcy, the European Commission recommends that – besides this possibility of suspension – it should also be possible to stay the recourse possibilities of creditors collectively.

4.2 The twilight period before the cram down plan is adopted and the creditors' bargain theory

The question now is to what extent the proposed framework of the CEA 2 is in accordance with the creditors' bargain theory on the issue of the possibility to seek individual recourse during the twilight period after a cram down plan is offered.

4.2.1 Common pool problem = imposing collective recourse

Starting point of the creditors' bargain theory regarding the limitation of the possibilities of individual recourse is relatively simple. A limitation of possibilities of individual recourse of a factual nature by creditors is justified as soon as there is a common pool problem.[48] That is to say: as soon as so many creditors seek recourse against the assets of the debtor that value is destroyed, the principle 'first come, first serve' should no longer apply, but a bankruptcy procedure should be opened.[49]

As such, it can be that an offered cram down plan does not come about. For example, if it is rejected by vote, the funding of an offered cram down plan cannot be obtained or there are insufficient funds to satisfy essential suppliers. It is to be expected that in such a situation a debtor cannot pay all creditors that seek recourse. It can also be that a debtor is no longer capable of paying new claims that have arisen in the period after the cram down plan was offered.

In the situation set out above the income stream is too small to pay claims that are due and payable. The debtor can be described as 'cash flow insolvent'. The recourse possibilities of creditors can then negatively influence the value of the pool of assets, because the are

47 EC Recommendation, recommendation 11.
48 Jackson 1986A, p. 402–403
49 See the first principle of the creditors' bargain theory above in § 1.

detrimental to the continuance of the business.[50] Such a situation provides for a classic common pool problem and justifies the opening of a bankruptcy procedure.[51] The CEA 2 acknowledges the above by stating in Section 3c(6) DBC (draft) that the District Court promptly ends the suspension of the handling of a bankruptcy request if the due and payable claims that have arisen during the suspension are not paid or if it turns out that an offered cram down plan will not be declared collectively binding. In that sense the CEA 2 is in accordance with the creditors' bargain theory.

4.2.2 The (lack of a) common pool problem during the twilight period after a cram down plan is offered

At the same time the starting point of the CEA 2 during the period after the cram down plan is offered – but before a final decision is taken regarding the plan – is that there is no stay of possibilities of individual recourse, except insofar as this follows from general property law. Therefore, a creditor can continue to seek individual recourse after a cram down plan is offered, but before the plan is confirmed. The question is whether this starting point is correct.

In a narrow sense, the sole threat of a common pool problem in this context is insufficient to assume the application of bankruptcy law.[52] This would mean that, if this view is strictly followed, there can be no limitation of individual recourse possibilities in case of a debtor who is balance sheet insolvent and who is clearly unable to pay his debts in some time, but who still satisfies his obligations in the period after the cram down plan is offered. The CEA 2 would then be correctly shaped.

This view of the common pool problem, however, does not take into account the specific problems that come into play in the twilight period after a cram down plan is offered. For, allowing individual recourse has the consequence that creditors will display 'opt-out behavior' in the period during which the cram down plan is brought about. Such behavior is displayed, because there can be an incentive from the perspective of the individual interest of a creditor to seek recourse as soon as possible after a cram down plan is offered instead if awaiting the coming about of the plan, under which the creditor will have to hand in part of his claim.[53] This incentive is particularly triggered because a cram down plan is offered to a creditor, through which offering the creditor knows that the debtor is or will be in financial difficulties.

50 Compare: S. Block-Lieb, 'Fishing in muddy waters: clarifying the common pool analogy as applied to the standard for commencement of a bankruptcy case', *American University Law Review* (42) 1993, p. 384.
51 Block-Lieb 1993, p. 379 and 384–386.
52 Block-Lieb 1993, p. 375.
53 Jackson 1986B, p. 122.

The creditors' bargain theory brings forward 'preference law' as the solution for the issue raised above.[54] This regards the possibility to affect acts that are not detrimental for the debtor himself, but through which an existing creditor is satisfied or ends up in a better position than the one in which he would have been in without the relevant act.[55] The consequence of such acts is a violation of the *paritas creditorum*, as a result of which there is less available for the remaining creditors. These acts can also concern the payment of debts which the debtor is obligated to pay.[56]

According to the creditors' bargain, in this context a statutory provision should be introduced that should state that" "*If a creditor tries to change his position after the extension of credit in order to improve his lot in an anticipated bankruptcy (or other collective) proceeding, or if the debtor at the behest of such creditor so tries to change the position for such creditor in order to improve such creditor's lot in an anticipated bankruptcy (or other collective) proceeding, the creditor must return any advantage so obtained.*"[57]

Using such a variant of the *actio pauliana* in the context of a cram down is, however, not the right solution. An enlargement of the possibilities to affect legal acts could in theory lead to creditors that would less rapidly press for payment of their claim during the bringing about of a cram down plan, but it is rather to be expected that creditors – under such a rule as set out above – will simply not be willing to, for example, extend additional funding or deliver orders.[58] Fear that legal acts will be invalidated will paralyze the business and will push the debtor into bankruptcy sooner.

In addition, using the *actio pauliana* is cumbersome from a practical point of view. This is a measure that has to be effectuated *ex post*. The debtor will generally have to start a costly and lengthy procedure and even if he is awarded a positive judgment, he still has to see that he is able to execute that judgment.

It seems more effective to determine – like the recommendation of the European Commission – that the judge can impose a collective stay during a certain period of time upon the

54 Jackson 1986B, p. 125. "*Preference law is best viewed as a solution to this replication of the common pool problem that results from strategic planning in the prebankruptcy period.*" See also: De Weijs 2012, p. 70.
55 R.J. de Weijs, *Faillissementspauliana, insolvenzanfechtung & transaction avoidance in insolvency*, Deventer: Kluwer 2010, p. 14.
56 De Weijs 2010, p. 15.
57 Jackson 1986B, p. 130.
58 Compare: De Weijs 2010, p. 19 and 37.

creditors to whom the cram down plan has been offered.[59] This could be achieved by extending the scope of Section 371 DBC (draft).[60]

The theoretical justification for the aforementioned collective stay can be found in the fact that a stay prevents an otherwise occurring common pool problem. The bringing about of a cram down plan takes time.[61] Recourse by op-out creditors during this time can lead to the situation that a value maximizing plan does not come about, because the resources that are necessary for the cram down plan have already been used to satisfy the creditors. In this way, an already impending common pool problem materializes itself. The cram down plan prevents this situation.

This justification only holds if a common pool problem occurs if the proposed cram down plan is not adopted. It is unclear whether the application of the CEA 2 is limited to this situation, if the debtor proposes a cram down plan.[62] Such a limitation can possibly be read in Section 370(3)(a) DBC (draft).[63] This subsection asserts that attached to the cram down plan there should be a plan which sets out through which ways the debtor intends to ensure the continuity of the business after the bringing about of the cram down plan. However, this requirement is not very clear. It is therefore recommended to include an explicit insolvency test in the framework of the CEA 2.

5 The 'lock-in' of creditors and its exceptions

After the proposing of a cram down plan there is – like the moment a bankruptcy procedure is opened – a fixation of the population of creditors. The creditors to which the cram down plan has been offered are mandatorily a party in the bringing about of the cram down plan. There is a kind of 'lock-in' of the liabilities that are to be affected.

As argued above in § 4.2, it should be possible under the CEA 2 to impose a collective stay upon creditors that fall under the lock-in. However, regardless of whether or not there is a collective stay, the concept of the lock-in can be relativized in three ways. The question is to what extent these relativizations – as they exist under the proposal for the CEA 2 – are in accordance with the creditors' bargain theory.

59 See about not offering a cram down plan to certain creditors hereafter in § 5.

60 This Section provides that a supervisory judge can be appointed to give an opinion about *inter alia* the valuation method that is used and the division in classes.

61 Compare: Jackson 1986B, p. 18, who also notes this problem.

62 For the situation that a creditor wishes to offer a cram down plan, this limitation lies enclosed in Section 368(2) DBC.

63 See: reaction AKD on the consultation proposal.

5.1 First relativization: payment of new creditors

Firstly, it is of importance during the process of the bringing about of a cram down plan that new debts – for example, those regarding additional funding – can be incurred. These new creditors are not affected by the lock-in and can – and should – be paid under the CEA 2. The creditors' bargain theory does not object to this.[64] According to the creditors' bargain theory bankruptcy law should not provide for a specific framework for keeping a business running.[65] Where every third party outside of the context of bankruptcy law will have to negotiate with suppliers about the delivery of goods or services, the same goes for a debtor that operates in the context of bankruptcy law. As such, payment of new, payable debts during the period of the bringing about of a cram down plan does not conflict with the creditors' bargain theory.

5.2 Second relativization: essential suppliers

In some instances, suppliers are only willing to deliver goods or services that are essential for the continuity of the business of the debtor if their outstanding claims are paid first during the period of the coming about of the cram down plan. The creditors' bargain theory does not seem to object to paying 'old' claims, dating from the time before the offering of the cram down plan, as to ensure new deliveries. This is because the right to refuse delivery has value for the debtor.[66] Without this delivery, the business of the debtor will come to a halt.[67] Considering the fact that outside an (impending) insolvency situation the supplier also has the right to make new deliveries conditional upon payment of outstanding claims, the value of this right to refuse should be respected. In this respect, there does not seem to be an objection to pay 'old' debts during the period of the coming about of a cram down plan, as to ensure delivery of essential goods or services.

5.3 Third relativization: selection of creditors and shareholders who are impaired

The third relativization of the concept of the lock-in might be the most interesting. It regards the possibility for the debtor to only offer the cram down plan to certain creditors

64 Compare: Jackson 1986B, p. 153 in the context of estate creditors in a bankruptcy procedure.
65 Jackson 1986B, p. 152.
66 Jackson 1986B, p. 159.
67 It has to concern goods or services that cannot be obtained elsewhere.

and/or shareholders. The cram down plan is then only binding for these parties.[68] This possibility does not exist under the current statutory frameworks for a reorganization plan.

According to the draft Explanatory Memorandum to the CEA 2 the possibility of selection follows from Section 369(1) DBC (draft).[69] However, this paragraph merely provides that a cram down plan can stipulate that creditors and shareholders are divided into separate classes. In my view, this Section only regards the position of creditors and shareholders between themselves under a cram down plan and not the position between plan parties and non-plan parties. The possibility of selection rather seems to follow from Section 368(1) DBC (draft). This paragraph provides that: *"A legal entity can offer his creditors, or a number of them, as well as his shareholders, or a number of them, a cram down plan."* ("*Een rechtspersoon (…) is bevoegd (…) zijn schuldeisers, dan wel een aantal van hen, alsmede zijn aandeelhouders, dan wel een aantal van hen, een akkoord aan te bieden (…).*") The possibility of offering a cram down plan to only certain creditors and/or shareholders has also been included in number 20 of the recommendation of the European Commission.

In the basis, the selection of only certain creditors that are bound to a cram down plan constitutes a form of unequal treatment. One creditor is bound and falls under the cram down regime of the CEA 2, while the other creditor can go on undisturbed and obtain full payment of his claim.

The key for the justification of this unequal treatment should in my view be sought in the preservation of value by the prevention of information leakage.[70] If a cram down plan has to be offered to all creditors, this will mean that in case of a business of considerable size a few hundred to thousands of people will be familiar with the fact that the debtor is in trouble or will be in trouble. The chance that this fact will leak is considerable, because of which the risk of a common pool problem due to massive individual recourse is enlarged and value will be destroyed.

For that reason, it is in my opinion, justified that the debtor can choose to fully pay certain creditors – for example trade creditors with a claim of up to € 1,000 or all creditors except banks – and only offer a cram down plan to certain creditors. This can prevent leakage of

68 Compare: Section 382 DBC (draft), which tries to ensure that rights of creditors and shareholders cannot be changed without giving these parties the opportunity to express themselves over this fact.

69 Draft Explanatory Memorandum CEA 2, p. 52.

70 See also § 15 of the explanatory document of the INSOLAD proposal for the revision of the suspension of payments procedure. This document can be found at: https://static.basenet.nl/cms/105928/website/2015_01_08-Toelichting-op-het-ontwerp-voor-een-nieuwe-surseance.docx. See for the proposed framework itself: https://static.basenet.nl/cms/105928/website/2015_01_30-Titel-II-Van-surseance-van-betaling.docx

information to the market and preserve value. In that sense the proposal for the CEA 2 is in accordance with the creditors' bargain theory.

6 The position of shareholders under a cram down plan

Besides the possibility to select the parties that are bound by a cram down plan, the possibility to bind shareholders to a cram down plan is one of the big changes from the framework for a bankruptcy or suspension of payments reorganization plan. Under the latter frameworks such a binding of shareholders is not possible.[71]

6.1 Shareholders and CEA 2

As described above in § 5, shareholders can be bound to a cram down plan based on Section 368(1) DBC (draft). In § 3.6 of the draft Explanatory Memorandum the choice for the possibility to bind shareholders is extensively explained.[72]

In essence the explanation comes down to the fact that, according to the Minister, where the starting point is that shareholders can profit from a business that is doing well – by receiving dividends –, they should also be the first to bear the losses if the business is not doing well.[73] If shareholders could not be bound to a cram down plan, then there could be, according to the draft Explanatory Memorandum, an incentive for shareholders to only let the (higher ranked) creditors write down on their debt and in this way evade the bearing of losses. The shareholders will hold on to their full equity interest and with it their right to future dividends.[74]

In this respect, it is pointed out that in case of a bankruptcy aimed at liquidation shareholders will only receive a distribution when all other creditors are satisfied. In such a bankruptcy this distribution will, however, rarely be made, because the shareholders are 'under water'. For this reason, it is, according to the draft Explanatory Memorandum, possible to bind the shareholders to a cram down plan and to have them accept a limitation of their rights.[75]

71 Compare Section 157 DBC regarding the bankruptcy reorganization plan and Section 273 DBC regarding the suspension of payments reorganization plan. The possibility to bind shareholders to a suspension of payments reorganization plan has been proposed in the INSOLAD proposal for the revision of the suspension of payments procedure.

72 The recommendation of the European Commission does not pay any attention to the position of shareholders and, as such, no attention to the recommendation in this respect is given.

73 Draft Explanatory Memorandum CEA 2, p. 16.

74 Draft Explanatory Memorandum CEA 2, p. 17–18.

75 Draft Explanatory Memorandum CEA 2, p. 17 and 21.

Under the CEA 2 this limitation of rights of shareholders can *inter alia* mean an exclusion of the pre-emptive right for existing shareholders in an issuance of new equity capital.[76] This way a debt-for-equity-swap can be effectuated by means of a cram down plan.[77] Such a debt-for-equity-swap entails that part of the debt is converted into equity, thus resulting in a watering down of the interest of the old shareholders and in a smaller write down for creditors.

6.2 *Shareholders and the creditors' bargain theory*

Now, is the position of the shareholder under the CEA 2 in accordance with the creditors' bargain theory? In this respect it is of importance to first set out the position of the shareholder under Dutch corporate law. Under this law the principle applies that if the business is doing well, everything that remains is for the shareholder. In theory this upside is unlimited. There is, however, the requirement that the business can keep paying its due and payable debts after the dividend payment is made.[78] A dividend payment is possible if the (higher ranked) creditors can be satisfied.[79]

According to the creditors' bargain theory redistribution of value should be prevented as much as possible under bankruptcy law.[80] The CEA 2 should therefore connect as much as possible with the position of creditors and shareholders under corporate law as applicable outside of the regime of the CEA 2. This can be achieved by using an absolute priority rule.[81] Under such a rule the shareholders may not retain an interest under a cram down plan, unless the higher ranked classes have been fully satisfied.

However, the possibilities of limiting the rights of shareholders under the CEA 2 do not constitute an absolute priority rule.[82] For the adoption of a cram down plan the CEA 2

76 Draft Explanatory Memorandum CEA 2, p. 46. Section 368(4) and (5) DBC (draft) further contain a number of rules that exclude the application of certain rules of Book 2 DCC, so there is, for example, no approval necessary from these shareholders for the offering of a cram down plan.

77 A voluntary debt-for-equity-swap is already possible under current law. See for example: Dutch Supreme Court 26 August 2003, *RvdW* 2003, 122 (*UPC*).

78 See; Section 2:216 DCC for the BV and Section 2:105 DCC in connection with Dutch Supreme Court 8 November 1991, *NJ* 1992, 174 (*Nimox*) for the NV. See also: Draft Explanatory Memorandum CEA 2, p. 17.

79 See also Section 2:23b(1) DCC, which states that in case of liquidation of a legal entity there can only be a distribution to shareholders if all creditors have been satisfied.

80 See: Jackson 1986A, p. 406 and Jackson 1986B, p. 28–29.

81 The absolute priority rule finds its roots in American bankruptcy law. The rule has been codified in 11 U.S.C. § 1129(b)(2)(B)(ii).

82 See different: Section 273(9) DBC (draft) of the INSOLAD proposal for the revision of the suspension of payments procedure.

merely requires that either all classes have consented to an offered plan or that – for a cross-class cram down – creditors do not receive less than they would have received in case of a bankruptcy.[83] There is therefore room for an shareholder to apportion himself (part of) the going-concern value that is realized. In this way the CEA 2 leaves the possibility open for shareholders to behave themselves opportunistically and to redistribute value. By using an absolute priority rule such a redistribution of value would be prevented.[84] On this issue the CEA 2 should be altered.[85] In this respect, there is no objection against shareholders retaining (part of) their interest – while higher ranking classes have not been satisfied in full – if in exchange they contribute value for this retention.[86]

In theory creditors could – in the absence of an absolute priority rule – prevent the redistribution by shareholders by offering a competing plan, in which the absolute priority rule is followed.[87] In practice, however, this will rarely occur. Creditors generally do not possess the necessary information to offer such a competing cram down plan. This will lead to considerable costs for the creditor in order for him to be able to offer a cram down plan, which costs will in practice prevent that a competing cram down plan is offered.

7 Conclusion

The proposed CEA2 fits in with the renewed attention for 'corporate rescue'. The same goes for the recommendation of the European Commission of March 12, 2014.

Although the proposal for the CEA 2 does not dedicate significant attention to it, this proposal does qualify as bankruptcy law. In my view the current proposal acknowledges

83 Section 372(2) in conjunction with 373(1) DBC (draft) and Section 372(2) DBC (draft). This last rule is also called the best-interest-of-creditors-test. A cross-class cram down means that the cram down plan is cram downed as if it were accepted by all classes, even though one or more classes voted against the plan.

84 See also: Hummelen 2014A, p. 171–174. In the United States the situation occurs that shareholders try to redistribute value by creating 'hold up value' through objecting – for example against the proposed valuation – against the cram down plan. Redistributing because of such objection is also called 'gifting'. In the report of the American Bankruptcy Institute Commission for the Reform of Chapter 11 from 2014 it is proposed to prohibit gifting. The report can be found at http://commission.abi.org.

85 Compare: Section 273 (9) DBC (draft) of the INSOLAD proposal for the revision of the suspension of payments procedure.

86 In this context reference can be made to the American figure of the new value exception, under which exception a shareholder can retain an interest under a plan if he contributes new value to it. See: ABI Report on the Reform of Chapter 11, p. 224–226. Reference can also be made to the proposal of the ABI for the introduction of an Equity Retention Structure in Chapter 1, under which structure it is possible to acknowledge value that is incorporated in the person of the shareholder and is contributed to the business after the coming about of the plan through his continued involvement. See: ABI Report on the Reform of Chapter 11, p. 296–302.

87 Compare: Draft Explanatory Memorandum, p. 48.

this insufficiently. It would therefore, in my opinion, be justified that – like the European Commission recommends – a collective stay can be imposed upon creditors that are to be bound to the cram down plan. This can possibly preserve value.

The focus on restructurings has also led to attention to the position of shareholders in such processes. Where the shareholders cannot be bound against their will under the current plan frameworks in bankruptcy and suspension of payments procedures, the CEA 2 provides for the possibility to force them to participate. Because of how the provisions are shaped, smart shareholders can, however, still retain part of their equity interest, despite the fact that higher ranked classes have not been satisfied in full. The legislator should not be afraid to be progressive in this respect.

8 Summarizing conclusion

1 Introduction

Change is inevitable. It provides for an opportunity to sometimes stop for a moment and contemplate whether you are still on the right path. As the 120th anniversary of the entering into force of the Dutch Bankruptcy Code approaches in 2016, a change in the dynamics of the bankruptcy process both in the Netherlands and the United States can be observed. These changed dynamics provide for a good opportunity to assess to what extent Dutch bankruptcy law is effective in providing for an efficient outcome of bankruptcies. To this end, I posed the central research question:

> "Is Dutch bankruptcy law regarding asset sales and reorganizations efficient, and, if not, in what way should it be changed?"

The answer to this question consists of three different parts. These different parts provide for a number of conclusions, which can be found in the subsequent paragraphs 2 through 4. An overall conclusion can be found in paragraph 5.

2 Determining 'efficiency': upgraded creditors' bargain theory

The first part of my research consisted of establishing how the term 'efficiency' was to be interpreted. This touches upon the justification for and goals of bankruptcy law. The big debate in this respect is whether bankruptcy law is only about value maximization or if other values should also play a role.

2.1 The creditors' bargain theory as explanation for bankruptcy law

In the last few decades, the most prominent normative theory of bankruptcy law has been the creditors' bargain theory. This theory argues that bankruptcy serves only one goal: maximizing the value of the pool of assets for the investors as a group. To achieve this goal bankruptcy law is to be shaped according to three principles:[1]

1 See § 2 of part B of Chapter 2. The principles are taken from: D.G. Baird and T.H. Jackson, 'Corporate reorganizations and the treatment of diverse ownership interests: a comment on adequate protection of secured creditors in bankruptcy', *The University of Chicago Law Review* 51(1) (1984), p. 100 and 103.

1. Bankruptcy law at its core should be designed to keep individual actions against assets, taken to preserve the position of one investor or another, from interfering with the use of those assets favored by the investors as a group.
2. Bankruptcy law should change a substantive nonbankruptcy rule only when doing so preserves the value of assets from the group of investors holding rights in them.
3. Bankruptcy should be concerned with the interests of those who have property rights in the assets of the firm.

The creditors' bargain theory argues that bankruptcy law shaped according to these principles provides for a higher yield than in case of individual debt collection. This higher yield is mainly the result of the prevention of a common pool problem by eliminating the possibility for creditors to seek individual recourse. Without such elimination creditors would have an incentive to be the first to seek recourse in case of a debtor in trouble. This would lead to a piecemeal sale of the assets of the debtor, which may provide for a lower value than in case of a joint sale of the assets. Or, in other words, according to the creditors' bargain theory bankruptcy law exists to prevent overuse of the resources of the debtor.[2]

2.2 Criticism on creditors' bargain theory is not convincing

The creditors' bargain theory has not been the only normative theory on bankruptcy law. There have been a number of theories that advance that maximizing economic value is not the only goal of bankruptcy law and that there is room for pursuing multiple goals in bankruptcy. As such, these theories are critical of the creditors' bargain theory.

In Part C of Chapter 2, I assessed whether or not several of these alternative theories provided for a better normative theory of bankruptcy law than the creditors' bargain theory. In this respect, I assessed: i) the risk sharing theory; ii) the rehabilitation view; iii) the feminism/communitarianism view; iv) the bankruptcy choice situation; and v) the team production theory.

In the end, I conclude that the discussion about the best normative theory of bankruptcy law comes down to a weighing of the costs and benefits of allowing wealth redistribution in bankruptcy. Such wealth distribution is not allowed under the creditors' bargain theory, as this theory provides that bankruptcy law is to be aimed at pure economic value maximization. Although this may lead to an externalization of the costs of bankruptcy, I conclude that pure economic value maximization provides for a larger overall societal value than theories that advance an internalization of the costs. The arguments underlying this con-

2 See further § 1 of part B of Chapter 2.

clusion are extensively set out in § 4 and 6 of Part C of Chapter 2, but the main point is that the purported benefits of wealth redistribution are smaller than contended and may be achieved better in other ways, such as via targeted taxation. As such, I qualify the goal of bankruptcy law as maximizing the value of the pool of assets for the investors as a group

2.3 *The goal of bankruptcy under the creditors' bargain theory shows resemblance with Dutch bankruptcy law, but is not the same*

It may seem as if the goal of pure value maximization is in clear conflict with positive Dutch bankruptcy law. Mainly because it seems as if in a Dutch bankruptcy a broader range of interests than outside of bankruptcy is to be taken into account. In particular, this concerns the taking into account of societal interests. However, based on Section 3:12 DCC such societal interests are also to be taken into account outside of bankruptcy under Dutch law. In this sense, the inclusion of societal interests does not entail the introduction of new substantive policies during a bankruptcy.[3]

At the same time, the goal of bankruptcy law does differ from that of the creditors' bargain theory. In particular, it can be pointed out that the goal of the creditors' bargain theory is aimed at providing value maximization for a broader range of parties – in particular creditors with a right of summary execution and creditors who have a fiduciary ownership, such as financial lessors – than are included in the term 'joint creditors', for whose benefit proceeds under Dutch bankruptcies are to be realized.[4] As such, the goal that is to be pursued under the creditors' bargain theory shows a large resemblance with positive Dutch bankruptcy law, but there are still differences.

2.4 *The upgrade: anticommons as justification for reorganizational law*

Under the creditors' bargain theory, the justification for bankruptcy law is the prevention of a common pool problem.[5] However, this explanation falls short as justification for bankruptcy law regarding reorganizations. In case of a reorganization plan, there is not only a problem if individual creditors act by seeking recourse in a way which destroys value (overuse), but also if an individual creditor does not act by refusing to consent to a value maximizing reorganization plan (underuse); for example, because the creditor hopes that he will get a premium for his consent. Without bankruptcy law that enables a cram down, this refusal to act would prevent the coming about of the reorganization plan. As

3 See § 3.2 of Chapter 4.
4 See § 3.2 of Chapter 4.
5 § 2.1 above and § 1 of Part B of Chapter 2.

such, an anticommons problem arises.[6] This justification for bankruptcy law is not acknowledged by the creditors' bargain theory. By taking the figure of the anticommons into account, a better normative explanation of bankruptcy law is provided for.

3 The efficiency of bankruptcy law regarding asset sales

In the second part of my research what I established to be 'efficiency' was used to assess Dutch bankruptcy law regarding asset sales. The relevant question in this respect was if this law is efficient, and, if not, to what extent it should be changed as to ensure that the value of the assets is maximized.

3.1 Introduce a possibility to override creditors with a right of summary execution

Relevant in the context of asset sales is the presence of a creditor with a right of summary execution. Creditors with such a right can keep exercising it during bankruptcy as if there was no bankruptcy and sell certain assets that are encumbered with a security interest. This entails *inter alia* that these creditors can interfere in the asset deployment. This may, for example, lead to the prevention of a value maximizing going-concern asset sale.[7]

With a view of value maximization in mind, creditors with a right of summary execution should not be allowed to act in such a way. However, this begs the question how this can be ensured. Since creditors with a right of summary execution also have this right outside of bankruptcy under Dutch law, outright abolishing it could give the creditors an incentive to stay on the safe side and execute their rights too early. Furthermore, the tools that Dutch law currently provides to limit creditors with a right of summary execution in their behavior are inadequate. The setting of a reasonable time limit of Section 58 DBC, the cooling-off period of Section 63a DBC nor the abuse of power doctrine of Section 3:13 DCC provide for an adequate 'override' that ensures that a creditor with a right of summary execution can be forced to consent to a value maximizing asset sale.[8]

To ensure efficiency, it is necessary to introduce a safeguard in Dutch law under which both the creditor with a right of summary execution and the trustee are given both the

6 See § 1.4 of Part B of Chapter 2 and § 2.2 of Chapter 7.

7 § 4.1 and 4.2 of Chapter 4.

8 § 4.2 of Chapter 4. Recently the Dutch Supreme Court has limited the possibilities of Section 58 DBC even further. See: Dutch Supreme Court 16 January 2015, *NJ* 2015, 58 (*T/Van der Molen q.q.*) and Dutch Supreme Court 6 February 2015, *RvdW 2015, 255* (*Tuinmeubelen*).

power and duty to request the prior approval of an auction or sale of an encumbered asset from the supervisory judge under Section 101 DBC. As such, both the creditor and the trustee can try and close the sale they deem the best possible sale. The supervisory judge can then assess a proposed sale and, subsequently, instruct the creditor or trustee to consent to a certain method of sale. Should the outcome of the procedure be that the creditor cannot exercise his right of summary execution, it will be necessary to respect the value of his right. This entails that he receives the net value of his right.[9]

3.2 Method of sale in asset sale

Also relevant in respect of asset sales is the method of sale that is used. For, in assessing whether a proposed sale maximizes the value of the assets that are sold, the absolute amount offered alone is not very useful. It does not say whether a certain price is the highest price possible.

Under Section 101 and 176 DBC the trustee can sell assets both by means of a public auction and a private sale. The Dutch Bankruptcy Code nor case law contains further rules regarding the structure of the bid process or the sale method that is to be used and, as such, provides little guidance.[10]

3.2.1 Public auctions: ensure value maximization by modernizing

Generally speaking, a public auction is to be preferred over a private sale in a bankruptcy asset sale. Such a sale method is deemed to be the best possible way to yield the market value of assets, as the sale takes place in public and the risk of price manipulation is reduced. So, in principle, the trustee should use this method of sale to achieve the highest possible price for assets.[11]

However, in practice private sales are far more popular than a public auction. There are at least two reasons for this: i) public auctions often generate a lower yield than the market value, due to *inter alia* a lack of independent bidders; and ii) public auctions can be costly to organize.[12]

These aforementioned objections can be obviated by using modern resources.[13] To ensure as many bidder as possible, a sale should be advertised as widely as possible. This could

9 See about the safeguard and what 'net value' entails § 4.3 of Chapter 4.
10 § 5.1 of Chapter 4.
11 § 5.3 of Chapter 4.
12 See further §5.2 of Chapter 4.
13 § 5.3 of Chapter 4.

inter alia be achieved by 'reinventing' the obligation of Section 94 DBC to draw up an inventory list. The trustee should be obligated to file an inventory list or, in larger cases, an information memorandum regarding the assets of the estate with the District Court. This list can then be published online on the Central Insolvency Register, where it can be viewed by everyone.

The costs of a public auction can be diminished by organizing an auction, but not using a public servant and, in effect, requalifying the public auction as private sale. The costs can be reduced further by holding auctions online or by organizing regional auctions, where multiple asset sales are held at the same time.

3.2.2 Private sales: introduce a duty of care for insiders

Sometimes, however, a private sale may be more suitable than a public auction to realize value maximization. Of particular interest in the context of such a sale are sales to 'insiders', such as the director and/or shareholder of the bankrupt debtor.

Dutch bankruptcy law, in principle, allows for such insider sales. However, problems arise if the insider uses the sale to divert value to himself by using his inside knowledge. Failure to realize this risk may lead to inefficient asset sales. The trustee is misled and a suboptimal value is realized. See, for example, the case I cite in § 5.4 of Chapter 4, in which the indirect majority shareholder/director of a debtor bought the inventory for an equivalent of € 113,000 and then immediately sold it to a third party for the equivalent of € 385,000.[14] To help prevent such opportunistic behavior, a duty of care should be imposed on insiders.[15]

A specific issue in the context of insider sales are sales concerning 'earmarked assets'.[16] Earmarked assets are assets of which the value is depressed if they are not used by the insider, such as clothes branded with the designer's logo. Because these assets are earmarked, their value is depressed. However, from a perspective of efficiency there is no objection against letting the insider buy the assets for the depressed value. If an insider cannot be obligated to continue with his business outside of bankruptcy, he can also not be obligated to do so inside bankruptcy. The value of this right to stop translates in the possibility for an insider to buy earmarked assets at a depressed value. An exception should apply, however, for cases in which the acquisition of the earmarked assets for a depressed price is a predesigned scheme.

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14 Dutch Supreme Court 11 February 2011, *NJ* 2011, 305 (*Ontvanger/Wesselman*).
15 § 5.4 of Chapter 4 and – in the context of pre-packaged asset sales – § 6.2.4 of Chapter 5.
16 See further § 5.4 of Chapter 4.

3.3 *Method of sale in a pre-packaged asset sale: increased risk of faulty pricing*

The sale method that is being used is even more relevant in pre-packaged asset sales. In such a sale, the asset sale is prepared by the debtor before the bankruptcy – under the monitoring of the intended trustee – and agreed upon by the trustee immediately after the bankruptcy procedure is opened. The advantage of such a pre-pack is that the amount of time between the declaration of bankruptcy and the asset sale can be shortened considerably, while at the same time the trustee can inform himself better as with regard to both the debtor and an intended sale.[17]

In a pre-pack, the sale process will in principle be conducted behind closed doors. The fact that it is unknown that an asset sale in bankruptcy is being prepared, prevents that the value of the debtor 'melts' away.[18] However, the private nature of a pre-pack also bears a risk. This risk is that the price is inadequately formed, because of the lack of market forces.[19] Specifically, it may be that the assets are sold to an insider, while an uninformed outsider was willing to pay more. This begs the question what powers an intended trustee should have to guarantee the integrity of the sale process in a pre-packaged transaction and to what extent these powers are codified in the proposal for the Continuity of Enterprises Act 1 (CEA 1).[20]

3.4 *Guaranteeing integrity of sale process: information rights and steering of sale process*

The first relevant aspect of guaranteeing the integrity of the sale process is the ability for the intended trustee to have all relevant information at his disposal. This entails that the intended trustee has access to all the books and records of the debtor and is free to obtain information from third parties. The current proposal for the CEA 1 does not go far enough in this respect, as it restricts the obtaining of information by the intended trustee.[21]

The second relevant aspect of ensuring integrity is the extent to which the intended trustee can steer the sale process in a pre-packaged asset sale. A lack of powers for the intended trustee to influence the sale process has at least two significant risks.

17 § 3 of Chapter 5.
18 See further about this problem of the 'melting ice cube' § 2 of Chapter 5.
19 § 4 of Chapter 5.
20 See § 1 and 2 of Chapter 5 for the essence of the proposal for the CEA 1.
21 § 5 of Chapter 5.

3.4.1 Steering the sale process I: intended trustee should be able to file for bankruptcy

A first risk is that the debtor tries to stall the sale process in the pre-bankruptcy phase as to remain in control for as long as possible and force a rescue in which current management continues to play a role. This may, however, be limited in a relatively easy way by giving the intended trustee the power to request the bankruptcy of the debtor or at least by giving the intended trustee the power to request that the supervisory judge orders him to do so.[22]

3.4.2 Steering the sale process II: stalking horse may be useful to ensure enough potential buyers

A second risk is that the debtor falls short in approaching and negotiating with potential buyers, as a result of which a suboptimal price is realized. Of particular importance in this context is the risk of opportunistic behavior by insiders, who perhaps would rather sell the assets for a suboptimal price to themselves or to a party that commits itself to keeping on current management.[23]

In the American restructuring practice the concept of the stalking horse procedure is used to overcome this second risk. In such a stalking horse procedure the debtor negotiates a sale purchase agreement preceding to the declaration of bankruptcy with a third party. This party is named the stalking horse. The agreement negotiated with this stalking horse is subject to the condition that no better price is obtained in a public auction held after the debtor is declared bankrupt.[24]

Such a stalking horse may also be used in the context of Dutch pre-packs and may lead to value maximization. As such, it can be of use in particular cases. However, the specifics of the Dutch market make it unlikely that a stalking horse procedure is efficient in every pre-pack. In particular, the size of the Dutch market and the prevalence of creditors with a right of summary execution in combination with the need for additional funding during the sale process might make a stalking horse procedure unsuitable.[25]

22 § 6.1 of Chapter 5.

23 See for evidence that insider sales in pre-packs are common: J.R. Hurenkamp, 'Failliet of fast forward? Een analyse van de pre-pack in de praktijk', *Tijdschrift voor Insolventierecht* 2015/20, in which Hurenkamp states that in a sample of 37 pre-packaged asset sales at least 15 (40.5%) were realized with insiders. In the context of the English pre-pack, the Graham Review into Pre-pack administration of June 2014 notes that in a set of 499 pre-packs 316 (63.3%) could be qualified as a 'connected sale'. See: Graham Report, p. 37.

24 See § 6.2.3.1 of Chapter 5 for a further explanation of the use of the stalking horse in the United States.

25 See further: § 6.2.3.2–6.2.3.4 of Chapter 5.

3.5 *Guaranteeing integrity of sale process: intended trustee should not be held hostage by debtor*

As stated, use of the stalking horse procedure is not always the best way to ensure an efficient sale process in pre-packs. At the same time, such efficiency is also not achieved by providing the intended trustee with formal powers to steer the sale process, as this would likely keep the debtor from taking timely measures. Neither would it be correct to categorically exclude insiders from buying assets in a pre-pack.[26]

Rather, the solution is to ensure that the intended trustee is not put in a hold by the debtor.[27] Currently, this is possible, because the intended trustee is supposed to step down if he does not agree with a certain deal. This leaves a succeeding intended trustee with the choice between the suboptimal deal presented to him by the debtor or the concluding of a deal after a bankruptcy procedure has been opened and the value of the assets has already (partly) 'melted' away. Preventing that the intended trustee is held hostage, entails that the intended trustee should stay on, even if he does not agree with a certain deal. Additionally, a duty of care should be introduced for the debtor in relation to opportunistic self dealing and acting in such a way that an intended trustee is put under pressure.[28]

4 The efficiency of bankruptcy law regarding reorganizations

In the third part of my research an assessment is made regarding the efficiency of Dutch bankruptcy law regarding reorganizations.

4.1 *The structure of reorganizations: reorganization plan to be preferred*

In assessing bankruptcy law regarding reorganizations, it was first necessary to define what form this law should take in order to be efficient. This regards the way in which reorganizations are structured by law.

Traditionally, the structure of reorganizations in the Netherlands and the United States has been that of an administrative reorganization procedure. In the Netherlands this is the reorganization plan (*faillissementsakkoord*) and in the United States a reorganization plan under Chapter 11. In an administrative reorganization procedure parties bargain in a way that is structured by law. The result of the bargaining is what parties agree to be the

26 § 6.2.4 of Chapter 5.
27 § 6.2.4 of Chapter 5.
28 § 6.2.4 of Chapter 5.

value of the debtor and how this value is divided. The outcome of the bargaining is laid down in a plan, which is then voted on by claimants. If adopted by the claimants a judge has the final say on the plan and can confirm it or deny confirmation. As a result, a going-concern value can be realized.[29]

However, there are also perceived costs associated with the administrative reorganization procedure. This regards costs concerning: i) the valuation of assets; ii) (direct) costs; iii) speed; and iv) perverse incentives.[30] The question is whether there is an alternative reorganization structure that provides for a more cost effective way of reorganizing than the administrative reorganization procedure.[31]

There have been several proposals that have argued that there are better ways to reorganize than by means of an administrative reorganization procedure.[32] And these proposals may indeed eliminate some of the costs of the administrative reorganization procedure. Most notably, the costs associated with the problem of valuing the assets, while they are not actually sold. However, these proposals cause other costs, which are not or to a lesser extent present in an administrative reorganization procedure. These costs are so high, that they are prohibitive to using such alternative procedures as a standard for reorganizations.[33]

As such, it is better to tweak the specific parts of the administrative reorganization procedure rather than changing the structure of reorganizations completely. Efforts in the first direction are already perceived to be taking place in practice. Most notably, this concerns the Report of ABI Commission to study the reform of Chapter 11.

4.2 The law regarding reorganizations: reform necessary

In the Netherlands there are efforts underway to reform bankruptcy law regarding reorganizations. In particular, this regards the introduction of a cram down plan outside

29 See: § 1.1 of Part B of Chapter 3.

30 See further § 1.2 of Part B of Chapter 3.

31 This was also the question that the American Bankruptcy Institute Commission for the reform of Chapter 11 originally asked itself. "*The charge of the commission is nothing less than the study of the need for comprehensive chapter 11 reform, by which we mean consideration of starting from scratch and re-inventing the statute.*" See: opening remarks ABI Commission to study the reform of Chapter 11 field hearing October 26, 2012 in San Diego, California. Available via: http://commission.abi.org/sites/default/files/statements/26oct2012/OPENING_REMARKS_10_17_12_FIELD_HEARING_NYC_Handout.doc.

32 See § 2, 3 and 4 of Part B of Chapter 3 for a discussion of these alternatives.

33 Interestingly enough, however, a variation on the Contingent and Chameleon Equity proposals discussed in Chapter 3 has been developed in practice as a way for banks to obtain more capital. See: http://www.ftadviser.com/2015/04/14/investments/jargon-busting-contingent-convertible-bonds-eIaHysaP6K6e9KSr5nj6zI/article.html.

bankruptcy as proposed under the Continuity of Enterprises Act 2 (CEA 2). These efforts are further influenced by the non-binding recommendation of the European Commission of March 12, 2014. At the same time, such reform efforts cannot, as of yet, be seen in the context of the Dutch reorganization plan (*faillissementsakkoord*).[34]

4.2.1 Reorganization plan: binding all creditors and improving confirmation criteria

However, with regard to the reorganization plan there are several aspects of the law that should be changed to ensure efficiency.

First, this regards the requirement of Section 146 DBC, that a majority of three quarter of the admitted and provisionally admitted ordinary creditors has to have voted for a proposed plan, in order to be eligible for a cram down by the judge. Such a requirement is inefficient, as it may lead to a situation in which a value maximizing reorganization plan is not confirmed, solely because more than a quarter of the creditors displays hold out behavior in the hopes of receiving a premium over the other creditors.[35]

Second, the law regarding reorganization plans should be changed as to enable the binding of creditors with a right of preference to a plan. Because they are currently not bound to a reorganization plan, such creditors can frustrate the bringing about of a value maximizing reorganization plan. By enabling the binding of creditors with a right of preference to a reorganization plan, this situation can be prevented.[36]

Finally, the confirmation criteria of Section 153 DBC are currently inadequate. In particular, they fail to ensure whether or not the proposed reorganization plan provides for a maximization of value. For this reason, an explicit 'value maximization' test should be included in Section 153 DBC.[37]

4.2.2 The cram down plan outside of bankruptcy: introduce possibility of a collective stay

Reform regarding reorganization plans is currently concentrated in the proposal for the CEA 2. This proposal aims to introduce a statutory framework that enables the conclusion of a cram down plan outside of bankruptcy.

34 Such efforts may be possibly made under the currently unavailable proposal for the Continuity of Enterprises Act 3.
35 § 4.1 of Chapter 6.
36 § 4.2 of Chapter 6.
37 § 4.3 of Chapter 6.

In principle, the possibility of a cram down plan is a good thing. It enables overcoming the problem of creditors who display hold out behavior in an effort to create nuisance value. Such creditors can be involuntarily bound to a proposed cram down plan.[38]

The problem with the proposal for the CEA 2 is that it does not include the possibility of a collective stay during the period after a cram down plan has been proposed, but before a final decision has been made on its acceptance. Such a possibility was not included, because the cram down plan is brought about outside the context of a bankruptcy procedure (*faillissement*) and, as such, creditors should keep their normal recourse possibilities. However, such a reasoning fails to acknowledge that creditors will display 'opt-out behavior' in the period after a cram down plan is proposed, because they will possibly receive less under such a plan than if they seek recourse on an individual basis before the plan is confirmed. To ensure value maximization and prevent such opt-out behavior, the possibility of a collective stay should therefore be included in the proposal for the CEA 2.[39]

At the same time, while some creditors will have to accept that they possibly have to give up part of their claim against their will under a cram down plan, some creditors may still get paid in full. This regards: i) creditors regarding debts that originate after a plan has been proposed; ii) suppliers of essential goods and services; and iii) creditors that are not selected to be included in the cram down plan. Payment of these creditors is, however, justified, as long as paying them helps attaining a value maximizing outcome.[40]

4.2.3 Reorganization plans: further measures regarding shareholders necessary

Finally, an important part of the reform regarding reorganizations concerns a group for which there has traditionally been little attention in Dutch reorganizations: the shareholders.

Under the provisions for the reorganization plan, it is not possible to bind shareholders against their will to a plan and make them give up part of their equity interest by means of a forced debt-for-equity-swap.[41] Such a binding is possible under the proposal for the CEA 2.[42]

From the point of view of efficiency it is good that there is a possibility to bind shareholders to a reorganization plan or cram down plan and make them give up part of their equity

38 § 2 and 3 of Chapter 7.
39 § 4 of Chapter 7.
40 See further § 5 of Chapter 7.
41 § 2 of Part A of Chapter 2.
42 § 6.1 of Chapter 7.

interest by means of a debt-for-equity swap. Otherwise the creditors will bear the costs of a reorganization, while shareholders remain unimpaired. In this respect, the provisions regarding the reorganization plan should be changed.

However, while the CEA 2 offers the opportunity to bind shareholders to a cram down plan, it does not go so far as introducing an absolute priority rule.[43] Such a rule would ensure that shareholders would not be able to retain their equity interest, unless – absent of their full consent – creditors are paid in full or shareholders contribute value to a plan. The shareholders would, just like outside of bankruptcy, only receive what is left to pay out after all debts have been satisfied.[44] The current provisions regarding the reorganization plan and the proposal for the CEA 2 do not take this into account sufficiently and should be changed in this regard.

5 Overall conclusion

In the preceding paragraphs I have set out the conclusions that I have drawn in answering my central research question. It is clear from these conclusions that current Dutch bankruptcy law does not provide rules that result in an efficient outcome of bankruptcies. A changed world has resulted in changed dynamics, as is shown by the Lehman Brothers bankruptcies. These changed dynamics have not yet led to sufficiently changed bankruptcy law regarding asset sales and reorganizations. In this respect, this research provides a solid foundation for a further fundamental discussion regarding bankruptcy that has been long overdue.

43 See § 2 of Part A of Chapter 2 for the analysis that the law regarding reorganization plans also does not contain an absolute priority rule.

44 § 6.2 of Chapter 7.

9 Samenvattende conclusie

1 Inleiding

Verandering is onvermijdelijk. Dergelijke verandering zorgt voor een kans om soms een moment stil te staan en te overdenken of je nog op het juiste pad zit. Met de 120e verjaardag van de inwerkingtreding van de Faillissementswet in 2016 in het vooruitzicht kan zowel in Nederland als in de Verenigde Staten een verandering in de dynamiek van het faillissementsproces worden waargenomen. Deze veranderende dynamiek biedt een goede kans om te beoordelen in hoeverre Nederlands faillissementsrecht effectief is in het bereiken van een efficiënte uitkomst van faillissementen. Hiertoe heb ik de centrale onderzoeksvraag geformuleerd:

> "Is Nederland faillissementsrecht aangaande activatransacties en reorganisaties efficiënt, en, zo niet, op welke wijze zou het dienen te worden gewijzigd?"

Het antwoord op deze vraag bestaat uit drie verschillende delen. Deze verschillende delen leveren een aantal conclusies op, welke kunnen worden gevonden in de hierna volgende paragrafen 2 tot en met 4. Een overkoepelende conclusie is opgenomen in paragraaf 5.

2 Het definiëren van 'efficientie': upgraded creditors' bargain theory

Het eerste deel van mijn onderzoek bestond uit het vaststellen hoe de term 'efficiëntie' diende te worden gedefinieerd. Dit raakt aan de rechtvaardiging voor en de doelen van faillissementsrecht. De grote discussie in dit verband is of faillissementsrecht alleen gaat over waardemaximalisatie of dat andere waarden ook een rol zouden moeten spelen.

2.1 De creditors' bargain theory as verklaring voor faillissementsrecht

De laatste decennia is de *creditors' bargain theory* de meest prominente normatieve theorie aangaande faillissementsrecht geweest. Deze theorie betoogt dat faillissementsrecht slechts één doel dient: het maximaliseren van de waarde van de *pool of assets* voor de *investors as*

a group. Om dit doel te bereiken dient faillissementsrecht te worden vorm gegeven aan de hand van drie principes:[1]

1. Faillissementsrecht zou in de kern moeten worden vorm gegeven om te voorkomen dat individuele acties aangaande de activa, bedoeld om de positie van een 'investor' of een ander te behouden, kunnen interfereren met de aanwending van die activa op een wijze zoals daar de voorkeur aan wordt gegeven door de investors as a group.
2. Faillissementsrecht dient een materiële niet-faillissementsrechtelijke regel slechts te wijzigen, indien dit leidt tot het behoud van de waarde van de activa voor de groep investors die hier rechten in hebben.
3. Faillissementsrecht dient zich slechts bezig te houden met de belangen van degenen die een 'property right' in de activa van de onderneming hebben.

De creditors' bargain theory betoogt dat faillissementsrecht gevormd aan de hand van deze principes zorgt voor een hogere opbrengst dan in het geval van individueel verhaal. Deze hogere opbrengst is voornamelijk het resultaat van het voorkomen van een commonpool-probleem door het elimineren van de mogelijkheid voor schuldeisers om individueel verhaal te zoeken. Zonder deze eliminatie zouden schuldeisers een prikkel hebben om de eerste te zijn om verhaal te zoeken in het geval een schuldenaar in problemen verkeert. Dit zou leiden tot een stuksgewijze verkoop, welke kan zorgen voor een lagere waarde dan in het geval de activa gezamenlijk worden verkocht. Of, in andere woorden, volgens de creditors' bargain theory bestaat faillissementsrecht om *overuse* van de middelen van de schuldenaar te voorkomen.[2]

2.2 Kritiek op de creditors' bargain theory is niet overtuigend

De creditors' bargain theory is niet de enige normatieve theorie aangaande faillissementsrecht. Er zijn een aantal theorieën geweest die betogen dat waardemaximalisatie niet het enige doel van faillissementsrecht is en dat er ruimte is voor het najagen van meerdere doelen in faillissement. Deze theorieën zijn, als zodanig, dus kritisch over de creditors' bargain theory.

In Part C van Chapter 2 heb ik onderzocht of een aantal van de theorieën een betere normatieve theorie van faillissementsrecht opleveren dan de creditors' bargain theory. In deze context heb ik onderzocht: i) de *risk sharing theory*; ii) de *rehabilitation view*; iii) de *femi-*

1 Zie § 2 van part B van Chapter 2. Deze principles komen uit: D.G. Baird and T.H. Jackson, 'Corporate reorganizations and the treatment of diverse ownership interests: a comment on adequate protection of secured creditors in bankruptcy', *The University of Chicago Law Review* 51(1) (1984), p. 100 en 103.

2 Zie verder § 1 van part B van Chapter 2.

nism/communitarianism view; iv) de *bankruptcy choice situation*; en v) de *team production theory*.

Uiteindelijk concludeer ik dat de discussie over de beste normatieve theorie aangaande faillissementsrecht neerkomt op een weging van de kosten en voordelen van het toestaan van de herverdeling van waarde in faillissement. Dergelijke herverdeling is niet toegestaan onder de creditors' bargain theory, aangezien deze theorie gericht is op puur economische waardemaximalisatie. Alhoewel dit kan leiden tot een externalisatie van de kosten van een faillissement, concludeer ik dat pure economische waardemaximalisatie leidt tot grotere maatschappelijke waarde ten opzichte van theorieën die een internalisering van kosten voorstaan. De argumenten die deze conclusie dragen, worden uitgebreid uiteengezet in § 4 en 6 van Part C van Chapter 2, maar het hoofdpunt is dat de voorgestelde voordelen van herverdeling van waarde kleiner zijn dan wordt betoogd en dat deze mogelijk beter op andere wijzen kunnen worden bereikt, zoals via gerichte belastingen. Ik kwalificeer het doel van het faillissementsrecht dan ook als het maximaliseren van de waarde van de pool of assets voor de investors as a group.

2.3 Het doel van faillissementsrecht volgens de creditors' bargain theory vertoont overeenkomsten met Nederlands faillissementsrecht, maar is niet hetzelfde.

Het zou kunnen lijken alsof het doel van pure economische waardemaximalisatie duidelijk in conflict is met positief Nederlands faillissementsrecht. Voornamelijk omdat het lijkt alsof onder Nederlands faillissementsrecht een bredere reeks van belangen in ogenschouw dient te worden genomen ten opzichte van de situatie buiten faillissement. In het bijzonder betreft dit het in ogenschouw nemen van maatschappelijke belangen. Echter, op basis van artikel 3:12 BW dienen dergelijke maatschappelijke belangen onder Nederlands recht ook al buiten faillissement een rol te spelen. In die zin behelst het opnemen van maatschappelijke belangen niet de introductie van nieuw materieel beleid tijdens een faillissement.[3]

Tegelijkertijd verschilt het doel van faillissementsrecht wel van dat van de creditors' bargain theory. In het bijzonder kan erop worden gewezen dat het doel van de creditors' bargain theory is gericht op het realiseren van waardemaximalisatie voor een bredere groep van partijen – in het bijzonder schuldeisers met een recht van parate executie en schuldeisers die zekerheidseigendom hebben, zoals financial lessors – dan de partijen die onder de term 'gezamenlijke schuldeisers' vallen, in wiens belang opbrengsten onder Nederlands faillisse-

3 Zie § 3.2 van Chapter 4

mentsrecht dienen te worden gerealiseerd.[4] In die zin vertoont het doel dat dient te worden nagestreefd onder de creditors' bargain theory grote overeenkomst met positief Nederlands faillissementsrecht, maar zijn er nog steeds verschillen.

2.4 De upgrade: anticommons als rechtvaardiging voor reorganisatierecht

Onder de creditors' bargain theory is de rechtvaardiging voor faillissementsrecht het voorkomen van een commonpoolprobleem.[5] Echter, deze rechtvaardiging schiet tekort als rechtvaardiging voor faillissementsrecht, aangaande reorganisaties. In het geval van een dwangakkoord is er niet alleen een probleem als individuele schuldeisers handelen door verhaal te zoeken op een wijze die waarde vernietigt (overuse), maar ook als een individuele schuldeiser niet handelt door te weigeren in te stemmen met een waardemaximaliserend akkoord (*underuse*); bijvoorbeeld omdat de schuldeiser hoopt dat hij een premie zal ontvangen voor zijn instemming. Zonder faillissementsrecht dat het mogelijk maakt een schuldeiser tegen zijn wil in aan een akkoord te binden, zou deze weigering te handelen de totstandkoming van een waardemaximaliserend akkoord voorkomen. Als zodanig doet zich een anticommonsprobleem voor.[6] Deze rechtvaardiging voor faillissementsrecht wordt niet onderkend door de creditors' bargain theory. Door de figuur van de anticommons echter wel in ogenschouw te nemen, wordt voorzien in een betere normatieve verklaring van faillissementsrecht.

3 De efficiëntie van faillissementsrecht betreffende activatransacties

In het tweede deel van mijn onderzoek heb ik de definitie van 'efficiëntie' gebruikt om Nederlands faillissementsrecht aangaande activatransacties te beoordelen. De relevante vraag in deze context was of dit recht efficiënt is, en zo niet, in hoeverre het dient te worden aangepast om maximalisatie van de waarde van de activa te waarborgen.

3.1 Introduceer een mogelijkheid om schuldeisers met een recht van parate executie te overrulen

Relevant in de context van activatransacties is de aanwezigheid van een schuldeiser met een recht van parate executie. Schuldeisers met een dergelijk recht kunnen hun rechten

4 Zie § 3.2 van Chapter 4.
5 § 2.1 hierboven en § 1 van Part B van Chapter 2.
6 Zie § 1.4 van Part B van Chapter 2 en § 2.2 van Chapter 7.

gedurende een faillissement blijven uitoefenen alsof er geen faillissement was en bepaalde activa verkopen die zijn bezwaard met een zekerheidsrecht. Dit behelst onder andere dat schuldeisers kunnen interfereren in de aanwending van de activa. Dit kan er, bijvoorbeeld, toe leiden dat een waardemaximaliserende going-concern activatransactie wordt voorkomen.[7]

Met het doel van waardemaximalisatie in gedachten, zou het schuldeisers met een recht van parate executie niet dienen te worden toegestaan dat zij zo handelen. Echter, dit roept de vraag op hoe dit kan worden verzekerd. Aangezien schuldeisers met een recht van parate executie dit recht onder Nederlands recht ook buiten faillissement hebben, zou het simpelweg afschaffen van dit recht de schuldeisers een prikkel kunnen geven om op veilig te spelen en hun recht te vroeg uit te oefenen. Het stellen van een redelijke termijn op basis van artikel 58 Fw, de afkoelingsperiode van artikel 63a Fw noch de doctrine van misbruik van bevoegdheid van artikel 3:13 BW voorziet in dit verband in een adequate '*override*', die verzekert dat schuldeisers met een recht van parate executie kunnen worden gedwongen om met een waardemaximaliserende activatransactie in te stemmen.[8]

Om efficiëntie te verzekeren, is het nodig om een waarborg in het Nederlandse recht te introduceren. Zowel de schuldeiser met een recht van parate executie als de curator wordt zowel het recht als de plicht gegeven om de rechter-commissaris op basis van artikel 101 Fw om toestemming te verzoeken voor een voorgenomen openbare of onderhandse verkoop. Op die wijze kunnen zowel de schuldeiser als de curator de volgens hen best mogelijke transactie sluiten. De rechter-commissaris kan vervolgens een voorgenomen verkoop beoordelen en vervolgens de schuldeiser of curator instrueren om met een bepaalde verkoopmethode in te stemmen. Is de uitkomst van de procedure dat de schuldeiser zijn recht van parate executie niet kan uitoefenen, dan is het nodig om de waarde van zijn recht te respecteren. Dit houdt in dat hij de netto waarde van zijn recht ontvangt.[9]

3.2 Wijze van verkoop in een activatransactie

Ook relevant in de context van activatransacties is de wijze van verkoop die wordt gebruikt. Immers, in het beoordelen van of een voorgestelde activatransactie waardemaximaliserend is, zegt het geboden absolute bedrag weinig. Het toont niet aan of een bepaalde prijs de hoogst mogelijke prijs is.

7 § 4.1 en 4.2 van Chapter 4.

8 § 4.2 van Chapter 4. Recent heeft de Hoge Raad de mogelijkheden van artikel 58 Fw nog verder beperkt. Zie:HR 16 januari 2015, *NJ* 2015, 58 (*T/Van der Molen q.q.*) en HR 6 februari 2015, RvdW *2015, 255* (*Tuinmeubelen*).

9 Zie over de waarborg en wat 'netto waarde' inhoudt § 4.3 van Chapter 4.

Onder artikel 101 en 176 Fw kan de curator activa zowel door middel van een openbare als een onderhandse verkoop vervreemden. De Faillissementswet noch rechtspraak bevat verdere regels aangaande de structuur van het biedproces of de verkoopmethode die dient te worden gebruikt en biedt dan ook weinig houvast.[10]

3.2.1 Openbare verkoop: waarborgen van waardemaximalisatie door te moderniseren

Over het algemeen is een openbare verkoop te verkiezen boven een onderhandse verkoop in het geval van een activatransactie in faillissement. Een dergelijke verkoopmethode wordt geacht de beste wijze te zijn om de marktwaarde van activa te realiseren, aangezien een dergelijke verkoop in het openbaar plaatsvindt en het risico op prijsmanipulatie wordt verminderd. Dus, in principe, zou de curator deze wijze van verkoop dienen te gebruiken om de hoogst mogelijke prijs voor de activa te behalen.[11]

Echter, in de praktijk is de onderhandse verkoop veel populairder dan de openbare verkoop. Er zijn ten minste twee redenen hiervoor: i) openbare verkopen leveren vaak een lagere opbrengst op dan de marktwaarde, onder andere vanwege het gebrek aan onafhankelijke bieders; en ii) openbare verkopen kunnen kostbaar zijn om te organiseren.[12]

Deze voornoemde bezwaren kunnen worden weg genomen door moderne middelen te gebruiken.[13] Om zoveel mogelijk bieders te waarborgen, zou een verkoop zo breed mogelijk moeten worden geadverteerd. Dit zou onder andere kunnen worden bereikt door de verplichting van artikel 94 Fw om een inventarislijst op te stellen te 'heruitvinden'. De curator zou moeten worden verplicht om een inventarislijst of, in grotere zaken, een informatiememorandum, aangaande de activa te deponeren bij de rechtbank. De lijst kan dan vervolgens online op het Centraal Insolventieregister worden gepubliceerd, waar het vervolgens door iedereen kan worden ingezien.

De kosten van een openbare verkoop kunnen worden verminderd door een veiling te houden, maar daarbij geen gebruik te maken van een openbaar ambtenaar, waarmee de facto een openbare verkoop wordt geherkwalificeerd als onderhandse verkoop. De kosten kunnen verder worden teruggebracht door openbare verkopen online te houden of regionale veilingen te organiseren, waar verscheidene activaverkopen tegelijkertijd worden gehouden.

10 § 5.1 van Chapter 4.
11 § 5.3 van Chapter 4.
12 Zie verder §5.2 van Chapter 4.
13 § 5.3 van Chapter 4.

3.2.2 Onderhandse verkoop: introduceer een zorgplicht voor insiders

Soms, echter, kan een onderhandse verkoop beter geschikt zijn dan een openbare verkoop om waardemaximalisatie te realiseren. In het bijzonder interessant in de context van dergelijke verkopen zijn de transacties met '*insiders*', zoals de bestuurder en/of aandeelhouder van de failliete schuldenaar.

Nederlands faillissementsrecht staat in beginsel activatransacties met insiders toe. Echter, er zullen zich problemen voordoen als de insider de transactie gebruikt om waarde naar zichzelf toe te trekken door gebruikmaking van zijn voorkennis. Het niet onderkennen van dit risico kan tot inefficiënte activatransacties leiden. De curator wordt misleid en een suboptimale waarde wordt gerealiseerd. Zie bijvoorbeeld de zaak die ik aanhaal in § 5.4 van Chapter 4, in welke zaak de meerderheidsaandeelhouder/bestuurder van de schuldenaar de voorraad kocht voor een equivalent van € 113.000 en deze toen direct doorverkocht aan een derde voor het equivalent van € 385.000.[14] Om dergelijk opportunistisch gedrag te voorkomen zou een insiders een zorgplicht moeten worden opgelegd.[15]

Een specifiek aandachtspunt in de context van activatransacties betreft '*earmarked assets*'.[16] Earmarked assets zijn activa waarvan de waarde wordt gedrukt als deze niet door de insider worden gebruikt, zoals kleren met het logo van de designer er overal op gedrukt. Aangezien deze activa 'geoormerkt' zijn, wordt de waarde gedrukt. Echter, vanuit het perspectief van efficiëntie is er geen bezwaar om de insider de activa tegen de lage waarde te laten kopen. Als een insider buiten faillissement niet kan worden verplicht om zijn onderneming voort te zetten, kan hij ook niet verplicht worden om dit in faillissement wel te doen. Een uitzondering dient echter te gelden voor gevallen waarin de verkrijging van de earmarked assets tegen een lagere waarde een vooropgezet plan is.

3.3 Wijze van verkoop in pre-packaged activatransacties: groter risico op gebrekkige prijsvorming

De keuze voor de verkoopmethode die wordt gebruikt, is nog relevanter in het geval van pre-packaged activatransacties. In een dergelijke transactie wordt de verkoop voorbereid door de schuldenaar voorafgaand aan het faillissement – onder toezicht van de beoogd curator – en wordt hier door de beoogd curator direct mee ingestemd direct nadat de faillissementsprocedure is geopend. Het voordeel van een dergelijke pre-pack is dat de hoeveelheid tijd tussen de faillietverklaring en de activatransactie aanzienlijk kan worden

14 HR 11 februari 2011, *NJ* 2011, 305 (*Ontvanger/Wesselman*).
15 § 5.4 van Chapter 4 en – in de context van pre-packaged activatransacties – § 6.2.4 van Chapter 5.
16 Zie verder § 5.4 van Chapter 4.

verkort, terwijl de curator zich tegelijkertijd beter kan informeren over zowel de schuldenaar als de voorgenomen transactie.[17]

In een pre-pack zal het verkoopproces in beginsel achter gesloten deuren plaatsvinden. Het feit dat het onbekend is dat een activatransactie in faillissement wordt voorbereid, voorkomt dat de waarde van de schuldenaar 'wegsmelt'.[18] Het besloten karakter van de pre-pack kent ook een risico. Dit risico is dat de prijs op een gebrekkige wijze wordt gevormd, door het gebrek aan marktwerking.[19] In het bijzonder kan het zo zijn dat de activa worden verkocht aan een insider, terwijl een niet-geïnformeerde *outsider* bereid zou zijn geweest meer te betalen. Dit roept de vraag op wat voor bevoegdheden een beoogd curator zou moeten hebben om de integriteit van het verkoopproces in een pre-pack transactie te waarborgen en in hoeverre deze bevoegdheden zijn opgenomen in het voorstel voor de Wet Continuïteit Ondernemingen I (WCO I).[20]

3.4 Het waarborgen van de integriteit van het verkoopproces: informatierechten en het sturen van het verkoopproces

Het eerste relevante aspect van het waarborgen van de integriteit van het verkoopproces is de mogelijkheid voor de beoogd curator om alle relevante informatie tot zijn beschikking te hebben. Dit houdt in dat de beoogd curator toegang dient te hebben tot alle administratie en bescheiden van de schuldenaar en vrij is om informatie in te winnen bij derden. Het huidige voorstel voor de WCO I gaat niet ver genoeg op dit punt, aangezien het het inwinnen van informatie door de beoogd curator beperkt.[21]

Het tweede relevante aspect van het waarborgen van de integriteit is de mate waarin de beoogd curator het verkoopproces in een pre-packaged activatransactie kan sturen. Een gebrek aan bevoegdheden van de beoogd curator om het verkoopproces te beïnvloeden, kent ten minste twee risico's.

3.4.1 Het sturen van het verkoopproces I: de beoogd curator zou faillissement moeten kunnen aanvragen

Een eerste risico is dat de schuldenaar het verkoopproces probeert te rekken in de fase voorafgaand aan de faillietverklaring en een redding probeert te forceren waarin het zittende management een rol blijft spelen. Dit risico kan echter op relatief eenvoudige wijze worden

17 § 3 van Chapter 5.
18 Zie verder over dit probleem van de '*melting ice cube*' § 2 van Chapter 5.
19 § 4 van Chapter 5.
20 Zie § 1 en 2 van Chapter 5 voor de essentie van het voorstel voor de WCO I.
21 § 5 van Chapter 5.

beperkt, door de beoogd curator de bevoegdheid te geven om het faillissement van de schuldenaar aan te vragen of door de beoogd curator ten minste de bevoegdheid te geven te verzoeken dat de rechter-commissaris hem opdraagt dit te doen.[22]

3.4.2 Het sturen van het verkoopproces II: stalking horse kan nuttig zijn in het waarborgen van voldoende potentiële kopers

Een tweede risico is dat de schuldenaar tekortschiet in het benaderen van en onderhandelen met potentiële kopers, waardoor een suboptimale prijs wordt gerealiseerd. In het bijzonder van belang in deze context is het risico van opportunistische insiders, die wellicht de activa voor een suboptimale prijs aan zichzelf verkopen of aan een partij die zichzelf commiteert aan het behouden van het zittende management.[23]

In de Amerikaanse herstructureringspraktijk wordt het concept van de *stalking horse* gebruikt om dit tweede risico tegen te gaan. In een stalking horse procedure onderhandelt de schuldenaar voorafgaand aan de faillietverklaring een koopovereenkomst uit met een derde. Deze derde wordt de stalking horse genoemd. De uitonderhandelde overeenkomst is onderhevig aan de voorwaarde dat geen betere prijs wordt gerealiseerd in een openbare verkoop, die wordt gehouden nadat de schuldenaar failliet is verklaard.[24]

Een dergelijke stalking horse kan ook worden gebruikt in de context van Nederlandse pre-packs en kan leiden tot waardemaximalisatie. Het kan dan ook nuttig zijn om deze procedure te gebruiken in bepaalde zaken. Echter, specifieke aspecten van de Nederlandse markt maken dat het onwaarschijnlijk is dat de stalking procedure in elke pre-pack efficiënt is. In het bijzonder maken de omvang van de Nederlandse markt en de aanwezigheid van schuldeisers met een zekerheidsrecht in combinatie met de noodzaak voor aanvullende financiering gedurende het verkoopproces dat een stalking horse procedure niet altijd geschikt is.[25]

22 § 6.1 van Chapter 5.

23 Zie voor bewijs dat insider transacties in pre-packs veelvoorkomend zijn: J.R. Hurenkamp, 'Failliet of fast forward? Een analyse van de pre-pack in de praktijk', *Tijdschrift voor Insolventierecht* 2015/20, waarin Hurenkamp stelt dat in een groep van 37 pre-packaged activatransacties ten minste 15 (40.5%) tot stand kwam met insiders. In de context van de Engelse pre-pack concludeert de Graham Review into Pre-pack administration van juni 2014 dat in een dataset van 499 pre-packs 316 (63,3%) kan worden gekwalificeerd als 'connected sale'. Zie: Graham Report, p. 37.

24 Zie § 6.2.3.1 van Chapter 5 voor een verdere uitleg over het gebruik van de stalking horse in de Verenigde Staten.

25 Zie verdere: § 6.2.3.2–6.2.3.4 van Chapter 5.

3.5 Het waarborgen van de integriteit van het verkoopproces: de beoogd curator zou niet gegijzeld moeten kunnen worden door de schuldenaar

Zoals gezegd, is het gebruiken van de stalking horse procedure niet altijd de beste manier om een efficiënt verkoopproces te waarborgen. Tegelijkertijd wordt dergelijke efficiëntie ook niet bereikt door de beoogd curator formele bevoegdheden te geven om het verkoopproces te sturen, aangezien dit de schuldenaar waarschijnlijk zou weerhouden van het tijdig nemen van maatregelen. Het zou voorts niet correct zijn om insiders categorisch uit te sluiten van het kopen van activa in pre-packs.[26]

De oplossing is om te waarborgen dat de beoogd curator niet in de houdgreep wordt genomen door de schuldenaar.[27] Op dit moment is dat mogelijk doordat de beoogd curator geacht wordt terug te treden als hij het niet eens is met een bepaalde deal. Dit laat een opvolgende beoogd curator de keuze tussen een door de schuldenaar aangeboden suboptimale deal of het bereiken van een transactie nadat de faillissementsprocedure geopend is en (een deel van) de waarde al is 'weggesmolten'. Het voorkomen dat de beoogd curator wordt gegijzeld, houdt in dat de beoogd curator zou dienen aan te blijven, zelfs als hij het niet eens is met een bepaalde deal. Daarenboven zou een zorgplicht moeten worden geïntroduceerd voor de schuldenaar in relatie tot opportunistische *self dealing* en het handelen op een zodanige wijze dat de beoogd curator onder druk wordt gezet.[28]

4 De efficiëntie van faillissementsrecht betreffende reorganisaties

In het derde deel van mijn onderzoek wordt de efficiëntie van Nederlands faillissementsrecht betreffende reorganisaties beoordeeld.

4.1 De structuur van reorganisaties: akkoordstructuur verdient voorkeur

Bij de beoordeling van faillissementsrecht betreffende reorganisaties was het eerst nodig om vast te stellen welke vorm dit recht aan diende te nemen om efficiënt te zijn. Dit betreft de wijze waarop reorganisaties gestructureerd worden door het recht.

Traditioneel gezien heeft de structuur van reorganisaties in Nederland en de Verenigde Staten de vorm van een administratieve reorganisatieprocedure. In Nederland is dit het faillissementsakkoord en in de Verenigde Staten het akkoord onder Chapter 11. In een

26 § 6.2.4 van Chapter 5.
27 § 6.2.4 van Chapter 5.
28 § 6.2.4 van Chapter 5.

administratieve reorganisatieprocedure onderhandelen partijen op een wijze die wordt gestructureerd door de wet. Het resultaat van deze onderhandelingen is wat partijen overeenkomen dat de waarde van de schuldenaar is en hoe deze waarde dient te worden verdeeld. De uitkomst van de onderhandelingen wordt vervolgens neergelegd in een akkoord, waarover wordt gestemd door de claimanten. Indien het akkoord wordt aangenomen, heeft de rechter een beslissende stem over het akkoord en kan hij het akkoord homologeren of homologatie weigeren. Hierdoor kan going-concernwaarde worden gerealiseerd.[29]

Echter, er zijn ook gepercipieerde kosten gemoeid met de administratieve reorganisatieprocedure. Dit betreft kosten aangaande: i) de waardering van de activa; ii) (directe) kosten; iii) snelheid; en iv) perverse prikkels.[30] De vraag is of er een alternatieve reorganisatiestructuur is, die zorgt voor een meer kosteneffectieve wijze van reorganiseren dan de administratieve reorganisatieprocedure.[31]

Er zijn verschillende voorstellen gedaan, die hebben betoogd dat er betere manieren zijn om te reorganiseren dan door middel van een administratieve reorganisatieprocedure.[32] Deze voorstellen elimineren inderdaad mogelijk een deel van de kosten die samenhangen met een administratieve reorganisatieprocedure. Het meest in het oog springend zijn in dat verband de kosten die samenhangen met het probleem van de waardering van de activa, terwijl deze niet daadwerkelijk worden verkocht. Echter, deze voorstellen kennen andere kosten, welke niet of in minder mate aanwezig zijn in een administratieve reorganisatieprocedure. Deze kosten zijn zodanig hoog dat zij verhinderen dat zulke alternatieve procedures als standaard voor reorganisaties worden gebruikt.[33]

Het is dan ook beter om specifieke onderdelen van de administratieve reorganisatieprocedure aan te passen dan de structuur van reorganisaties compleet te veranderen. Inspannin-

29 Zie: § 1.1 van Part B van Chapter 3.

30 Zie verder § 1.2 van Part B van Chapter 3.

31 Dit was ook de vraag die de American Bankruptcy Institute Commission tot herziening van Chapter 11 zich oorspronkelijk stelde: "*The charge of the commission is nothing less than the study of the need for comprehensive chapter 11 reform, by which we mean consideration of starting from scratch and re-inventing the statute.*" Zie: opening remarks ABI Commission to study the reform of Chapter 11 field hearing October 26, 2012 in San Diego, California. Beschikbaar via: http://commission.abi.org/sites/default/files/statements/26oct2012/OPENING_REMARKS_10_17_12_FIELD_HEARING_NYC_Handout.doc.

32 Zie § 2, 3 en 4 van Part B van Chapter 3 voor een discussie van deze alternatieven.

33 Opmerkelijk genoeg heeft zich in de praktijk een variatie op de Contingent en Chameleon Equity voorstellen, zoals onderzocht in Chapter 3, ontwikkeld als een manier voor banken om meer kapitaal te verkrijgen. Zie: http://www.ftadviser.com/2015/04/14/investments/jargon-busting-contingent-convertible-bonds-eIaHysaP6K6e9KSr5nj6zI/article.html.

gen in deze laatste richting kunnen al worden waargenomen in de praktijk. Dit betreft met name het Report van de ABI commissie inzake de herziening van Chapter 11.

4.2 Het recht betreffende reorganisaties: herziening nodig

In Nederland zijn er inspanningen gaande om faillissementsrecht betreffende reorganisaties te herzien. In het bijzonder betreft dit de introductie van een regeling voor een dwangakkoord buiten faillissement, zoals voorgesteld onder de Wet Continuïteit Ondernemingen II (WCO II). Deze inspanningen worden verder beïnvloed door de niet-bindende aanbeveling van de Europese Commissie van 12 maart 2014. Tegelijkertijd kunnen zulke inspanningen niet worden waargenomen in de context van het Nederlandse faillissementsakkoord.[34]

4.2.1 Het faillissementsakkoord: het binden van alle schuldeisers en verbeteren van de homologatiecriteria

Echter, er zijn een aantal aspecten van het recht betreffende het faillissementsakkoord die aanpassing behoeven om efficiëntie te waarborgen.

Allereerst betreft dit het vereiste van artikel 146 Fw dat een meerderheid van driekwart van de erkende en voorwaardelijk erkende concurrente schuldeisers voor aanname van het akkoord moet hebben gestemd om in aanmerking te komen voor een *cram down* door de rechter. Een dergelijk vereiste is inefficiënt, aangezien dit kan leiden tot een situatie waarin een waardemaximaliserend akkoord niet wordt gehomologeerd, enkel omdat meer dan een kwart van de schuldeisers hold-outgedrag vertoont in de hoop een premie boven de andere schuldeisers te ontvangen.[35]

Ten tweede zou het recht betreffende het faillissementsakkoord dienen te worden aangepast, om het zo mogelijk te maken schuldeisers met een recht van voorrang te binden aan een akkoord. Omdat dergelijke schuldeisers op dit moment niet zijn gebonden aan een faillissementsakkoord, kunnen zij de totstandkoming van een waardemaximaliserend akkoord frustreren. Door het mogelijk te maken schuldeisers met een recht van voorrang te binden aan een faillissementsakkoord, kan deze situatie worden voorkomen.[36]

Ten slotte geldt dat de homologatiecriteria van artikel 153 Fw op dit moment ontoereikend zijn. In het bijzonder waarborgen zij niet dat een voorgesteld faillissementsakkoord zorgt

34 Dergelijke inspanningen zullen wellicht wel gemaakt worden onder het voorstel voor de Wet Continuïteit Ondernemingen III.
35 § 4.1 van Chapter 6.
36 § 4.2 van Chapter 6.

voor waardemaximalisatie. Om die reden zou een expliciete 'waardemaximalisatie' test dienen te worden opgenomen in artikel 153 Fw.[37]

4.2.2 Het dwangakkoord buiten faillissement: introduceer de mogelijkheid van een collectief moratorium

Herziening aangaande akkoorden is op dit moment geconcentreerd in het voorstel voor de WCO II. Dit voorstel beoogt een wettelijke kader te introduceren dat het mogelijk maakt een dwangakkoord buiten faillissement te sluiten.

In beginsel is de mogelijkheid een akkoord vast te stellen als ware het aangenomen een goede zaak. Het maakt het mogelijk het probleem op te lossen van schuldeisers die hold-outgedrag vertonen in een poging om *nuisance value* te creëren. Dergelijke schuldeisers kunnen tegen hun wil worden gebonden aan een voorgesteld dwangakkoord.[38]

Het probleem met het voorstel voor de WCO II is dat het niet de mogelijkheid bevat om een collectief moratorium af te kondigen gedurende de periode nadat een dwangakkoord is aangeboden, maar voordat een finale beslissing is gemaakt aangaande de totstandkoming. Een dergelijke mogelijkheid was niet opgenomen, omdat het dwangakkoord tot stand komt buiten de context van een faillissementsprocedure en schuldeisers hun normale verhaalsmogelijkheden zouden moeten behouden. Echter, een dergelijke redenering onderkent onvoldoende dat schuldeisers 'opt-outgedrag' zullen vertonen in de periode nadat een dwangakkoord is voorgesteld, omdat zij mogelijk minder zullen ontvangen onder een dergelijk akkoord dan als zij individueel verhaal zoeken voordat het akkoord is gehomologeerd. Om waardemaximalisatie te waarborgen en dergelijk opt-outgedrag te voorkomen, zou de mogelijkheid van een collectief moratorium moeten worden opgenomen in het voorstel voor de WCO II.[39]

Tegelijkertijd geldt dat, terwijl sommige schuldeisers zullen moeten accepteren dat zij tegen hun wil in een deel van een vordering moeten opgeven, sommige schuldeisers wellicht nog steeds volledig betaald zullen worden. Dit betreft: i) schuldeisers met een vordering die haar oorsprong vindt in de periode nadat een akkoord is aangeboden; ii) leveranciers van essentiële goederen en diensten; iii) schuldeisers die niet worden betrokken onder een dwangakkoord. Betaling van deze schuldeisers is echter gerechtvaardigd, zolang als dit bijdraagt aan een waardemaximaliserende uitkomst.[40]

37 § 4.3 van Chapter 6.
38 § 2 en 3 van Chapter 7.
39 § 4 van Chapter 7.
40 Zie verdere § 5 van Chapter 7.

4.2.3 Dwangakkoorden: verdere maatregelen aangaande aandeelhouders noodzakelijk

Ten slotte geldt dat een belangrijk deel van de herziening betreffende reorganisaties een groep betreft voor wie traditioneel weinig aandacht is geweest in Nederlandse reorganisaties: de aandeelhouders.

Onder de bepalingen betreffende het faillissementsakkoord is het niet mogelijk om aandeelhouders tegen hun wil in aan een akkoord te binden en hen een deel van hun aandelenbelang af te laten staan door middel van een *debt-for-equity-swap*. Een dergelijke binding is wel mogelijk onder het voorstel voor de WCO II.[41]

Vanuit het oogpunt van efficiëntie is het goed dat er een mogelijkheid is om aandeelhouders te binden aan een faillissementsakkoord of dwangakkoord buiten faillissement en ze een deel van hun aandelenbelang te laten opgeven door middel van een debt-for-equity-swap. Anders zouden de schuldeisers de kosten van een reorganisatie dragen, terwijl de aandeelhouders onaangetast blijven. In dit opzicht zouden de bepalingen betreffende het faillissementsakkoord moeten worden gewijzigd.

Echter, hoewel de WCO II de mogelijkheid biedt om aandeelhouders aan een dwangakkoord te binden, gaat dit voorstel niet zo ver dat een *absolute priority rule* wordt geïntroduceerd.[42] Een dergelijke regel zou waarborgen dat aandeelhouders geen aandelenbelang zouden mogen behouden, tenzij – in afwezigheid van volledige instemming – schuldeisers hun volledige vordering voldaan krijgen of aandeelhouders een bijdrage leveren aan een akkoord. De aandeelhouders zouden, zoals ook buiten faillissement, alleen dienen te krijgen wat er over is om uit te delen nadat alle schulden zijn voldaan.[43] De huidige bepalingen betreffende het faillissementsakkoord en het voorstel voor de WCO II nemen dit onvoldoende in ogenschouw en zouden op dit punt moeten worden aangepast.

5 Overkoepelende conclusie

In de voorgaande paragrafen heb ik de conclusies uiteengezet die ik heb getrokken in de beantwoording van mijn centrale onderzoeksvraag. Het is op basis van deze conclusies duidelijk dat Nederlands faillissementsrecht niet voorziet in regels die een efficiënte uitkomst van faillissementen opleveren. Een veranderde wereld heeft geresulteerd in een

41 § 6.1 van Chapter 7.

42 Zie § 2 van Part A van Chapter 2 voor de analyse dat het recht betreffende faillissementsakkoorden geen absolute priority rule bevat.

43 § 6.2 van Chapter 7.

veranderde dynamiek, zoals ook aangetoond door de Lehman-faillissementen. Deze veranderde dynamiek heeft nog niet geleid tot voldoende aangepast faillissementsrecht betreffende activatransacties en reorganisaties. In dit opzicht biedt dit onderzoek een solide fundering voor een hoognodige verdere fundamentele discussie over faillissementsrecht.

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