EIGHTH WORLD CONGRESS

Academics’ Group Meeting

20 – 21 June 2009
Level 1, West Wing, Meeting Room 121
Vancouver Convention & Exhibition Centre

Sponsored by:

- Begbies Global Network
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President’s Welcome

I am delighted to welcome you all to INSOL International’s 11th Academics’ Group Meeting being held in conjunction with our 8th Quadrennial Congress.

The past 18 months have presented a number of challenges, even for some of the most developed insolvency systems. These issues and challenges need to be addressed in a thoughtful and considered manner and the Academic Community’s contribution will be vital in ensuring that knee jerk political responses are appropriately tempered.

In the corporate world the failure of former icons such as Lehman Bros, Chrysler and General Motors, all of whom operated on a global platform, have demonstrated the importance of continuing to develop our thinking on how to best manage international multi-entity groups while ensuring that the local societal expectations are honoured. These and other failures have also called into question whether or not the current approach to corporate governance is working, especially by those from emerging markets where they have been pressed by the global leaders to adopt a much more rigorous approach to corporate governance. The ‘do as I say not as I do’ is wearing thin!

Individuals, in record numbers, are seeking to relieve the pressure of having taken on to much debt either through some form of consumer plan of arrangement or bankruptcy. New approaches need to be developed, however I suggest that consideration also needs to be given as to the appropriate balance between responsibility for one’s actions and the opportunity for a ‘fresh start’.

The papers presented during the day and half will, I am sure, provide the opportunity for lively debate with the result of some new and fresh ideas for all of us to consider.

Thanks to the continuing leadership of Ian Fletcher in organizing this meeting and for all of the activities the INSOL Academics’ Group undertakes throughout the year.

Yours sincerely,

[Signature]

Robert O. Sanderson
President
INSOL International
Chairman's Welcome

It is with much pleasure that I welcome you to this, the Eleventh International Conference of the INSOL Academics' Group. Some of you, I know, were in attendance at the inaugural gathering of the Group in New Orleans, on 23 March 1997. From those auspicious beginnings, our meetings have gathered in strength and in quality, to become an annual event forming part of the ancillary programme of a regional or global congress of INSOL International. This symbiosis has proved to be mutually beneficial, as the general membership of INSOL and the academic members have opportunities to interact with each other, and form productive alliances. I encourage everyone to take full advantage of this opportunity once again as we gather in Vancouver for what promises to be a diverse and stimulating programme of presentations and discussions, including (at the time of writing) 16 papers to be delivered in the course of a day and a half. I look forward to the proceedings, and to the pleasure of greeting you in person during the course of our meeting.

Ian Fletcher
INSOL Academics’ Group Chair
INSOL International – Academics’ Group Meeting
Vancouver 20-21 June 2009
Vancouver Convention & Exhibition Centre
Level One, West Meeting Room 121

PROGRAMME

Saturday 20 June

8.30 a.m. – 9.00 a.m.  Welcome Coffee

9.00 a.m. – 9.15 a.m.   Opening and Chairman’s Welcome
                      Professor Ian Fletcher, UCL
                      Sumant Batra, Vice – President, INSOL International

9.15 a.m. – 5.30 p.m.   Working sessions – Day One
                        (interspersed by morning and afternoon refreshment
                        breaks and delegate lunch)

9.15 a.m. – 11.00 a.m.  Session 1: Insolvency Law Reform
                        - One Step Forward, Two Steps Back: A Response to the CAMAC
                          Report on Shareholders as Creditors in Australia: Jason Harris and Anil
                          Hargovan (University of Technology, Sydney; University of New South
                          Wales)

                        - An Extended Role for the Solvency and Liquidity Test as Protective
                          Measure for Company Creditors: Kathleen van der Linde (University of
                          Johannesburg)

                        - The Global Financial Crisis and Implications for Corporate Governance:
                          Janis Sarra (University of British Columbia)

11.00 a.m. – 11.15 a.m.  Coffee Break

11.15 a.m. – 12.45 p.m.  Session 2: Corporate Groups
                        - Corporate Groups: Coordination; Consolidation; and Comity: Irit
                          Mevorach (University of Nottingham)

                        - Cross-border Insolvency of Groups of Companies: Reinout Vriesendorp
                          and Jiri Verschure (Tilburg University)

12.45 p.m. – 2.00 p.m.  Lunch – West Meeting Room 122
2.00 p.m. – 3.45 p.m.  
**Session 3: Personal Bankruptcy Issues**
- *Swelling the Insolvent Estate*: Harry Rajak (University of Sussex)
- *Exemptions from the Insolvent Estate*: Donna McKenzie Skene (University of Aberdeen)
- *Alternatives to Bankruptcy: Assetless Estates and the New Zealand Model*: David Brown (University of Adelaide)

3.45 p.m. – 4.00 p.m.  
**Coffee Break**

4.00 p.m. – 5.15 p.m.  
**Session 3 (continued)**
- *Consumer Bankruptcy in Australia*: David Morrison (University of Queensland)

5.15 p.m. – 5.30 p.m.  
**Summing up and closure of Day One**

Evening  
**Free**

**Sunday 21 June**

8.00 a.m. – 8.30 a.m.  
**Welcome Coffee**

8.30 a.m. – 8.45 a.m.  
**Welcome back**  
Professor Ian Fletcher, UCL

8.45 a.m. – 12.50 p.m.  
**Working sessions – Day Two**

8.45 a.m. – 9.15 a.m.  
**Business meeting of the INSOL Academics’ Group, including report on the activity of the Academic Steering Committee.**

9.15 a.m. – 9.45 a.m.  
**Session 4: Global Principles of Insolvency Law**
9.45 a.m. – 11.15 a.m.  
**Session 5: “To rescue, or not to rescue?”**

- *To Rescue or Not to Rescue? Can the Question be Answered for Australia’s Voluntary Administration Scheme?:* David Morrison (University of Queensland) and Colin Anderson (Queensland University of Technology)

- *Empirical Study Comparing the Costs of US and Dutch Rescue Procedures:* Stephen Lubben (Seton Hall) and Oscar Couwenberg (University of Groningen)

- *Business Rescue: Myth or Miracle?:* Anneli Loubser (University of South Africa, Pretoria)

11.15 a.m. – 11.30 a.m.  
Coffee Break

11.30 a.m. – 12.45 p.m.  
**Session 5 (continued)**

- *Israel’s Bonds Crisis – Has Reorganisation Gone Bankrupt?:* David Hahn (Bar Ilan University, Israel)

- *The Transfer of Real Security Rights to the SPV during Traditional Securitisation in South African Law:* Natania Locke (University of South Africa, Pretoria)

12.45 p.m. – 12.50 p.m.  
Conclusion of conference

12.35 p.m. – 1.30 p.m.  
Lunch – West Meeting Room 122

7.00 pm – 10.00 pm  
**Welcome Cocktail Reception & Buffet Dinner**  
Sponsored by Deloitte  
West Ballroom C&D, Level 1, West Wing,  
Vancouver Convention & Exhibition Centre  
For academic delegates, congress delegates and registered accompanying persons

The Programme may be subject to change.
INSOL INTERNATIONAL
ACADEMICS’ MEETING 2009
QUESTIONNAIRE

It would be appreciated if you would complete this questionnaire and return it to the meeting provider.

DELEGATE DETAILS

Name:........................................................................................................................................................................

MEETING EVALUATION please indicate your views below:

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10. Having been on the course, and if the course was repeated, would you recommend it to anyone else?  Yes  No

11. Based upon your overall impression of the course provider, would you attend other courses provided by the same organisation? Yes  No

12. General Comments - Please give your comments below:

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Signature:.................................................................................................................................................. Date:..........................
INSOL International is a world-wide federation of national associations of accountants and lawyers who specialise in turnaround and insolvency. There are currently over 40 Member Associations with over 9,500 professionals participating as members of INSOL International. Full details of INSOL International member associations are listing in this brochure.

INSOL also has ancillary groups that represent the judiciary, regulators, lenders and academics. These groups play an invaluable role within INSOL and provide valuable forums for discussions of mutual problems.

INSOL was formed in 1982 and has grown in stature to become the leading insolvency association in the world. It is a valuable source of professional knowledge, which is being put to use around the world on diverse projects to the benefit of the business and financial communities.

INSOL’S Mission

INSOL with its Member Associations will take the leadership role in international turnaround, insolvency and related credit issues; facilitate the exchange of information and ideas; encourage greater international co-operation and communication amongst the insolvency profession, credit community and related constituencies.

Our Goals:

To work with and involve our Member Associations in our activities
To implement research into international and comparative turnaround and insolvency issues
To participate in Government, NGO and intergovernmental advisory groups and to liaise with these institutions on relevant issues
To assist in developing cross-border insolvency policies, international codes and best practice guidelines
To provide a leadership role in international educational matters relating to turnaround and insolvency topics
To facilitate the exchange of knowledge amongst our Member Associations through our conferences and publications

Through these goals INSOL International aims to assist its members with vital research, by developing internationally accepted legislation and guidelines, and providing through conferences, the web site and publications, a forum to exchange knowledge and learn from the experiences of other countries.
Member Associations

American Bankruptcy Institute (Professional Section)
Asociación Argentina de Estudios Sobre la Insolvencia
Association of Business Recovery Professionals – R3
Association of Hungarian Insolvency Lawyers
Association of Insolvency and Restructuring Advisors
Association of Insolvency Practitioners of Southern Africa
Business Recovery and Insolvency Practitioners Association of Nigeria
Business Recovery and Insolvency Practitioners Association of Sri Lanka
Canadian Association of Insolvency and Restructuring Professionals
Canadian Bar Association (Bankruptcy and Insolvency Section)
China University of Politics and Law, Bankruptcy Law and Restructuring Research Centre
Commercial Law League of America (Bankruptcy and Insolvency Section)
Consiglio Nazionale Dei Dottori Commercialisti and Esperti Contabili
Czech Chamber of Insolvency Practitioners
Especialistas de Concursos Mercantiles de Mexico
Ghana Association of Restructuring and Insolvency Advisors
Groupe de Réflexion sur l’insolvabilité et sa prévention 21
Hong Kong Institute of Certified Public Accountants (Insolvency Interest Group)
Hungarian Association of Insolvency Practitioners
INSOL New Zealand
INSOLAD - Vereniging Insolventierecht Advocaten
INSOL–Europe
INSOL–India
Insolvency Practitioners Association of Australia
Insolvency Practitioners Association of Singapore
Instituto Brasileiro de Gestão e Turnaround
Instituto Iberoamericano de Derecho Concursal
Institute of Certified Public Accountants of Singapore (Special Interest Group of Insolvency)
International Association of Insurance Receivers
International Women’s Insolvency and Restructuring Confederation
Japanese Federation of Insolvency Professionals
Law Council of Australia (Business Law Section)
Malaysian Institute of Certified Public Accountants
Nepalese Insolvency Practitioners Association
REFor – The Insolvency Practitioners Register of the National Council of Spanish Schools of Economics
Russian Union of Self-Regulated Organizations of Arbitration Managers
Self-regulated organisation of arbitration managers of the Chamber of Commerce and Industry of the Russian Federation
The Association of the Bar of the City of New York
Turnaround Management Association (INSOL Special Interest Group)
The Group of Thirty-Six features some of the most prominent and influential firms within the insolvency and turnaround profession. The aim of the Group of Thirty-Six is to work with INSOL to develop best practice guidelines and develop legislation to enhance the ability of practitioners globally to save businesses throughout the world.

Allen & Overy LLP  Huron Consulting Group LLC
Alvarez & Marsal LLC  Jones Day
Baker Tilly  Kaye Scholer LLP
Begbies Global Network  Kirkland & Ellis LLP
Bingham McCutchen LLP  KPMG LLP
Cadwalader, Wickersham & Taft LLP  Linklaters LLP
Chadboume & Parke LLP  Lovells LLP
Cleary Gottlieb Steen & Hamilton LLP  Norton Rose LLP
Davis Polk & Wardwell  Pepper Hamilton LLP
Deacons  PPB
De Brauw Blackstone Westbroek  PricewaterhouseCoopers
Deloitte LLP  RSM Corporate Advisory Services
Ernst & Young  Shearman & Sterling LLP
Ferrier Hodgson  Skadden, Arps, Slate, Meagher & Flom LLP
Freshfields Bruckhaus Deringer  Vantis
Goodmans LLP  Weil, Gotshal & Manges LLP
Grant Thornton  White & Case LLP
Greenberg Traurig LLP  Zolfo Cooper LLP
INSOL Board Directors

**Executive Committee Directors**

President - Robert O. Sanderson, KPMG
Vice-President - Sumant Batra, Kesar Dass B. & Associates
Executive Director - Claire Broughton, INSOL International
Treasurer – Johnson Kong, BDO Limited

**Directors**

Mark Aukema, RWV Advocaten
INSOLAD

Bruno Arboit, Baker Tilly
Hong Kong Institute of Certified Public Accountants

Stephen Darr, Mesirow Financial Consulting
Association of Insolvency and Restructuring Advisors

Claude Gilbert, PricewaterhouseCoopers
Canadian Association of Insolvency & Restructuring Professionals

Steven Golick, Osler, Hoskin & Harcourt LLP
American Bankruptcy Institute

Adam Harris, Bowman Gilfillan
Association of Insolvency Practitioners of Southern Africa

John Melluish, Ferrier Hodgson
Insolvency Practitioners Association of Australia

Maggie Mills, Ernst & Young*

David Perry, Buddle Findlay
INSOL New Zealand (Auckland)

Howard Seife, Chadbourne & Parke LLP*

James H.M. Sprayregen, Kirkland & Ellis LLP*

Gordon Stewart, Allen & Overy LLP
R3 – Association of Business Recovery Professionals

Michael Thierhoff, Thierhoff Illy & Partner
INSOL – Europe

*Nominated Directors*
Curriculum Vitaes
Curriculum Vitae

Colin Anderson
Queensland University of Technology
cj.anderson@qut.edu.au

Dr Colin Anderson is Associate Professor in the School of Law at the Queensland University of Technology at Brisbane, Australia. He teaches and researches in the area of Corporations and Insolvency Law and is editor of the Insolvency Law Journal. Colin has a strong research and teaching interest in the area of insolvency law generally and in particular the legal processes that provide company rescue procedures for insolvent entities. Colin has published several articles in his areas of interest. Colin is a member of the Institute of Chartered Accountants in Australia, the American Bankruptcy Institute as well as a Fellow of the Taxation Institute of Australia.

David Brown
University Of Adelaide
d.brown@adelaide.edu.au

David Brown, MA (Oxon), is an Associate Professor at the University of Adelaide where he teaches Corporations Law and Insolvency Law, and is a member of the Law Council of Australia’s Business Law Committee. He has recently moved after 12 years at Victoria University of Wellington, New Zealand, where he was a consultant to the New Zealand government on insolvency law reform, and a member of the Joint Insolvency Committee. David has written or contributed to several books, including Brown, Corporate Rescue (Wiley, 1996), the new Heath and Whale on Insolvency (LexisNexis NZ), Brokers Land Law in New Zealand, Brown and Telfer on Personal and Corporate Insolvency Legislation. He was also Policy and Operations Manager for the New Zealand Council of Legal Education. David is a Barrister and Solicitor in New Zealand and trained initially at the English Bar, practising with a leading London insolvency lawyers before turning to academia.

Hermie Coetzee
University of Pretoria
Hermie.coetzee@up.ac.za

Hermie Coetzee is an admitted attorney of the High Court of South Africa and a qualified debt counsellor accredited by the National Credit Regulator (NCR). She is a lecturer in the Department of Mercantile Law at the University of Pretoria and has completed research projects for the NCR in the following:

- The debt counselling process: Challenges to consumers and the credit industry in general.
- Employee financial wellness: A corporate social responsibility.
- The incidents of and undesirable practices relating to garnishee orders in South Africa.

She is a member of the Debt Counselling Association of South Africa (DCASA) and has lectured, presented papers and published in the field of debt relief.
Oscar Couwenberg
University of Groningen
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Oscar Couwenberg is professor of law and economics at the University of Groningen, Faculty of Law, Department of Law and Economics, the Netherlands. His research interests include firms in financial distress and bankruptcy, the efficiency of bankruptcy systems, and, in a more abstract perspective, the economic organization of firms and markets and the use of governance instruments in these forms. He has published in international journals on bankruptcy, financial distress, corporate architecture. He teaches law and economics, corporate law and economics and corporate finance.

Ian Fletcher
University College London
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Ian Fletcher is the Professor of International Commercial Law at University College London. Previously, he was Professor of Commercial Law at Queen Mary, University of London and Director of the Centre for Commercial Law Studies from 1994 -2000. A graduate of Cambridge University, he undertook postgraduate studies at Tulane University, U.S.A. He was called to the Bar by Lincoln’s Inn in 1971, of which he was elected a Bencher in 2003, and currently practices from 3/4 South Square, Gray’s Inn.

Professor Fletcher’s principal scholarly interests are in the fields of Bankruptcy and Insolvency Law, Commercial Law, European Community Law, Conflict of Laws and Comparative Law. He is the author of numerous books and articles including The Law of Insolvency (1990; 4th edition 2009); and Insolvency in Private International Law (1999, 2nd edition 2005). He is a member of the American Law Institute and of the Insolvency Lawyers’ Association, and is an International Fellow of the American College of Bankruptcy. He has been the Editor in Chief of the INSOL International Insolvency Review since 1992, and a Specialist Editor of Palmer’s Company Law since 1987. He is one of the joint authors and editors of The EC Regulation on Insolvency Proceedings, A Commentary and Annotated Guide (Oxford University Press, 2002, 2nd edition 2009).

David Hahn
Bar-Ilan University
hahnda@mail.biu.ac.il

A former J.S.D. graduate of New York University School of Law, David Hahn is a senior lecturer at the Law Faculty of Bar-Ilan University. He teaches Corporate Law and Insolvency Law.

Dr. Hahn recently concluded the writing of a comprehensive book (in Hebrew) on Insolvency Law. In the book, he calls for the reform of Israel's outdated laws on insolvency and their modernization in accord with the main themes of contemporary bankruptcy laws in the Western World. Dr. Hahn serves as a member of the audit committee in the liquidation case the Trade Bank in Israel.

**Jason Harris**  
University of Technology Sydney  
Jason.Harris@uts.edu.au

Jason Harris teaches and researches in the areas of Corporate Law, Securities Law and Corporate Insolvency Law, having joined the UTS Law Faculty in 2007. Jason has previously worked at UNSW, ANU, UWS, the Australian Government Solicitor, South West Sydney Legal Centre and for a major international legal publishing house. In 2006 Jason was a visiting scholar at the University of Western Ontario in Canada and in 2008 Jason was an adjunct professor at Widener University.

Jason is an active researcher in the Corporate Law, Securities Law and Corporate Insolvency fields and has published many articles, books and book chapters on these areas. Jason's research on these areas has been cited in the Supreme Courts of New South Wales, South Australia and Western Australia and his papers have been cited both in Australia and internationally. Jason is a regular presenter at professional and academic conferences and seminars on Corporate Law and Insolvency Law issues. Jason's research is focused on the regulation of corporate groups, corporate governance and directors' duties, securities class actions and voluntary administration.

**Natania Locke**  
University of South Africa  
locken@unisa.ac.za

Natania Locke BA (Law) *cum laude* (UJ), LLB *cum laude* (UJ), LLM *cum laude* (UJ), LLD (Unisa) is a senior lecturer in the Department of Mercantile Law at the University of South Africa. She teaches corporate law and her research is in the field of corporate finance law. She has published several articles in this field. She is a co-author of *South African Corporate Business Administration* and the co-author of the South African chapter on Corporations and Partnerships in R Blanpain (gen ed) *International Encyclopaedia of Laws*.

**Anneli Loubser**  
University of South Africa (UNISA)  
loubsa@unisa.ac.za

Completed BA (Law) and LLB degrees at the University of Pretoria and an LLM in Corporate Law at the University of South Africa (UNISA). Practised as Attorney, Notary and Conveyancer of the High Court of South Africa for several years. Associate professor in the Department of Mercantile Law at UNISA, teaching mostly postgraduate courses in corporate law. Member of the Litigation Committee of the Financial Services Board of South Africa; member of the subcommittee on business rescue of the 3rd King Committee on Corporate Governance; director (Education) of the Turnaround Management Association of Southern Africa.
Author of a chapter on South African corporate rescue in *Corporate Rescue An Overview of Recent Developments* by K G Broc and R Parry (eds) 2 ed (2006); four chapters of *Mars Law of Insolvency in South Africa* 9ed (2009); and chapters in *The Future of Consumer Credit Regulation* (2008) and *Companies and other Business Structures in South Africa* (2009). Published several articles in accredited journals and presented papers at international conferences.

Stephen Lubben  
Seton Hall University School of Law  
Stephen.Lubben@shu.edu

Stephen J. Lubben is the Daniel J. Moore Professor of Law at Seton Hall University School of Law. Professor Lubben joined Seton Hall after several years in practice with Skadden, Arps, Slate, Meagher & Flom in New York and Los Angeles, where he represented parties in chapter 11 cases throughout the country. He received his bachelor’s degree from the University of California, Irvine; his J.D., *magna cum laude*, from Boston University School of Law, where he was an editor of the Boston University Law Review; and his LL.M from Harvard Law School, where he was a teaching fellow. Following graduation from Boston University, he clerked for now Chief Justice John T. Broderick, Jr. of the New Hampshire Supreme Court.

Professor Lubben was the principal investigator under a $345,000 grant from the American Bankruptcy Institute that funded the 2007 ABI Chapter 11 Fee Study, the leading empirical study of professional fees in chapter 11 bankruptcy cases. His recent research has focused on professionals in chapter 11 and the effect of credit default swaps on chapter 11 reorganizations. He is a frequent speaker at distressed investing and corporate reorganization conferences throughout the world.

Donna McKenzie-Skene  
University of Aberdeen  
d.w.mckenzie@abdn.ac.uk

Donna is a senior lecturer in law at the University of Aberdeen and teaches and researches mainly in domestic and international insolvency law and related fields. She chaired the Scottish Executive’s Working Group on Debt Relief which reported in June 2005 and provided technical consultancy services for the Scottish Executive in relation to the bankruptcy aspects of the Bankruptcy and Diligence etc (Scotland) Act 2007. She was a member of the Insolvency Solicitors’ Committee of the Law Society of Scotland from 1995-2008 and currently sits on R3’s Scottish Technical Committee. She is a qualified solicitor and regular contributor to CPD events including Judicial Studies training events. Recent major publications include: *Corporate Insolvency (Re-issue)* in *The Laws of Scotland Stair Memorial Encyclopaedia* (2008) and *Consuming Passions: Benchmarking Consumer Insolvency Law Systems* (with Adrian Walters) in *Insolvency Law: Issues, Themes and Perspectives*, ed Omar (2008).
Dr. Irit Mevorach holds degrees in law from Tel-Aviv University (LLB with distinction, LLM) and UCL, London (PhD). Prior to joining the University of Nottingham in 2006, Irit practiced corporate and insolvency law in a law firm in Tel-Aviv. She is a barrister and a solicitor, member of the Israeli Bar Association. Her main interests are in corporate law (especially the law of corporate groups and international aspects of corporate law) and insolvency law, in particular European, comparative and international insolvency. In 2005, she has won the 2005 gold medal prize for research in international insolvency from the International Insolvency Institute. Irit is a member of INSOL Europe and of INSOL International Academic group. She has advised the European Bank for Reconstruction and Development. She is currently taking active part in the UNCITRAL work in the area of insolvency (since 2006 she has been an advisor to the UK government in UNCITRAL Working Group V's deliberation in the area of enterprise groups in insolvency), and she is an advisor to the International Insolvency Institute Committee on international jurisdiction and cooperation. She currently teaches corporate and business structures, principles of insolvency law, commercial conflict of laws (undergraduate modules) and international aspects of corporate and insolvency law (LLM module). Her book *Insolvency within Multinational Enterprise Groups* is to be published by OUP in May 2009.

Dr David Morrison is Senior Lecturer at the TC Beirne School of Law at The University of Queensland (Australia) and has teaching and research interests in personal and corporate insolvency law, financial literacy and revenue law, including most recently his appointment as Visiting Professor at the University of Illinois College of Law (Spring 2007). Previously a practicing accountant, solicitor and barrister, David now serves on the Law Council of Australia Business Law Section on Insolvency and on the CPA Centre of Excellence in Insolvency and is Section Editor Recent Developments for the Insolvency Law Journal. He holds current research grants including support of the Australian Research Council.

Harry Rajak is professor emeritus in the Sussex Law School; formerly the joint editor of Insolvency Law and Practice and a consultant at Lovells, solicitors, Harry Rajak was a member of the United Kingdom DTI/Treasury Review of Company Rescue and Business Reconstruction Mechanisms, and he has been a consultant and author on studies of the bankruptcy laws for the World Bank and of a number of foreign jurisdictions, including South Africa. He has written widely on Company Law, Corporate Insolvency and Commercial Law issues.
Janis Sarra  
University of British Columbia  
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Dr. Sarra is Professor of Law, University of British Columbia Faculty of Law, Vancouver British Columbia, and served as Associate Dean of the faculty from 2002 to 2007. She was founding Director of the National Centre for Business Law. In 2004, she was awarded title of Distinguished University Scholar for her work in corporate and securities law. Dr. Sarra was one of two INSOL Scholars for 2006-2007.

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Jiri Verschure is currently finishing his PhD on the topic of Insolvency of a Group of Companies within the European Union and is a lecturer in property law and insolvency law at Tilburg University. He graduated from Tilburg University in 2003 and became a lecturer there, before starting doing research in 2004. From march 2007 until may 2009 Jiri Verschure also worked parttime at the law firm NautaDutilh N.V., where he was a member of the Banking & Finance practice and the Corporate & Commercial Litigation practice respectively. He is member of the editorial board of the journal ‘Finance, Securities and Insolvency Law Practice’ (Tijdschrift Financiering, Zekerheden en Insolventierechtrecht).

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Reinout Vriesendorp is professor of Civil and Commercial Law at Tilburg University in the Netherlands since 1992. Before he was a lawyer (admitted to the Bar of the Supreme Court in The Hague, working in the The Hague and New York offices of the firm) in the law firm of (nowadays called) De Brauw Blackstone Westbroek (1985-1992) and associate teacher/researcher Roman Law at Groningen University (1982-1985), where he also graduated in Law and defended his Ph.D thesis on "Retention of title".

Reinout Vriesendorp teaches Property Law and (International) Insolvency Law and is currently one of the researchers of TISCO (Tilburg Institute for the Interdisciplinary Study of Contract Law and Conflict Systems)/Insolventure and fellow of the European Banking Centre of Tilburg University. In addition, he is member of the editorial board of the Dutch Insolvency Law Review (Tijdschrift voor Insolventierecht) since its inception in 1995 and member of the editorial board of International Insolvency Review and commentator in the well-known Dutch Student Law Review "Ars Aeque". He is one of the teachers and directors of the joint professional insolvency law course required for INSOLAD members. Vriesendorp is substitute-judge in the Court of Appeals in Amsterdam (insolvency chamber) and member of the Governmental Committee preparing a revised Insolvency Act for the Netherlands. He is academic member of INSOL International and INSOL Europe since 1997.
Session 1:
Insolvency Law Reform
AN EXTENDED ROLE FOR
SOLVENCY AND LIQUIDITY TO
PROTECT CREDITORS

Kathleen van der Linde
Solvency and liquidity

• Solvency
  – balance sheet
  – bankruptcy sense
  – factual

• Liquidity
  – cash flow
  – equity sense
  – commercial
Liquidity?

- all debts
- debts due
- debts as they become due
- debts as they become payable in the ordinary course of business

- Time period?
Company Law: financial restriction

- Distributions
  - alternative to capital maintenance
- Justification
  - Priority of creditors over shareholders
  - Representation of ability to pay

- Solvency satisfied by capital maintenance
- Preference shareholders?
- Liquidity?
Extension of solvency and liquidity test

- Mergers/amalgamations (SA, NZ, Can)
- Financial assistance for the acquisition of shares (SA, NZ)
- Financial assistance to directors, related persons (SA)
- Shareholder discounts (NZ) – distributions?
- Registration/removal from register (SA, NZ)
Insolvency Law: avoidance of transactions

• Role of insolvency differs
  – Prerequisite
  – Factor

• Role of inability to pay differs
  – Factor: ordinary course of business
  – Factor: intention to prefer
  – Prerequisite
Avoidance

• Distributions
  – Without value

• Financial assistance
  – Transfer, settlement, disposition, transaction, charge?

• Mergers/amalgamations
  – Transfer?
  – Value?

• Registration/removal
  – Administrative conduct only?
Manner of application

• Ex ante
  – Objective enquiry or subjective belief?
  – Prediction or actual position?
  – Positive or negative duty?
  – Formal or informal procedure?

• Ex post
  – Objective
  – Can be combined with subjective factors for purposes of liability
Context of application

- Authorization of transactions
- Enforceability of agreements
- Recovery from shareholders
- Liability of directors
- Avoidance in insolvency proceedings

- timing
Relative creditor protection (1)

- Distributions
  - Large degree of duplication between company law and insolvency law
  - Director liability additional
  - Shareholder recovery sometimes more limited in company law
Relative creditor protection (2)

- Other transactions
  - Less duplication with insolvency law
  - Invalidity – enrichment law
  - Director liability

- Non-arm’s length transactions
- Distinction companies and other debtors
An extended role for the solvency and liquidity test as protection measure for company creditors

Kathleen van der Linde

A solvency and liquidity test is often imposed as a financial restriction on distributions by a company to its shareholders. It has been adopted as a replacement for the capital maintenance approach in several leading company law jurisdictions. The practical difference between a solvency test and the capital maintenance test as a restriction on distributions is that the latter requires a margin over solvency which is equal to the share capital of the company. It stands to reason that satisfaction of the capital maintenance test will simultaneously amount to satisfaction of a simple solvency test in the bankruptcy sense. In contrast with the solvency element which is by necessary implication satisfied if a company makes distributions in accordance with the capital maintenance principle, satisfaction of the capital maintenance test does not indicate that the company is able to pay its debts as they become due in the ordinary course of business. This explains why some jurisdictions apply a liquidity or equity solvency test in addition to the capital maintenance principle.

Solvency in the sense of an excess of assets over liabilities is also referred to as solvency in the bankruptcy sense and is determined through a balance sheet test. It is distinguished from equity solvency or the ability to satisfy one's debts as they become due, which is the second element. The terms “equity insolvency test”, “equity solvency” and “equity test” are all used to refer to what is generally called the liquidity test in South Africa. The term “solvency test” is also sometimes used to refer to solvency in both meanings, ie an excess of assets over liabilities as well as the ability to pay debts as they arise.

The solvency and liquidity requirements have different theoretical justifications. The solvency element gives advance recognition to the ultimate priority that creditors enjoy over shareholders upon dissolution of the company. It prevents the company from favouring its shareholders through a partial liquidation.

The justification for a liquidity element is that it addresses the fundamental expectation of creditors to be paid on time and also fits in well with the representation a debtor is said to make when incurring a debt, namely that he reasonably expects to be able to pay as and when the debt becomes due. It would be unfair to allow a company which has made an implied representation of liquidity to subsequently compromise that liquidity by making distributions to shareholders.

There are different approaches to determining liquidity or the ability to service debt. One method entails a balance sheet test based on current assets and current liabilities, while another involves a cash flow analysis. A reference to debts “as they become due” or “as they become payable in the ordinary course of business” indicates that a cash flow prediction should be used. This takes into account not only current assets but also future income of and credit given to the company. On the liabilities side existing current liabilities as well as prospective liabilities are included. The choice between these two approaches may also have an impact on the valuation of contingent liabilities. The cash flow prediction approach is more commonly used, and is also followed South Africa, New Zealand, Canada and in the American Model Business Corporations Act.

However, a solvency and liquidity test can also serve to protect creditors in a range of other transactions that may adversely affect their interests, mainly transactions that are not at arm’s length. South Africa has extended the function of solvency and liquidity restrictions beyond the regulation of distributions. In addition to distributions to shareholders, the new South African Companies Act 2008 prescribes compliance with the solvency and liquidity test in the following instances:

- financial assistance in connection with the acquisition of a company’s securities,
- financial assistance to directors and related or inter-related companies,
• amalgamations and mergers

New Zealand employs its solvency test to distributions as well as
• shareholder discounts,
• financial assistance in the purchase of a company’s own shares,
• amalgamations,
• registration of overseas companies,
• removal from the companies register in case of a company transferring to another jurisdiction.

Under the Canada Business Corporations Act, distributions as well as mergers and amalgamations are subject to solvency and liquidity requirements. However, in the American Model Business Corporations Act such restrictions apply only to distributions.

Company law uses solvency and liquidity as a preventive or ex ante measure, coupled with corrective measures such as recovery from directors, shareholders and others in the event of non-compliance. Insolvency law also regards insolvency, and to a lesser extent illiquidity, as justification or part of the justification for the avoidance of transactions, ie on an ex post basis.

Distributions to shareholders would be impeachable in terms of avoidance provisions applicable to dispositions without value unless expressly excluded from their ambit. This overlap between company law and insolvency law measures pertaining to distributions is recognised, for example, in the Official Comment to the MBCA. The extent of overlap will depend on the particular company law and insolvency law provisions of each jurisdiction.

Under South African law, insolvency in the bankruptcy sense is a prerequisite for the setting aside of pre-liquidation transactions as dispositions without value or preferences to creditors. Illiquidity as such is not taken into account in order to determine whether a transaction can be set aside, although it may be relevant in determining whether a transfer was in the ordinary course of business or made with the intention to prefer.

In New Zealand, the inability to pay due debts (ie illiquidity) is a requirement for the setting aside of insolvent transactions and charges, and transactions at an undervalue. However, it is not required for the setting aside of certain transactions with and charges created in favour of directors, controllers and related persons. Insolvency in the bankruptcy sense does not appear to be relevant.

In Canada, a trustee wishing to avoid a settlement made more than one year but less than five years prior to bankruptcy has to prove that the debtor was at the time of making the settlement unable to pay all debts without the aid of the property that was the subject of the settlement. The Canadian insolvency legislation also provides for an inquiry into distributions to shareholders in the form of dividends, share repurchases and redemptions made within the year preceding bankruptcy. If it is found that the corporation was insolvent or became insolvent as a result of the distribution, directors and certain shareholders may be held liable.

Under the American Uniform Fraudulent Transfer Act, insolvency in either the bankruptcy or equity sense is a factor relevant to the setting aside of a transfer without reasonably equivalent value and a prerequisite for the setting aside of preferences.

While insolvency law can consider the solvency of a company with the benefit of hindsight, the company law applications have to rely on a prediction based on someone’s opinion. My paper describes differences in the manner of application of solvency and liquidity restrictions in relation to the authorization of transactions, enforceability of authorized transactions, recovery of unlawful payments, imposition of director liability and lastly, avoidance of transactions under insolvency legislation.

As regards distributions, company law usually provides additional creditor protection by allowing recovery from company directors. In other situations where company legislation prescribes solvency
and liquidity requirements, non-compliant transactions will not necessarily be voidable under insolvency law. On a practical level these extra instances may thus extend the level of protection afforded to creditors of insolvent companies considerably.

1 The company may experience cash-flow problems despite the fact that it has valuable fixed assets exceeding the value of its liabilities plus share capital.


3 See Manning and Hanks *Legal Capital: Being a Concise Practical Exposition with Illustrative Examples* (1990) 65.

4 See Manning and Hanks op cit 63.

5 See s 4 of the New Zealand Companies Act 1993.

6 See *Ex parte De Villiers NNO: In re Carbon Developments (Pty) Ltd (in liquidation)* 1993 (1) SA 493 (A) 504.

7 An example is found in s 500(b)(2) of the California General Corporation Law of 1977, also known as the California Corporations Code, ch 682 of the Statutes of 1975 where the ratio of current assets to current liabilities is relevant. However, a cash-flow test applies in addition, see s 501.


9 Section 46(1) of the South African Companies Act 2008. “Distribution” is defined in s 1.

10 This Act is expected to come into operation towards the middle of 2010.

11 Section 44(3) of the South African Companies Act 2008. The regulation extends to financial assistance in respect of the acquisition of shares of any related or inter-related company, s 44(2).

12 Section 45(3) of the South African Companies Act 2008. The regulation further extends to prescribed officers, members of related or inter-related close corporations and persons and entities related to such company, corporation, director, prescribed officer or member, s 45(2).

13 Section 113(1) of the South African Companies Act 2008.

14 Section 52 of the New Zealand Companies Act 1993.

15 Section 55 of the New Zealand Companies Act 1993. This provision deals with discount prices in respect of goods or services provided by the company under a discount scheme.

16 Section 76 of the New Zealand Companies Act 1993. The giving of assistance by a subsidiary in respect of the purchase of shares in its holding company is also covered.

17 Sections 221 and 222 of the New Zealand Companies Act 1993.

18 Section 347 of the New Zealand Companies Act 1993.

19 Section 354(2) of the New Zealand Companies Act 1993.

20 The different types of distributions are dealt with in separate provisions and the solvency and liquidity requirement is repeated in each of these provisions, see ss 34(2), 35(3), 36(2), 38(3), 42. See also ss 190 and 241(6) regarding payments under the minority buy-out and oppression remedies.

21 Section 185 of the Canada Business Corporations Act.

22 Section 6.40 of the MBCA.

23 See Official Comment to MBCA s 6.40, paragraph 3.

24 Sections 26, 29 and 30 of the South African Insolvency Act 1936.

25 Sections 292 and 293 of the New Zealand Companies Act 1993.

26 Section 297 of the New Zealand Companies Act 1993.

27 Sections 298 and 299 of the New Zealand Companies Act 1993.
28 Section 91(2) of the Canadian Bankruptcy and Insolvency Act.
29 Section 101 of the Canadian Bankruptcy and Insolvency Act.
30 This provision is in addition to s 118 of the Canada Business Corporations Act which also provides for director liability and recovery from shareholders in respect of unlawful distributions.
31 Drafted by the National Conference of Commissioners on Uniform State Laws.
32 Section 2 of the Uniform Fraudulent Transfer Act.
33 Section 4 of the Uniform Fraudulent Transfer Act.
34 Section 5 of the Uniform Fraudulent Transfer Act.
Session 3: Personal Bankruptcy Issues
Global Economic Meltdown: New Legislation and some Debt Relief Lessons for Over-indebted Consumers from South Africa

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It is perceived that the National Credit Act 34 of 2005, that became fully effective on 1 June 2007, was timely introduced and that it created some buffer for South African consumers against the worldwide economic meltdown. A number of countries have shown interest in this Act with the view to improve their own credit legislation and policies.

The Act introduced greater consumer protection by strict regulation of the credit industry that includes harsh consequences for non-compliant role players. The protection of consumers is addressed by measures introduced to prevent over-indebtedness and reckless credit extension and further to provide for remedial measures should a consumer find him- or herself in financial dire straits. Preventative measures include, but is not limited to, the regulation of costs, credit assessment prior to extending credit, and restrictions on the waiver of consumer rights in terms of the Act. The remedial measures, termed 'debt review' or 'debt counseling', serve as an alternative to insolvency and other debt relief measures.

This paper will focus on the advantages and disadvantages of the new debt review procedure as contemplated in terms of section 86 of the Act. Even though this procedure serves as a debt relief mechanism for those consumers who do not qualify for sequestration, various practical and procedural challenges are facing all role players. This paper further highlights shortcomings and unintended consequences relating to debt relief and recommends legislative amendments within the broader ambit of South African insolvency law.
Session 4: Global Principles of Insolvency Law
1. Where we are, and how we got here

In February 2006, the American Law Institute and the International Insolvency Institute (III or “Triple-I”) announced the inception of a joint dissemination and extension project with respect to the “Principles of Cooperation” developed in the ALI Transnational Insolvency Project. The stated objective of the two bodies was to establish acceptance of the ALI’s *Principles of Cooperation Among the NAFTA Countries (NAFTA Principles)*\(^1\) in jurisdictions across the world, subject to any necessary local modifications, and to obtain the endorsement of leading domestic associations, courts, and other groups in those jurisdictions. The intended timeframe for completion was set at within twenty-four to thirty months, thereby envisaging the production of a finalized text before the end of the year 2008.\(^2\) It was also anticipated that the Joint Reporters would carry out their task in collaboration with an International Advisory Group whose membership would be drawn primarily from the international membership of III. Given the specialized nature of the subject matter of the project, and also its international character, the technical expertise and professional stature of the III membership makes them ideally qualified for the task in hand, although it was expected that ALI members with an interest in the field of international bankruptcy would be drawn to participate, even if they do not happen to be members of III.\(^3\) In addition, an ALI Members’ Consultative Group was formed in accordance with the organization’s usual procedure for the conduct of projects.\(^4\) In a further extension of the circle of consultation, an invitation was extended to members of the INSOL International Academics’ Group to volunteer to become international consultants to the project, and a gratifying number of the Group duly responded.

The Joint Reporters initially drew up a provisional statement of objectives, with a view to launching an interactive discussion with the membership of the Advisory Group and thereafter refining and reshaping the objectives themselves. The aim was to design a systematic consultation exercise, drawing on the expert, first-hand knowledge of

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\(^2\) The Co-Reporters’ proposed timetable for the project was set out in an internal document circulated to members of the American Law Institute and the International Insolvency Institute participating in the project. The document, titled as *Manifesto of Aims and Objectives* is dated June 14 2006 and is unpublished.

\(^3\) The Co-Chairs of the International Advisory Group are Professor Jay L. Westbrook, the Reporter for the *NAFTA Principles Project* (see footnote 1), and E. Bruce Leonard, who was Chair and Reporter for Domestic Aspects of Canadian Law for the previous Project, and who is currently Chair of the International Insolvency Institute.

members of the Advisory Group, to determine the extent to which the NAFTA Principles and also the Guidelines are capable of being applied within a wide and representative range of legal systems around the world, and also the extent to which current practice in those countries may be said to conform to those standards. Conversely, to the extent that local circumstances give rise to any obstacles to the acceptance of such standards and practices, these should be identified, and consideration could then be given to possible means of resolving them.

Secondly, the Reporters perceived that the Global Principles Project could provide an appropriate vehicle for exploring further the possibilities for devising global standards to regulate the transnational insolvency process itself. A number of issues which have an important bearing upon the overall quality and efficiency of the international insolvency “process” were either not directly addressed in the context of the NAFTA Principles Project or were there dealt with on a somewhat tentative basis. These include the principles and procedures to be applied where insolvency occurs within multinational corporate groups (the subject of Procedural Principles 23 and 24 of the NAFTA Principles). In view of the complexity of this subject, and in the light of its subsequently becoming the subject of a fresh initiative by UNCITRAL, it was later decided not to incorporate the subject of corporate groups into the Global principles project. Further issues which are self-evidently in need of study and development are the conflict-of-laws aspects of insolvency, including choice-of-law rules and the principles relating to the exercise of jurisdiction, together with the elaboration of internationally tenable definitions of some of the fundamental concepts employed in the standardized principles. Also of direct relevance to the goal of promoting effective co-operation in international cases are some very practical questions, including how to overcome the inevitable problems where the respective courts are operating concurrently in different regions and time zones and have different working languages. In such situations, direct communication between courts may be impracticable, but it may be that some alternative means of achieving cooperation through one or more designated intermediaries could be established. Each of these objectives were retained within the overall plan of the Global Principles project.

The Reporters also considered that it would be useful to take stock of the considerable volume of work that had already been developed in this field in recent years. The number of projects and studies published since 1990 which either directly or indirectly relate to insolvency matters amount to a striking demonstration of the globalization of commercial activity in the present era, and the raised awareness internationally of the need to address insolvency-related issues which arise in a cross-border context. It was therefore decided to enlist the collective wisdom of the International Advisory Group to try to distill, and if

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5 The Objectives of the Global Principles Project, and the Proposed Method of Execution, were explained in the document, Manifesto of Aims and objectives, referred to in note 2.
6 UNCITRAL, at its meeting in July 2006, resolved to undertake a project dealing with the insolvency of groups of companies. The Co-Reporters thereupon concluded that it would involve a needless duplication of effort if this subject were retained as one of the main concerns of the Global Principles Project.
possible synthesize, the fruits of recent activity, and hopefully thereby provide a legislative tool which could be a point of reference in future.\textsuperscript{7}

A meeting with the inaugural members of the Advisory Group was convened at Columbia University School of Law on June 14, 2006, attended by judges, practitioners, and academics from more than ten countries.\textsuperscript{8} The meeting reviewed the Reporters’ provisional statement of objectives and discussed a number of associated themes which could potentially be included within the revised objectives. There was a consensus on the need to maximize the opportunities presented by the assembling of a globally drawn group of experts by examining, within the limits of reasonableness, certain related issues which those engaged in the \textit{NAFTA Principles} Project had not managed to resolve. For example, it was considered that some of the practical aspects of cross-border cooperation should be addressed, including, as already mentioned, the resolution of differences of working languages of the courts involved, and of the time zones in which the respective courts are located. There was also a consensus that the Project should try to address some of the more pressing issues in the area of private international law which to date have defeated the attempts of international organizations to devise clear and workable solutions.

\textbf{2. \textit{Festina lente!}}

As we embarked on the detailed implementation of our project manifesto, the logistical complexity of our task began to become apparent. Reliant as we were on the voluntary assistance of experts capable of distilling the current law and practice of their “local” system, we were completely dependent on finding enough such persons who were willing to devote the necessary time and effort to respond to our detailed inquiries about how the Global Principles might be received from the perspective of each jurisdiction which we hoped to interrogate. During 2007 and 2008 we circulated three questionnaires dealing with, respectively, (I) the acceptability of the ALI Statement of General Principles of Transnational Bankruptcy, and the accompanying Statement of Procedural Principles; (II) the acceptability and potential for application of the ALI Guidelines on Court-to-Court Communication; and (III) our proposals for a set of Draft Principles on Conflict of Law Matters. Although we attempted to specify deadlines for the submission of responses to each questionnaire, consultees – almost inevitably – found themselves confronted by the more urgent demands of their own work schedules. Consequently the rate of flow of returns was out of step with our initial time line, and we were obliged to make a series of revisions in order to ensure that the data on which we were eventually able to draw would be sufficiently representative of a wide spectrum of systems from around the world. This has resulted in our having to delay embarking on the task of writing our Draft Report. Our patience has been rewarded by the receipt of responses from consultees representing, between them, some 32 states across Europe, North and South America, India, South-East Asia, China, Japan, Australia, South Africa and the OHADA organisation.

\textsuperscript{7} With this task in mind, a \textit{Taxonomy of Guidelines and Principles in International Insolvency} was drawn up with the assistance of Dr. Paul Omar. This document (currently unpublished) provides a synoptic display of the principles formulated by eight different studies, arranged thematically.

\textsuperscript{8} See the brief report of the meeting published in the \textit{ALI Reporter, Summer 2006}, at p.4.
Admittedly there are some noticeable gaps in our coverage, especially in the case of the Middle East and much of Africa, and the sole representative of those parts of the world influenced by Islamic law is Malaysia. While we regret these omissions in our coverage – which are largely a reflection of the current patterns of active membership of the III and INSOL International respectively – the Joint Reporters believe that the data on which our conclusions will be based indicates that they can claim the support of a diverse range of legal systems and traditions, widely dispersed across the globe. The re-amended time line for completion of our Report in draft is October/November 2009, at which point it will be circulated for comment to all those who have so generously assisted us as consultees. When the feedback from that exercise has been digested, a revised text will be lodged with the ALI and III for further consideration.


In my previous reports to the INSOL Academics’ Group charting the progress of this project, I have described the evolving structure of our plan of treatment, as we gathered information and feedback from our successive questionnaires, and from the annual meetings with members of the consultative groups convened under the joint auspices of the ALI and III. In the latest iteration of our plan, four principal sections are envisaged:

I. Introduction and overview

II. Definitions

III. Global Principles for Cooperation in International Insolvency Cases (a reappraisal of Principles of Cooperation among NAFTA countries, for global application)

IV. Principles on Courts (a reappraisal of the Guidelines Applicable to Court-to-Court Communications in Cross-Border Cases)

Appendix

Draft Uniform Rules on Conflict of Laws

4. Conversation piece: the proposed Uniform Rules on Conflict of Laws

In previous progress reports, I have tried to show our line of approach to the formulation of some conflict of laws rules which, if given general acceptance, might add a much-needed element of stability to the conduct of debtor-creditor relations in a cross-border

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context. This was always destined to be a controversial aspect of our project, and our current thinking is that it would be preferable to locate our proposals in an Appendix to our Report rather than to place them within the body of the Report itself. In that way, they may contribute to the ongoing debate about future initiatives which might be pursued at international level, without impairing the thrust of our main proposals for the conduct of cases by the adoption of practical approaches to cooperation between courts and office holders following a common framework of principles. In the interests of sustaining the hitherto fruitful debates which have ensued from my previous exposures of the work-in-progress, I append the current (but not necessarily definitive) set of Draft Uniform Rules, with a renewed invitation to all those in attendance at the Vancouver meeting to communicate any comments – critical or otherwise – that they may wish to make – orally or in writing.

Uniform Rules of Choice of Law [Not to be cited without permission]

The General Rule

Rule U.R.1. Save as otherwise provided in [this Act/these Rules] the law applicable to insolvency proceedings and their effects shall be that of the State within the territory of which such proceedings are opened, hereafter referred to as “the State of the opening of proceedings”. In particular, that law shall determine the rules relating to the voidness, voidability or unenforceability of legal acts detrimental to the general body of creditors.

Rule U.R.2. The law of the State of the opening of proceedings shall determine the conditions for the opening of those proceedings, their conduct and their closure.

Rule U.R.3. If insolvency proceedings are opened in a jurisdiction other than that where the centre of main interests of the debtor is situated (“non-main” proceedings), the effects of the application of the law of the State of the opening of such proceedings shall be restricted to those assets of the debtor situated in the territory of that State at the time of the opening of those proceedings. (This Rule is subject to Rule U.R.4).

Rule U.R.4. In relation to any asset of the debtor which is of a moveable character, Rules U.R.1 and U.R.3 shall apply subject to the following modifications:

(a) Any rule of insolvency law which is applicable by virtue of the situation of an asset in the territory of the State of the opening of insolvency proceedings at the time of the opening of the proceedings shall not apply if it is shown that the asset in question has been moved to that location from the territory of another State, to whose insolvency law it would otherwise have been properly subject, in
circumstances which suggest that the transfer was effected wholly or primarily for the purpose of avoiding the effects of the law of the other State, including its insolvency law.

(b) Conversely, where an asset has been moved from the territory of one State to that of another State under the circumstances stated in paragraph (a), the effects of any insolvency proceedings which are opened in the former State shall apply to the asset in question.

(c) In the absence of evidence to the contrary, it shall be presumed that any asset which has been removed from the territory of the State in which insolvency proceedings are opened within [30]/[60]/[90] days prior to the opening of such proceedings was made with intent to avoid the effects of the law of that State. It is for the party who seeks to maintain the validity of the act whereby the property was removed from the territory of that State to provide evidence that the transfer was made for a bona fide and legitimate purpose.

(d) Except in a case to which paragraph (c) is applicable, it is for the party who alleges that the provisions of paragraphs (a) and (b) of this Rule are applicable in relation to a particular asset to prove that this is the case.

Exceptions to the General Rule

Third parties' rights in rem

Rule U.R.5. Insolvency proceedings shall not affect the rights in rem of creditors or third parties in respect of tangible or intangible, moveable or immovable assets - both specific assets and collections of indefinite assets as a whole which change from time to time - belonging to the debtor which are situated within the territory of another State at the time of the opening of proceedings. (This Rule is subject to Rules U.R.8 and U.R.9).

Rule U.R.6. The rights referred to in Rule U.R.5 shall in particular mean:

(a) the right to dispose of assets or have them disposed of and to obtain satisfaction from the proceeds of or income from those assets, in particular by virtue of a lien or a mortgage;

(b) the exclusive right to have a claim met, in particular a right guaranteed by a lien in respect of the claim or by assignment of the claim by way of a guarantee;
(c) the right to demand the assets from, and/or to require restitution by, anyone having possession or use of them contrary to the wishes of the party so entitled;

(d) a right in rem to the beneficial use of assets.

Rule U.R.7. The right, recorded in a public register and enforceable against third parties, under which a right in rem within the meaning of Rule U.R.5 may be obtained, shall be considered a right in rem.


Rule U.R.9. By way of exception to Rule U.R.5, a right in rem (“in rem security right”) shall not be exempted from the effects of insolvency proceedings if proof is provided that the State where the assets are situated at the time of the opening of insolvency proceedings has no substantial relationship to the parties or the transaction in relation to which the security right was created and there is no other reasonable basis for the fact that the assets are so situated. It is for the party who claims that the conditions specified in this Rule are met in relation to a particular security right to prove that those conditions are in fact met in the relevant case.

Set-off

Rule U.R.10. Subject to Rules U.R. 11 and U.R.12, insolvency proceedings shall not affect the right of creditors to demand the set-off of their claims against the claims of the debtor, where such a set-off is permitted by the law applicable to the insolvent debtor’s claim.

Rule U.R.11. Where a right of set-off is demanded on the basis of Rule U.R.10, if it is the case that, in the absence of express choice made by the parties, the law applicable to the insolvent debtor’s claim would be that of the State of the opening of insolvency proceedings, Rule U.R.10 shall not apply if the law of the State chosen by the parties has no substantial relationship to the parties or the transaction and there is no other reasonable basis for the parties’ choice.


Reciprocal Contracts: General Rule
Rule U.R.13. Save as otherwise provided by [this Act/these Rules], mutual obligations in respect of a reciprocal contract, which has been concluded prior to insolvency of one of the parties, shall be governed solely by the law of the State of the opening of proceedings.

Contracts of employment (labour contracts)

Rule U.R.14. The effects of insolvency proceedings on employment contracts and relationships shall be governed solely by the law of the State applicable to the contract of employment.


Defences to the avoidance of detrimental acts

Rule U.R.16. Subject to Rule U.R.17, Rules U.R.1, last sentence, U.R.8, U.R.12, and U.R.15 shall not apply where the person who benefited from an act detrimental to the general body of creditors provides evidence that:

(i) the said act is subject to the law of a State other than that of the State of the opening of proceedings; and

(ii) that law does not allow any means of challenging that act in the relevant case.

Rule U.R.17. By way of exception to Rule U.R.16, a transaction detrimental to the general body of creditors shall not be exempted from the effect of the avoidance rule of the law of the State of the opening of insolvency proceedings if proof is provided that the State to whose law the transaction is subject has no substantial relationship to the parties or the transaction and there is no other reasonable basis for the selection of the law of that State as the law to govern the transaction in question. It is for the party who claims that the conditions specified in this Rule are met in relation to a particular transaction to prove that those conditions are in fact met in the relevant case.

Exclusion of renvoi

Rule U.R.18. In these Uniform Rules, any reference to the law of a State means the internal (“domestic”) rules of law in force in that State other than its rules of private international law.

*****

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Session 5:
“To rescue, or not to rescue”
The Costs of Chapter 11 in Context: American and Dutch Business Bankruptcy

Oscar Couwenberg
Stephen J. Lubben
Dutch system

• Characteristics:
  – Auctioning system with a rudimentary reorganization provision
  – A short automatic stay (2 months)
  – Trustee replaces management
  – Continuation in bankruptcy is possible
  – Outcome of a bankruptcy procedure is normally a (private) sale of assets
  – Reorganization occurs via a going concern asset sale
The Dutch vs the US system

- Three main differences with US system:
  - management loses control to a trustee
  - a two month automatic stay only
  - composition works only on ordinary creditors

- Dutch rules are creditor-oriented, or harsh
Dutch data

• 172 bankrupt companies
  – Three districts (incl. Amsterdam)
  – Years 1983-2004
  – 43 liquidation cases
  – Leaves (net) 112 cases involving firms continuing operations via sale of assets
Dutch data adjustment

- Inflation per year
- GDP growth per year
- Conversion to € in 2004
- Conversion to $ in 2004

These data provides the basis for matching
US Data

- 99 Chapter 11 cases filed in 2004
- "Big case" dataset from ABI Chapter 11

Fee Study

- Cases constitute the 2004 chapter 11 cases from www.bankruptcycdata.com
Joining the samples

• Use propensity score matching
  – nearest-neighbor matching, with no replacement
• Results in a sample of 88 cases, evenly split between jurisdictions
## The sample

### Statistics of Matched Sample

<table>
<thead>
<tr>
<th></th>
<th>Total Assets (USD)</th>
<th>Total Debts (USD)</th>
<th>Assets/Debts</th>
<th>Unsecured/Total Debt</th>
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<tbody>
<tr>
<td>Mean</td>
<td>$69,500,000.00</td>
<td>$140,000,000.00</td>
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<td>se(mean)</td>
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<tr>
<td>Median</td>
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<td>std. dev.</td>
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<td>skewness</td>
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<td>6.05</td>
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<tr>
<td>N</td>
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<td>44</td>
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</table>

<table>
<thead>
<tr>
<th></th>
<th>Total Assets (USD)</th>
<th>Total Debts (USD)</th>
<th>Assets/Debts</th>
<th>Unsecured/Total Debt</th>
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<tr>
<td>Mean</td>
<td>$88,300,000.00</td>
<td>$133,000,000.00</td>
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<td>se(mean)</td>
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<td>$181,000,000.00</td>
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<td>0.31</td>
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<td>skewness</td>
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<td>1.73</td>
<td>1.74</td>
<td>-0.06</td>
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<table>
<thead>
<tr>
<th></th>
<th>Total Assets (USD)</th>
<th>Total Debts (USD)</th>
<th>Assets/Debts</th>
<th>Unsecured/Total Debt</th>
</tr>
</thead>
<tbody>
<tr>
<td>Mean</td>
<td>$78,900,000.00</td>
<td>$136,000,000.00</td>
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<td>se(mean)</td>
<td>$17,100,000.00</td>
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<td>std. dev.</td>
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<td>$376,000,000.00</td>
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<td>0.27</td>
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<tr>
<td>skewness</td>
<td>4.23</td>
<td>7.24</td>
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<td>N</td>
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Case size

Figure 3: Assets and Debt (log transformed)
### Preliminary results

<table>
<thead>
<tr>
<th></th>
<th>Direct Costs</th>
<th>Direct Costs (std. by size)</th>
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<tr>
<td><strong>Netherlands</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Mean</td>
<td>$2,017,258.00</td>
<td>0.031</td>
</tr>
<tr>
<td>se(mean)</td>
<td>$655,453.90</td>
<td>0.004</td>
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<tr>
<td>Median</td>
<td>$416,319.60</td>
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<tr>
<td>Sd</td>
<td>$4,347,789.00</td>
<td>0.029</td>
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<tr>
<td>Skewness</td>
<td>3.31</td>
<td>1.463</td>
</tr>
<tr>
<td>N</td>
<td>44</td>
<td>44</td>
</tr>
<tr>
<td><strong>United States</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Mean</td>
<td>$7,923,381.00</td>
<td>0.118</td>
</tr>
<tr>
<td>se(mean)</td>
<td>$1,691,663.00</td>
<td>0.014</td>
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<tr>
<td>Median</td>
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<td>Sd</td>
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<td>Skewness</td>
<td>1.99</td>
<td>0.982</td>
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<td>N</td>
<td>43</td>
<td>43</td>
</tr>
<tr>
<td><strong>All cases</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Mean</td>
<td>$4,936,376.00</td>
<td>0.074</td>
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<td>se(mean)</td>
<td>$949,098.90</td>
<td>0.009</td>
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<tr>
<td>Median</td>
<td>$906,245.20</td>
<td>0.038</td>
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<td>Sd</td>
<td>$8,852,605.00</td>
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<td>Skewness</td>
<td>2.76</td>
<td>1.701</td>
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<tr>
<td>N</td>
<td>87</td>
<td>87</td>
</tr>
</tbody>
</table>
But . . . (law matters)

- Jurisdictions measure cost differently
  - Netherlands costs include
    - Trustee’s lawyers work on the case
    - Accountants or appraisers
  - US costs include
    - All significant debtor professionals
      - Whether bankruptcy related or not
      - Accountants, investment bankers, “local” counsel
    - All committee professionals
### Adjusted costs

**Table 6: Total Direct Costs & Cost by Debtor Size (Alternative Measures)**

<table>
<thead>
<tr>
<th></th>
<th>Alternative Direct Costs</th>
<th>Alt. Direct Costs (std. by size)</th>
</tr>
</thead>
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<tr>
<td></td>
<td>Mean</td>
<td>se(mean)</td>
</tr>
<tr>
<td>Netherlands</td>
<td>$2,017,258.00</td>
<td>$655,453.90</td>
</tr>
<tr>
<td></td>
<td>0.031</td>
<td>0.004</td>
</tr>
<tr>
<td></td>
<td>Sd</td>
<td>$4,347,789.00</td>
</tr>
<tr>
<td></td>
<td>skewness</td>
<td>3.31</td>
</tr>
<tr>
<td></td>
<td>N</td>
<td>44</td>
</tr>
<tr>
<td>United States</td>
<td>$2,056,104.00</td>
<td>$432,440.70</td>
</tr>
<tr>
<td></td>
<td>0.043</td>
<td>0.007</td>
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<td></td>
<td>Sd</td>
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<td>skewness</td>
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<td>Total</td>
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<tr>
<td></td>
<td>Sd</td>
<td>$3,654,000.00</td>
</tr>
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<td></td>
<td>skewness</td>
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<tr>
<td></td>
<td>N</td>
<td>86</td>
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</table>

*US cases only including only debtor and committee counsel*
## The model

### Table 8: Regression models of professional costs

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<tr>
<th></th>
<th>Model 1</th>
<th></th>
<th>Model 2</th>
<th></th>
<th>Model 3</th>
<th></th>
<th>Model 4</th>
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<th>Model 5</th>
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</thead>
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<tr>
<td></td>
<td>B</td>
<td>SE</td>
<td>p-value</td>
<td>B</td>
<td>SE</td>
<td>p-value</td>
<td>B</td>
<td>SE</td>
<td>p-value</td>
<td>B</td>
</tr>
<tr>
<td>Debtor size (log of</td>
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<td>0.078</td>
<td>0</td>
<td>0.723</td>
<td>0.074</td>
<td>0</td>
<td>0.81</td>
<td>0.078</td>
<td>0</td>
<td>0.811</td>
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<td>average of debts and</td>
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<td></td>
<td></td>
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<td></td>
<td></td>
<td></td>
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<tr>
<td>assets)</td>
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<tr>
<td>Solvency (assets over</td>
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<td>0.006</td>
<td>-0.586</td>
<td>0.195</td>
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<td>Secured debt over</td>
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<td>-1.683</td>
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<td>0.022</td>
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</tr>
<tr>
<td>Ordinary debt over</td>
<td>-0.413</td>
<td>0.755</td>
<td>0.587</td>
<td>-0.846</td>
<td>0.783</td>
<td>0.284</td>
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<td>Payout to ordinary</td>
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<td>creditors, if Dutch</td>
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<td>Case jurisdiction</td>
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<td>(0=Netherlands;</td>
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<td>1=US)</td>
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<tr>
<td>(Constant)</td>
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<td>R-Square</td>
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<td>0.612</td>
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<td>0.009</td>
<td>0.654</td>
<td>0.7226</td>
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<tr>
<td>Dependent: Log of</td>
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<td>total fees and</td>
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</table>
Conclusions

• Legal systems differ but their economic outcomes differ less
• Paper focuses on bankruptcy costs in both jurisdictions
  – Cost difference is large, 9%
  – Difference due to specific legal set up in the US
  – Eliminating this effect shows that
  – Costs are then explained by size, solvency, secured debt ratio
• Costs are driven by the same firm variables
• Any comparative study requires detailed study of the specific systems
The Costs of Chapter 11 in Context: American and Dutch Business Bankruptcy

Oscar Couwenberg
Professor of Law and Economics, University of Groningen Faculty of Law

and

Stephen J. Lubben
Daniel J. Moore Professor of Law, Seton Hall University School of Law

First Draft

(please do not circulate or quote without our consent)
THE COSTS OF CHAPTER 11 IN CONTEXT: AMERICAN AND DUTCH BUSINESS BANKRUPTCY

Oscar Couwenberg*

&

Stephen J. Lubben**

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After Britain, the Netherlands is arguably the European nation with the greatest overall influence on the history of the United States. The annually celebrated Pilgrims came to the shores of Massachusetts in 1621 from Amsterdam and Leiden.¹ America’s financial capital began

* Professor of Law and Economics, Department Law & Economics, University of Groningen Faculty of Law. We are grateful for the valuable research assistance of Sonja K. Tomas in constructing part of the Dutch dataset in used in this paper.
** Daniel J. Moore Professor of Law, Seton Hall University School of Law. The American data used in this paper was gathered by Professor Lubben as part of the ABI Chapter 11 Professional Fee Study, which was funded by a grant from the American Bankruptcy Institute, the ABI Endowment Fund, and the National Conference of Bankruptcy Judges. We are grateful for the ABI and NCBJ’s assistance with this important project. All conclusions are our own and do not necessarily reflect the views of the ABI or the NCBJ or their members.
its existence as the port city in a Dutch colony in the New World.² That heritage gave the United States two of its most celebrated Presidents of the Twentieth Century – Theodore and Franklin Roosevelt.³

Nonetheless, and even given these historical ties and a generally similar economic development during the industrial revolution, the two countries have rather distinct legal systems. The Dutch legal system is based on the French Code Civil with influences from Roman law and Dutch customary law and, more recently, German civil law.⁴ The United States, as is well known, has a common law legal system originally derived from England.⁵

This split between the similar social and economic history of the two countries, on the one hand, and the legal systems used presents an opportunity to examine the comparative cost of the legal systems. In particular, this paper examines the costs of business bankruptcy in the United States and the Netherlands.

Since its enactment in 1978, chapter 11 has been frequently criticized for its cost, which is said to have ex ante effects on the cost

² EDWIN G. BURROWS & MIKE WALLACE, GOTHAM: A HISTORY OF NEW YORK CITY TO 1898 (1999).
⁴ See Erhard Blankenburg, Patterns of Legal Culture: The Netherlands Compared to Neighboring Germany, 46 AM. J. COMP. L. 1 (1998).
of debt. In an absolute sense there is no doubt that very large chapter 11 cases incur professional fees at a very high level. But examining the cost of chapter 11 in this manner suffers from two errors: it assumes that financial distress would be resolved in a costless manner outside of chapter 11 and ignores the reality that large corporations pay large professional fees whenever they engage in fundamental corporate transactions.

To be meaningful, examinations of the costs of chapter 11 must contextualize those costs: chapter 11 is expensive relative to what? One common way of contextualizing chapter 11 costs is to compare these costs to the costs of other, significant corporate transactions like mergers, tender offers, and initial public offerings. This approach suffers from the lack of cost transparency in these other transactions; corporations reveal the costs incurred only with a good deal of opacity.

In this paper we adopt a new approach to the issue and contextualize the cost of chapter 11 by comparison to the costs of business bankruptcy in the Netherlands. Using unique datasets that each author has developed in connection with other projects, we match a group of comparable cases from each jurisdiction. The results not only contextualize chapter 11 by reference to a comparable international economy, but also provide important comparative insights.

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6 For a good summary of this issue, see STEPHEN A. ROSS ET AL., CORPORATE FINANCE 456-57 (2007).
We submit that the results of this paper highlight the importance of a deep understanding of legal rules and systems when comparing corporate financial structures across jurisdictions. Initially our results indicate that the American system is much more expensive than its Dutch counterpart. But the United States bankruptcy system involves a wider array of professionals and under the Bankruptcy Code many professional fees are counted whether or not the professional’s services were related to the bankruptcy process. In prior work, Lubben estimated that as much as sixty percent of the legal costs may be exogenous to chapter 11.8

Once these differences are accounted for, the costs of the two systems are essentially indistinguishable.

This strongly suggests that the key question is not whether or not chapter 11 is expensive relative to some alternative system -- part of the putative extra cost of chapter 11 comes from comparing incomparable ways of measuring professional costs. And the rest comes from the extra “professionalization” of the American process: larger chapter 11 cases routinely involve multiple professionals, each working on a specialized aspect of the case or representing a unique constituency. Whether or not chapter 11 is “too expense” largely turns on whether or not this unique aspect of chapter 11 – like the extensive involvement of investment bankers and other financial advisers – produces benefits in excess of cost.

The point is subtle but very important: comparing bankruptcy systems at a high level of abstraction certainly makes the comparison

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easier, but it will also tend to overstate differences and ignore systemic differences that complicate the implicit judgments that are made by such shallow comparisons.

The paper begins with an overview of the business bankruptcy system used to “save” firms in the Netherlands. The next part of the paper describes the propensity score matching technique that we used to create a comparable group of cases from the United States and the Netherlands. In the third part of the paper we examine the relative costs of the Dutch and American business bankruptcy system through comparison of these matched cases.

We initially find that “law matters.” In particular, because the two jurisdictions consider the cost of corporate reorganization in different ways – chapter 11 includes almost all professional costs incurred during the case to be chapter 11 costs, whereas the Netherlands considers a narrower range of professionals – the difference in jurisdictions is initially the most important factor in explaining the cost of reorganization. We then account for these legal distinctions, and find that economic factors like the size of the debtor, the solvency of the debtor, and the degree to which the firm’s debts are secured explain most of the cost of corporate bankruptcy – irrespective of jurisdiction. Consistent with other recent research in this area, we also find that there is a scale effect to corporate bankruptcy – all else being equal, a very large case will cost somewhat less than would be suggested if there were a simple one to one relationship between size and cost.

In the final part of the paper we examine the implications of these findings for future research. We argue that much of the existing
chapter 11 literature has suffered from either an excessive degree of abstraction (primarily the finance literature) or an excessive degree of insularity (primarily the legal literature). We ultimately conclude that, as with most things, corporate bankruptcy scholarship would benefit from more crosspollination and more interdisciplinary and international engagement. This paper is just the beginning.
I. An Overview of Dutch Business Bankruptcy

American chapter 11 is often said to inspire business bankruptcy systems – especially reorganization systems – throughout the world. Despite this claim, chapter 11 remains somewhat unique. Unlike most jurisdictions, there is no insolvency requirement for firms seeking protection in chapter 11. And the American debtor typically remains “in possession” of its estate, without supervision by a trustee or other administrator.⁹

Business bankruptcy in the Netherlands differs from this model. It is built on the idea of creditor protection. Although recent changes have somewhat modified this strong creditor oriented position,¹⁰ the bankruptcy law remains geared to creditors. In the description below we focus on the Act as it was operative for the companies in the sample. We thus do not incorporate these recent changes into this discussion.

The Dutch bankruptcy law system is to be characterized as an auction system, with a rudimentary reorganization provision. This Dutch system provides two procedures: suspension of payment and bankruptcy.

A. Suspension of payment

The suspension of payments procedure is aimed at firms experiencing financial distress, but with good enough prospects to

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¹⁰ Main changes are a lengthening of the automatic stay from 2 to 4 months maximum and bringing preferred charges under the umbrella of the agreement rules in the Act.
recover economic health in short time.\textsuperscript{11} The suspension procedure applies only to ordinary creditors. It suspends all debt collection procedures by ordinary creditors. Secured and preferred creditors are not bound by the procedure. Any write-down on the secured and preferred claims by these creditors is voluntarily. Within the suspension procedure, the firm has to offer its ordinary creditors an agreement. The agreement rules do not apply to secured creditors and those holding preferred claims. If the creditors accept the terms of the agreement, then the procedure ends. A firm that has failed in the agreement procedure in suspension of payments cannot again opt for the identical agreement procedure in bankruptcy. Most firms enter bankruptcy via the suspension procedure as company directors can initiate a suspension procedure but not a bankruptcy procedure – only shareholders can put the firm directly into bankruptcy, but firms often do not have enough time to convene a shareholder meeting.

B. Bankruptcy

If the suspension of payment procedure is not used, then the only alternative is the bankruptcy procedure. A firm -- through its shareholders -- or its creditors may petition for bankruptcy. As in American chapter 7 cases, an independent trustee, appointed by the court, replaces the incumbent management team. This trustee has a fiduciary responsibility to all creditors, and may be allowed to continue operating the debtor.

Since 1992, firms filing bankruptcy have been sheltered from creditors by an automatic stay provision of at most two months. The

firm can obtain debtor-in-possession financing with super-priority. However, the trustee may only offer unencumbered assets as security. The trustee organizes a sale of all the assets, either piecemeal or as a going concern. This sale may take the form of a private sale of assets or a public auction. In practice, most going concern asset sales take the form of a private sale, while piecemeal liquidations are sometimes effectuated via a public auction.

The proceeds of this sale are to be distributed according to absolute priority. Administrative costs, estate-financing and taxes accrued during the period of continuation in bankruptcy have super-priority; secured claims are entitled the proceeds of the sale of the collateral, any unpaid part is treated as an unsecured claim; next in line are audit claims, tax claims, wage claims, and lastly, unsecured claims.

Under Dutch law the trustee may annul transactions that classify as fraudulent conveyance or preferred transaction. Furthermore, she is authorised to bring suit against directors of companies if evidence exists that they have failed in their duties. Directors who violate their duties may be personally liable for unpaid claims. The most important evidence for establishing this failure is to be found in inadequate administrative bookkeeping.12

In table 1 we summarize the characteristics of Dutch law and compare these to the characteristics of the U.S. Bankruptcy Code. Of special interest here is the difference in the rules concerning the reorganization procedure of both laws. Dutch rules are much more stringent than the U.S. rules, and it is more difficult to adopt a plan in the Netherlands. For example, in prior research Couwenberg found

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12 Articles 2: 9, 10, 248 Civil Code.
that only 2.8% of all filings (suspensions and bankruptcy procedures) resulted in an agreement with creditors.\textsuperscript{13} Furthermore, the U.S.-rules give management of the firm more discretion in drafting and proposing a plan, effectively making it a more attractive option to management.

\begin{table}
\centering
\begin{tabular}{|l|l|l|}
\hline
\textbf{Feature} & \textbf{Dutch Act} & \textbf{U.S. Code} \\
\hline
initiation of bankruptcy & voluntary by management; creditors & voluntary by management; creditors \\
& no; criterion is “unable to pay” & no \\
& liquidation: sale of assets & Chapter 7: sale of assets \\
& agreement: sale of assets & Chapter 11: reorganization of claims or sale \\
& bankruptcy: trustee & Chapter 7: trustee \\
& suspension: management together with trustee & Chapter 11: management \\
& Lawyer & lawyer \\
\hline
filing related to insolvency-rule & & initial right is with firm \\
& no; criterion is “unable to pay” & < 120 days \\
& & no more than one \\
& & after exclusivity period \\
& & qualified majority \\
& & yes \\
& & half a year \\
\hline
control over bankruptcy process & & interest and principal payment stop, but may accrue when covered by collateral value \\
& & yes \\
\hline
restructuring methods & voluntary by management; creditors & initial right is with firm \\
& no; criterion is “unable to pay” & no more than one \\
& liquidation: sale of assets & after exclusivity period \\
& agreement: sale of assets & qualified majority \\
& bankruptcy: trustee & yes \\
& suspension: management together with trustee & half a year \\
& Lawyer & yes \\
\hline
professional affiliation & & interest and principal payment stop, but may accrue when covered by collateral value \\
& Lawyer & yes \\
\hline
rules regarding reorganization plan: & voluntary by management; creditors & initial right is with firm \\
& no; criterion is “unable to pay” & no more than one \\
& liquidation: sale of assets & after exclusivity period \\
& agreement: sale of assets & qualified majority \\
& bankruptcy: trustee & yes \\
& suspension: management together with trustee & half a year \\
& Lawyer & yes \\
\hline
- who proposes & voluntary by management; creditors & initial right is with firm \\
& no; criterion is “unable to pay” & no more than one \\
& liquidation: sale of assets & after exclusivity period \\
& agreement: sale of assets & qualified majority \\
& bankruptcy: trustee & yes \\
& suspension: management together with trustee & half a year \\
& Lawyer & yes \\
\hline
- when to propose & voluntary by management; creditors & initial right is with firm \\
& no; criterion is “unable to pay” & no more than one \\
& liquidation: sale of assets & after exclusivity period \\
& agreement: sale of assets & qualified majority \\
& bankruptcy: trustee & yes \\
& suspension: management together with trustee & half a year \\
& Lawyer & yes \\
\hline
- number of proposals & voluntary by management; creditors & initial right is with firm \\
& no; criterion is “unable to pay” & no more than one \\
& liquidation: sale of assets & after exclusivity period \\
& agreement: sale of assets & qualified majority \\
& bankruptcy: trustee & yes \\
& suspension: management together with trustee & half a year \\
& Lawyer & yes \\
\hline
- creditor proposals allowed & voluntary by management; creditors & initial right is with firm \\
& no; criterion is “unable to pay” & no more than one \\
& liquidation: sale of assets & after exclusivity period \\
& agreement: sale of assets & qualified majority \\
& bankruptcy: trustee & yes \\
& suspension: management together with trustee & half a year \\
& Lawyer & yes \\
\hline
- who votes the plan & voluntary by management; creditors & initial right is with firm \\
& no; criterion is “unable to pay” & no more than one \\
& liquidation: sale of assets & after exclusivity period \\
& agreement: sale of assets & qualified majority \\
& bankruptcy: trustee & yes \\
& suspension: management together with trustee & half a year \\
& Lawyer & yes \\
\hline
- when is agreement approved & voluntary by management; creditors & initial right is with firm \\
& no; criterion is “unable to pay” & no more than one \\
& liquidation: sale of assets & after exclusivity period \\
& agreement: sale of assets & qualified majority \\
& bankruptcy: trustee & yes \\
& suspension: management together with trustee & half a year \\
& Lawyer & yes \\
\hline
- cram down procedure & voluntary by management; creditors & initial right is with firm \\
& no; criterion is “unable to pay” & no more than one \\
& liquidation: sale of assets & after exclusivity period \\
& agreement: sale of assets & qualified majority \\
& bankruptcy: trustee & yes \\
& suspension: management together with trustee & half a year \\
& Lawyer & yes \\
\hline
automatic stay & voluntary by management; creditors & initial right is with firm \\
& no; criterion is “unable to pay” & no more than one \\
& liquidation: sale of assets & after exclusivity period \\
& agreement: sale of assets & qualified majority \\
& bankruptcy: trustee & yes \\
& suspension: management together with trustee & half a year \\
& Lawyer & yes \\
\hline
debt service & voluntary by management; creditors & initial right is with firm \\
& no; criterion is “unable to pay” & no more than one \\
& liquidation: sale of assets & after exclusivity period \\
& agreement: sale of assets & qualified majority \\
& bankruptcy: trustee & yes \\
& suspension: management together with trustee & half a year \\
& Lawyer & yes \\
\hline
debtor-in-possession financing & voluntary by management; creditors & initial right is with firm \\
& no; criterion is “unable to pay” & no more than one \\
& liquidation: sale of assets & after exclusivity period \\
& agreement: sale of assets & qualified majority \\
& bankruptcy: trustee & yes \\
& suspension: management together with trustee & half a year \\
& Lawyer & yes \\
\hline
Wages & voluntary by management; creditors & initial right is with firm \\
& no; criterion is “unable to pay” & no more than one \\
& liquidation: sale of assets & after exclusivity period \\
& agreement: sale of assets & qualified majority \\
& bankruptcy: trustee & yes \\
& suspension: management together with trustee & half a year \\
& Lawyer & yes \\
\hline
\end{tabular}
\caption{Comparison of features of the Dutch Act and U.S. Bankruptcy Code.}
\end{table}

II. American and Dutch Business Bankruptcy: Sample Selection

The sample used for this paper begins with two distinct datasets. The American chapter 11 data comes from Lubben’s work on the ABI Chapter 11 Fee Study. In particular, this paper utilizes the “big case” dataset from that project. It is comprised of all 2004 bankruptcy cases listed in the “Major Bankruptcies” database on bankruptcydata.com (New Generation Research, Inc.) except for cases initially filed under chapter 7 and not converted and cases filed under former section 304 of the Bankruptcy Code. There are 99 cases in this dataset and all data comes from publicly available court filings that were primarily collected from PACER.

The Dutch data comes from a dataset of 172 bankruptcy files collected by Couwenberg. All cases selected involved debtors with debts of more than €227,000 or at least ten employees. The sample is

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14 The ABI Chapter 11 Fee Study is available online (http://ssrn.com/abstract=1020477) and is extensively discussed in Stephen J. Lubben, Corporate Reorganization & Professional Fees, 82 AM. BANKR. L.J. 77 (2008).
15 http://pacer.psc.uscourts.gov/.
16 Part of this dataset (139 cases) is described in Oscar Couwenberg & Abe de Jong, Costs and Recovery Rates in the Dutch Liquidation-Based Bankruptcy System, 26 EUR. J. L & ECON. 105 (2008) and part of it (33 cases) comes from an ongoing research effort, in which the same methodology has been used, to study large Dutch bankruptcy cases. As the American sample includes larger cases than the first Dutch set of cases, these larger cases are added to the Dutch sample in order to facilitate the matching procedure.
non-random in that it includes only those cases where either courts or trustee’s law firm granted Couwenberg access to the case file. The majority of the cases are from three districts (Amsterdam, Arnhem, and Utrecht) and cover the years of 1983 to 2004, although the nineteen nineties are more prevalent in the sample. The mean (median) Dutch case in the sample is from mid-1994 (1995). For comparison purposes, liquidation cases are eliminated from the Dutch sample (43 cases). Due to data insufficiencies, the total number of cases drops to 112.

Of course, it would be ideal to compare only cases from the same years across jurisdictions. Unfortunately the size differences between the two countries makes such year to year comparison very difficult – three States (California, Texas, and New York) each individually have substantially larger gross domestic products than the Netherlands, whose GDP rivals that of Florida.\(^{17}\) Given the differences in economic size, the United States has more business bankruptcy cases in a year than the Netherlands might see in a decade. Moreover, there are indications that American chapter 11 procedures, which involve both codified rules and common law adjudication, may be too dynamic to allow for meaningful results to be gathered from a sample stretching back to the early 1980s.

Of course, the multi-year nature of the Dutch sample must be addressed. Thus, all Dutch cases were adjusted for inflation and

\(^{17}\) Both Florida and the Netherlands also have similar populations – about 16 million people – although geographically the Netherlands is closer in size to Massachusetts (which has a population of about 6.5 million). The figures in this part of the paper come from the CIA World Factbook, available at https://www.cia.gov/library/publications/the-world-factbook/.
changes in GDP and converted into 2004 Euros. These figures were then converted into the equivalent amount of U.S. dollars, using the average annual 2004 dollar-euro conversion rates. In addition, because the Dutch dataset only includes completed cases involving a successful sale of the business, the American dataset was limited to those cases with confirmed chapter 11 plans – cases that were converted to chapter 7 or dismissed were dropped from the sample.\footnote{All else being equal, dropping these cases from the sample will tend to increase the apparent cost of the American cases, since a converted or dismissed case is likely to incur lesser chapter 11 costs.} Descriptive statistics for the initial group of cases is set forth in Appendix A.

Having standardized the Dutch and American monetary figures into 2004 dollars and a generally similar group of cases, we used propensity score matching to select out a subsample of comparable cases from each jurisdiction.\footnote{We used the PSMATCH2 module for StataSE 10.1 for OSX, using nearest-neighbor matching, with no replacement (i.e., each case is used only once) and common support in the tails (essentially dropping certain extreme matches, which reduces the risk of an inappropriate match). The regression table and related information for the matching is reproduced in Appendix B.} Using this procedure we are able to mimic a world in which firms are randomly assigned to the United States and the Netherlands – which, of course, they are not – to allow for the consideration of the two jurisdiction’s bankruptcy systems.\footnote{See Stephen J. Lubben, \textit{Business Liquidation}, 81 AM. BANKR. L.J. 65 (2007) (discussing the use of matching techniques in bankruptcy scholarship); see also Lee Epstein et al.; \textit{The Supreme Court During Crisis: How War Affects only Non-War Cases}, 80 NYU L. REV. 1, 65-69 (2005).} Using a propensity score, which is based on debtor financial characteristics, the computer “matches” each American case with its most comparable Dutch case.
Table 2: Descriptive Statistics of Matched Sample

<table>
<thead>
<tr>
<th>Cases</th>
<th>Total Assets (USD)</th>
<th>Total Debts (USD)</th>
<th>Assets/Debts</th>
<th>Unsecured/Total Debt</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Netherlands</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Mean</td>
<td>$69,500,000.00</td>
<td>$140,000,000.00</td>
<td>0.68</td>
<td>0.46</td>
</tr>
<tr>
<td>se(mean)</td>
<td>$28,400,000.00</td>
<td>$75,900,000.00</td>
<td>0.10</td>
<td>0.03</td>
</tr>
<tr>
<td>Median</td>
<td>$14,100,000.00</td>
<td>$24,200,000.00</td>
<td>0.54</td>
<td>0.39</td>
</tr>
<tr>
<td>std. dev.</td>
<td>$188,000,000.00</td>
<td>$503,000,000.00</td>
<td>0.67</td>
<td>0.22</td>
</tr>
<tr>
<td>skewness</td>
<td>4.89</td>
<td>6.05</td>
<td>3.62</td>
<td>0.55</td>
</tr>
<tr>
<td>N</td>
<td>44</td>
<td>44</td>
<td>44</td>
<td>44</td>
</tr>
<tr>
<td><strong>United States</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Mean</td>
<td>$88,300,000.00</td>
<td>$133,000,000.00</td>
<td>0.71</td>
<td>0.51</td>
</tr>
<tr>
<td>se(mean)</td>
<td>$19,300,000.00</td>
<td>$27,300,000.00</td>
<td>0.08</td>
<td>0.05</td>
</tr>
<tr>
<td>Median</td>
<td>$14,600,000.00</td>
<td>$45,500,000.00</td>
<td>0.60</td>
<td>0.53</td>
</tr>
<tr>
<td>std. dev.</td>
<td>$128,000,000.00</td>
<td>$181,000,000.00</td>
<td>0.55</td>
<td>0.31</td>
</tr>
<tr>
<td>skewness</td>
<td>1.61</td>
<td>1.73</td>
<td>1.74</td>
<td>-0.06</td>
</tr>
<tr>
<td>N</td>
<td>44</td>
<td>44</td>
<td>44</td>
<td>44</td>
</tr>
<tr>
<td><strong>All cases</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Mean</td>
<td>$78,900,000.00</td>
<td>$136,000,000.00</td>
<td>0.70</td>
<td>0.48</td>
</tr>
<tr>
<td>se(mean)</td>
<td>$17,100,000.00</td>
<td>$40,100,000.00</td>
<td>0.07</td>
<td>0.03</td>
</tr>
<tr>
<td>Median</td>
<td>$14,200,000.00</td>
<td>$30,600,000.00</td>
<td>0.58</td>
<td>0.44</td>
</tr>
<tr>
<td>std. dev.</td>
<td>$161,000,000.00</td>
<td>$376,000,000.00</td>
<td>0.61</td>
<td>0.27</td>
</tr>
<tr>
<td>skewness</td>
<td>4.23</td>
<td>7.24</td>
<td>2.98</td>
<td>0.20</td>
</tr>
<tr>
<td>N</td>
<td>88</td>
<td>88</td>
<td>88</td>
<td>88</td>
</tr>
</tbody>
</table>

In the procedure, we matched cases based on the debtor’s assets, debts, the ratio of ordinary unsecured debt to total debt, and the ratio of assets to total debt. This results in a sample of 88 bankruptcy cases, equally divided between the two jurisdictions. 90 cases were deleted from the combined sample as part of this process. Table 2 sets forth basic descriptive statistics for the sample and its two halves.

As shown on the table, the average debtor in the sample has assets of more than $78 million, although the cases from both jurisdictions are heavily skewed by a few large cases – the median debtor having but $14.2 million in assets. Matching the cases removes the largest
American debtors, leaving no significant difference between the cases from the two. This matched sample of 88 cases informs the remainder of the paper.

III. Direct Costs in Context

Based simply on press reports of chapter 11 cases, it seems likely that chapter 11 costs substantially more than its Dutch counterpart. No case in the Netherlands is likely to ever reach the $750 to $900 million anticipated cost of Lehman Brothers. Of course, it is also unlikely

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that the Netherlands bankruptcy courts will handle a debtor with assets of more than $650 billion any time soon.

Table 4: Total Direct Costs & Cost by Debtor Size

<table>
<thead>
<tr>
<th></th>
<th>Direct Costs</th>
<th>Direct Costs (std. by size)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Netherlands</td>
<td>Mean</td>
<td>$2,017,258.00</td>
</tr>
<tr>
<td></td>
<td>se(mean)</td>
<td>$655,453.90</td>
</tr>
<tr>
<td></td>
<td>Median</td>
<td>$416,319.60</td>
</tr>
<tr>
<td></td>
<td>Sd</td>
<td>$4,347,789.00</td>
</tr>
<tr>
<td></td>
<td>Skewness</td>
<td>3.31</td>
</tr>
<tr>
<td></td>
<td>N</td>
<td>44</td>
</tr>
<tr>
<td>United States</td>
<td>Mean</td>
<td>$7,923,381.00</td>
</tr>
<tr>
<td></td>
<td>se(mean)</td>
<td>$1,691,663.00</td>
</tr>
<tr>
<td></td>
<td>Median</td>
<td>$3,535,018.00</td>
</tr>
<tr>
<td></td>
<td>Sd</td>
<td>$11,100,000.00</td>
</tr>
<tr>
<td></td>
<td>Skewness</td>
<td>1.99</td>
</tr>
<tr>
<td></td>
<td>N</td>
<td>43</td>
</tr>
<tr>
<td>All cases</td>
<td>Mean</td>
<td>$4,936,376.00</td>
</tr>
<tr>
<td></td>
<td>se(mean)</td>
<td>$949,098.90</td>
</tr>
<tr>
<td></td>
<td>Median</td>
<td>$906,245.20</td>
</tr>
<tr>
<td></td>
<td>Sd</td>
<td>$8,852,605.00</td>
</tr>
<tr>
<td></td>
<td>Skewness</td>
<td>2.76</td>
</tr>
<tr>
<td></td>
<td>N</td>
<td>87</td>
</tr>
</tbody>
</table>

Table 4 presents direct cost information for American and Dutch cases in the matched sample. The American cases cost, on average, almost four times the cost of the Dutch cases: $7.9 million compared with $2 million. The difference between median costs in the cases is even more extreme, with the American cases costing more than eight times their Dutch counterparts.
These results are similar when the costs are standardized by debtor size: debtor size defined here as the sum of assets and liabilities, divided by two. Dutch cases cost, on average, 3% of debtor size, while cases from the United States cost 12% of debtor size.

It is at this point that it becomes important to describe with greater precision what we are measuring when we report the direct costs of cases in each jurisdiction. In the Netherlands, the professional fees reported include the trustee’s law firm’s bankruptcy work on the case and retained advisors, such as auditors or appraisers. Furthermore, in none of the cases a creditor committee was involved. Lastly, the legal counsel individual creditors may have contracted do not show up as bankruptcy expenses in the bankruptcy reports. This is typically the full extent of the professionals retained in a Dutch corporate bankruptcy.

In the United States, on the other hand, the range of professionals that are subject to oversight by the bankruptcy court, and thus captured in the data reported on Table 4, is substantially broader. For example, in the United States the largest chapter 11 cases are increasingly handled by one of three law firms: Kirkland & Ellis; Skadden, Arps, Slate, Meagher & Flom, and Weil, Gotshal & Manges. These firms, and others like them that handle large chapter 11 cases, are full service, corporate law firms. That is, they provide corporations with legal advise that is often unrelated to the debtor’s bankruptcy case – yet all of the work performed by these firms during the pendency of the case will be reported on the fee application filed with the

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bankruptcy court. Lubben has previously estimated that up to 60% of the legal work billed in chapter 11 cases is unrelated to the core chapter 11 process.23

In addition, American cases routinely involve a host of non-legal professionals whose fees also contribute to the total direct cost of chapter 11 cases. Table 5 below reproduces data from the ABI Chapter 11 Fee Study’s “big case dataset,” the source of the American cases used in this paper, that details the types of professionals debtors retain in chapter 11 cases, beyond the lead and local law firms that directly manage the case.

Table 5: Additional professionals retained by debtors (ABI Chapter 11 Fee Study; Big Case Dataset)

<table>
<thead>
<tr>
<th>Professional</th>
<th>N</th>
<th>Percent of total</th>
<th>Percent of cases</th>
</tr>
</thead>
<tbody>
<tr>
<td>Attorney retained under sec. 327(e)</td>
<td>91</td>
<td>24.20</td>
<td>105.81</td>
</tr>
<tr>
<td>Financial adviser or investment banker (but not an accountant)</td>
<td>61</td>
<td>16.22</td>
<td>70.93</td>
</tr>
<tr>
<td>Attorney retained under sec. 327(a)</td>
<td>54</td>
<td>14.36</td>
<td>62.79</td>
</tr>
<tr>
<td>Other</td>
<td>36</td>
<td>9.57</td>
<td>41.86</td>
</tr>
<tr>
<td>Turnaround/restructuring/management consultant or adviser</td>
<td>31</td>
<td>8.24</td>
<td>36.05</td>
</tr>
<tr>
<td>Auditor</td>
<td>24</td>
<td>6.38</td>
<td>27.91</td>
</tr>
<tr>
<td>Financial adviser and accountant (any type)</td>
<td>23</td>
<td>6.12</td>
<td>26.74</td>
</tr>
<tr>
<td>Other accountant (tax, forensic, etc.)</td>
<td>21</td>
<td>5.59</td>
<td>24.42</td>
</tr>
<tr>
<td>Real estate professional</td>
<td>20</td>
<td>5.32</td>
<td>23.26</td>
</tr>
<tr>
<td>Appraiser or auctioneer</td>
<td>15</td>
<td>3.99</td>
<td>17.44</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>376</td>
<td><strong>100.00</strong></td>
<td></td>
</tr>
</tbody>
</table>

In addition, large American chapter 11 cases typically feature committees of unsecured creditors. These committees can hire their own professionals, to be paid from the estate, and they typically do so. In addition to counsel, almost 80% of the committees in the ABI big case dataset retained financial advisors.

In short, there is a problem of comparability between the two jurisdictions, even after the cases are matched: the American cases involve a wider range of professionals, and even the comparable professionals’ fee applications reflect a wider scope of work than the comparable Dutch fee records. The first disconnect is easily addressed: by limiting the American figures to the cost of the key attorneys – namely the lead and local counsel for the debtor and the
committee\textsuperscript{24} – we can achieve a rough measure of comparable costs.\textsuperscript{25}

Table 6, set forth below, revisits the data from Table 4 with the new measure of the cost of the American cases.

Table 6: Total Direct Costs & Cost by Debtor Size (Alternative Measure)

<table>
<thead>
<tr>
<th></th>
<th>Alternative Direct Costs</th>
<th>Alt. Direct Costs (std. by size)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Mean</td>
<td>$2,017,258.00</td>
</tr>
<tr>
<td></td>
<td>se(mean)</td>
<td>$655,453.90</td>
</tr>
<tr>
<td></td>
<td>Median</td>
<td>$416,319.60</td>
</tr>
<tr>
<td></td>
<td>Sd</td>
<td>$4,347,789.00</td>
</tr>
<tr>
<td>skewness</td>
<td></td>
<td>3.31</td>
</tr>
<tr>
<td>N</td>
<td></td>
<td>44</td>
</tr>
<tr>
<td>Netherlands</td>
<td></td>
<td></td>
</tr>
<tr>
<td>United States</td>
<td>Mean</td>
<td>$2,056,104.00</td>
</tr>
<tr>
<td></td>
<td>se(mean)</td>
<td>$432,440.70</td>
</tr>
<tr>
<td></td>
<td>Median</td>
<td>$1,075,781.00</td>
</tr>
<tr>
<td></td>
<td>Sd</td>
<td>$2,802,536.00</td>
</tr>
<tr>
<td>skewness</td>
<td></td>
<td>3.28</td>
</tr>
<tr>
<td>N</td>
<td></td>
<td>42</td>
</tr>
<tr>
<td>Total</td>
<td>Mean</td>
<td>$2,036,229.00</td>
</tr>
<tr>
<td></td>
<td>se(mean)</td>
<td>$394,020.90</td>
</tr>
<tr>
<td></td>
<td>Median</td>
<td>$649,154.20</td>
</tr>
<tr>
<td></td>
<td>Sd</td>
<td>$3,654,000.00</td>
</tr>
<tr>
<td>skewness</td>
<td></td>
<td>3.51</td>
</tr>
<tr>
<td>N</td>
<td></td>
<td>86</td>
</tr>
</tbody>
</table>

\textsuperscript{24} In the United States, attorneys are licensed to practice on a state-by-state basis. Large corporate debtors typically hire counsel from New York, or, to a lesser degree, Chicago or Los Angeles. But if the debtor’s bankruptcy cases are filed in a different jurisdiction (e.g., Delaware) the debtor will also have to hire “local” counsel admitted to the bar of that state, unless the firm in question has a local office in the state in question. Of the three major debtor law firms, see supra note 21, only Skadden, Arps has an office in Delaware. This same basic need to hire multiple law firms also applies to committees.

\textsuperscript{25} The measure is still somewhat crude, in that Dutch cases rarely have committees, but do retain accountants or appraisers.
As shown on the table, measured this way there is no significant difference between the costs of the two jurisdictions.\textsuperscript{26} Given that the reported American legal costs on Table 6 still include costs that are exogenous to the chapter 11 process, such as non-bankruptcy related legal expenses, the actual costs of chapter 11 may even be lower than the corresponding Dutch costs. Under this interpretation of our data, the marginal difference between the United States and the Netherlands appears to be attributable to the inclusion of non-bankruptcy costs and non-legal professionals in the American figures.

This suggests that the key question is one that nobody is asking: do American debtors (or their stakeholders) obtain value in excess of the costs of the additional professionals employed in chapter 11 cases? And while our data does not directly address this issue, because of a lack of recovery data for the American cases, there is some evidence that chapter 11 offers greater return to unsecured creditors.

Couwenberg’s Dutch data shows that the mean (median) return to unsecured creditors in the Netherlands is 9.9% (0%). This is both lower than Lubben’s previously reported recovery data for chapter 11 liquidation plans, which shows a mean recovery of 45%,\textsuperscript{27} and historical data for recovery on high-yield (or junk bonds) in the United States. Indeed, even in the current economic crisis practitioners

\textsuperscript{26} Alternative Direct Costs (p-value: 0.9607); Alt. Direct Costs (std. by size) (p-value: 0.1396).
\textsuperscript{27} Stephen J. Lubben, Business Liquidation, 81 AM. BANKR. L.J. 65 (2007).
estimate that the average recovery on junk bonds in the United States is approximately 15 to 20%.\textsuperscript{28}

The remaining differences in costs between the two jurisdictions are easy to overstate. As shown in Figure 7, the size of the debtor is a universal factor in the overall cost of cases. Moreover, it is not simply a matter of “bigger cases costing more,” because the cases also show scale effects. Consistent with our prior individual work, it appears that in both jurisdictions costs escalate with debtor size on a less than one-to-one basis. In particular, as shown on the next table, costs increase at about 80% of size, so that a $100 increase in the debtor’s size results in but an $80 increase in cost.\textsuperscript{29}

\begin{figure}[h]
\centering
\includegraphics[width=\textwidth]{Figure7.png}
\caption{Cost and Debtor Size (variables log transformed; lowess line shown)}
\end{figure}

\begin{table}[h]
\centering
\begin{tabular}{|c|c|c|}
\hline
Debtor Size & Cost &
\\hline
10 & 12 &
\\hline
15 & 16 &
\\hline
20 & 18 &
\\hline
\end{tabular}
\caption{Cost and Debtor Size}
\end{table}


\textsuperscript{29} Table 8, Model 5.
We examine this issue, and the other factors that influence cost across jurisdictions, in Table 8. In conducting this analysis, we use the modified cost variable – explored in Table 6 – as our measure of cost. If we measured cost with the general or total cost variable, the lack of comparability in what counts as “cost” in the two jurisdictions would mean that jurisdiction itself would be the biggest factor in the cost of reorganization. This selective accounting for costs does represent an express acknowledgement that law matters – in particular, the background law of each jurisdiction informs what counts as a cost of bankruptcy and inhibits efforts to make a direct comparison of cost.

Having thus accounted for the law, we move to consider the financial characteristics of debtors that influence the cost of bankruptcy. A variety of factors beyond size could be thought to influence overall cost. First of all, we hypothesize that greater insolvency will lead to more work for the management of the estate, resulting in more disputes about the allocation of the debtor’s assets, and thus increasing cost. Conversely, we would expect that increasing the degree to which the debt is secured would reduce cost, as the debt would likely be concentrated in a smaller number of larger lenders, resulting in less negotiation effort. This second hypothesis is consistent with recent American literature on the growth of creditor control in chapter 11 cases.\textsuperscript{30} We also hypothesize that increasing the proportion of unsecured debt, especially if it results in an actual

distribution to creditors, could increase costs by increasing the administrative burden to the estate.

On Table 8 we model these theories by sequential inclusion of specific variables that address each hypothesis. We begin in model 1 by probing the relationship between size – here the average of assets and debts – and cost. As previously discussed, cost and debtor size are closely related in both jurisdictions. Size has a positive sign and is significant at the 1% level.

In the second model, we add the ratio of the debtor’s assets to its debts, a measure of the debtor’s solvency. The coefficient is significant at the 1% level and has a negative sign, implying that more solvent debtors incur less cost. This supports the hypothesis stated above. In model 3, we add the ratio of secured debt to overall indebtedness. The coefficient is significant at the 1% level and has a negative sign. As we hypothesized, a higher level of secured debt reduces cost. The estimated coefficients show that the economic impact of the ratio of secured debt on costs is bigger than the effect of solvency on costs.
Table 8: Regression models of professional costs

<table>
<thead>
<tr>
<th>Model 1</th>
<th>Model 2</th>
<th>Model 3</th>
<th>Model 4</th>
<th>Model 5</th>
</tr>
</thead>
<tbody>
<tr>
<td>$B$</td>
<td>$SE$</td>
<td>$p$-value</td>
<td>$B$</td>
<td>$SE$</td>
</tr>
<tr>
<td>Debtor size (log of average of debts and assets)</td>
<td>0.737</td>
<td>0.078</td>
<td>0.000</td>
<td>0.723</td>
</tr>
<tr>
<td>Solvency (assets over debts)</td>
<td>-0.574</td>
<td>0.203</td>
<td>0.006</td>
<td>-0.586</td>
</tr>
<tr>
<td>Secured debt over total debt</td>
<td>-1.336</td>
<td>0.494</td>
<td>0.009</td>
<td>-1.683</td>
</tr>
<tr>
<td>Ordinary debt over total debt</td>
<td>-0.413</td>
<td>0.755</td>
<td>0.587</td>
<td>-0.413</td>
</tr>
<tr>
<td>Payout to ordinary creditors, if Dutch case (y/n)</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Case jurisdiction (0=Netherlands; 1=US)</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>(Constant)</td>
<td>0.631</td>
<td>1.346</td>
<td>1.270</td>
<td>1.302</td>
</tr>
<tr>
<td>$R$-Square</td>
<td>0.567</td>
<td>0.612</td>
<td>0.006</td>
<td>0.650</td>
</tr>
<tr>
<td>Adj. $R$-square</td>
<td>0.560</td>
<td>0.601</td>
<td>0.635</td>
<td>0.627</td>
</tr>
</tbody>
</table>

OLS Regressions (n=71)
Dependent: Log of total fees and expenses requested

In model 4 we consider the hypothesis that with a higher level of unsecured debt and paying a recovery to these creditors will result in a higher level of cost. We add two variables to the model to address this hypothesis: first, the ratio of unsecured debt to total debt, and second a dummy (yes or no) variable that answers the question “was there any payout to unsecured creditors, conditional on this being a Dutch case?”31 Addition of these variables to the model does not result in

31 Recall that the dataset does not include unsecured creditor recovery data for the American cases. Thus, a “no” answer to this variable could mean either that the
any significant change in the utility of the model – the variables are insignificant and the change in R-squared is negligible.

In the final model we add a simple jurisdictional dummy variable into the model to test for unmodeled jurisdictional differences. Given the previous propensity score matching, and the use of a jurisdictionally adjusted dependent variable, it would be startling if this variable had any role to play. The dummy variable is insignificant by conventional measures and the change in R-squared indicates that the addition of the new variable does not alter the outcome.32

The R-square indicates that more than 67% of the variance in cost is explained by model 5, or just over 63% of the variance using the adjusted R-Square, which compensates for the positive bias in the R-square measure. In short, our model explains about two-thirds of the cost of corporate bankruptcy, but about one-third of the cost remains unexplained. It shows that in both jurisdictions much that drives cost is the same: size, solvency and secured debt. Lower relative costs result if firms are larger, more solvent upon entering bankruptcy and have a bigger slice of secured credit in their capital structures.

However, our model fails to account for factors like the complexity of the debtor’s capital structure, which Lubben has previously found to be a significant predictor of overall cost in American cases. For Dutch cases, the model fails to account for the time it took the trustee to sell firm assets and the number of disputes the trustee had to settle. Both these factors have proven to exert a positive influence on costs.

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32 To be sure, the new variable and change in r-squared would be significant at the 10% level, and are suggestive of some unmodeled jurisdictional effects.
IV. Conclusion

In this paper, we compare the bankruptcy costs of firms in two very different jurisdictions. The two countries have very different bankruptcy systems. The Netherlands has a liquidation-based rule, with a rudimentary reorganization provision; the US has a full-fledged reorganization procedure in chapter 11 and a separate liquidation procedure in chapter 7.

Nevertheless, in the Dutch system many bankruptcies involve a going concern asset sale of the firm, preserving assets and activities, either in parts or in full. In the US, many chapter 11 cases involve a liquidation plan in which assets are sold, either piecemeal or as going concern, apart from cases that reorganize via a confirmed plan.

Bankruptcy systems may thus differ in their legal structure, their economic outcomes may actually differ less. In this paper, we assess whether these legal differences actually result in differences in economic costs. We focus on bankruptcy costs of firms as these figures are available to us for both systems, leaning on work each of us has done separately on US and Dutch bankruptcies. In order to control for differences in cases and differences in the working of legal rules we construct a matched sample of US and Dutch cases that are equivalent with respect to economic variables and firm survival. Specifically, this means that we select firms of equal size and firms that continue their activities either via going concern sale (in the Dutch situation) or via a reorganization plan in chapter 11 in the US.
Our sample consists of 88 firms, equally distributed over the two jurisdictions. The cost differences between the two are large: In the US costs are approximately 4 times higher than in the Netherlands, 12% versus 3%. A large part of this difference is attributable to the specific legal set up in the US. The range of professionals that are subject to oversight by the bankruptcy court, and thus captured in the cost figure, is substantially broader than in the Netherlands. Addressing this issue lowers costs considerably for the US cases, i.e. 4%.

The regression analysis with this revised cost figure reveals that no jurisdictional specific effects occur anymore. Costs in both jurisdictions are explained by the size of the firm, revealing a scale effect, solvency, and the ratio of secured debt over total debt. With these variables, the regression explains 61% of the variance in the cost data. Due to data limitations, we are unable to further refine our findings in order to control for, e.g. capital structure complexity, asset sale characteristics, and procedural and procedural issues associated with both jurisdictions. Nevertheless, the high adjusted $R^2$ points out that with the two-third of the variance in costs explained, other variables may raise the explanatory power of the model, it will be in a marginal way compared to the firm characteristics that drive costs in bankruptcy procedures.

The conclusion is then twofold: costs in both systems are driven by the same firm variables, and in order to functionally compare costs, a deep understanding is needed on actual costs incurred in bankruptcy. Finally, in order to assess the value effects of the additional legal costs, e.g. the realization of higher recovery rates, further detailed comparative research is needed.
## Appendix A: Unmatched Sample Descriptive Statistics

|                | Direct Costs | Alternative Direct Costs |  |  | Direct Costs (std. by size) |  |  | Total Assets | Total Debts | Year |
|----------------|--------------|--------------------------|  |  | (std. by size)              |  |  |            |            |     |
| **Netherlands** |              |                          |  |  |                           |  |  |            |            |     |
| mean           | $890,519.30  | $890,519.30              | 0.051 | 0.051 | $28,400,000.00 | 0.051 | $57,400,000.00 | 1994.80 |
| se(mean)       | $270,300.70  | $270,300.70              | 0.004 | 0.004 | $11,500,000.00 | 0.004 | $30,300,000.00 | 0.37   |
| median         | $142,587.00  | $142,587.00              | 0.037 | 0.037 | $1,833,070.00  | 0.037 | $5,076,701.00  | 1995.00 |
| sd             | $2,860,594.00| $2,860,594.00            | 0.046 | 0.046 | $122,000,000.00| 0.046 | $320,000,000.00| 3.94   |
| skewness       | 6            | 6                        | 2    | 2    | 8              | 8    | 10           | -1     |
| N              | 112          | 112                      | 112  | 112  | 112            | 112  | 112          |        |

| **United States** |              |                          |  |  |                           |  |  |            |            |     |
| mean            | $8,836,976.00| $2,455,983.00            | 0.109 | 0.039 | $206,000,000.00 | 0.039 | $344,000,000.00 | 2004.00 |
| se(mean)        | $1,608,986.00| $411,703.10             | 0.012 | 0.006 | $112,000,000.00 | 0.006 | $161,000,000.00 | 0.00   |
| median          | $3,553,673.00| $1,200,284.00            | 0.083 | 0.027 | $15,000,000.00 | 0.027 | $60,000,000.00 | 2004.00 |
| sd              | $13,100,000.00| $3,319,257.00           | 0.090 | 0.041 | $819,000,000.00| 0.041 | $1,170,000,000.00| 0.00   |
| skewness        | 3            | 3                        | 1    | 2    | 7              | 7    | 6            |        |
| N               | 66           | 65                       | 52   | 51   | 53             | 53   | 70           |        |

| **Total**       |              |                          |  |  |                           |  |  |            |            |     |
| mean            | $3,836,958.00| $1,465,407.00            | 0.069 | 0.047 | $85,400,000.00 | 0.047 | $150,000,000.00 | 1998.34 |
| se(mean)        | $681,594.10  | $234,580.10             | 0.005 | 0.004 | $37,300,000.00 | 0.004 | $56,200,000.00 | 0.40   |
| median          | $349,362.60  | $296,215.00             | 0.043 | 0.034 | $3,877,283.00  | 0.034 | $9,613,197.00  | 1998.00 |
| sd              | $9,093,599.00| $3,120,885.00           | 0.069 | 0.045 | $479,000,000.00| 0.045 | $723,000,000.00| 5.45   |
| skewness        | 4            | 4                        | 2    | 2    | 11             | 11   | 9            | -1     |
| N               | 178          | 177                      | 164  | 163  | 165            | 165  | 182          |        |
Appendix B: Regression Model for Propensity Score Matching

Number of obs = 165
LR chi2(4) = 65.86
Prob > chi2 = 0.00
Log likelihood = -70.6524 Pseudo R2 = 0.32

|                | Coef. | Std. Err. | z     | P>|z| | [95% Conf. Interval] |
|----------------|-------|-----------|-------|-----|----------------------|
| Debtor Assets (log) | -0.424 | 0.219     | -1.940| 0.052 | -0.852 - 0.005      |
| Debtor Debts (log)  | 0.861  | 0.240     | 3.580 | 0.000 | 0.390 1.331         |
| Unsec. Debt/All Debt| 1.592  | 0.496     | 3.210 | 0.001 | 0.620 2.564         |
| Debt/Assets         | 0.970  | 0.335     | 2.890 | 0.004 | 0.313 1.627         |
| Constant            | -9.484 | 1.377     | -6.890| 0.000 | -12.184 6.784       |

Probit regression; dependent is country of case (1=US case)

| Variable          | Sample     | Mean | Mean | %bias | %reduct | t-test | p>|t| |
|-------------------|------------|------|------|-------|---------|--------|-----|
|                   | Sample     | Treated | Control |       |         | t      | p>|t| |
| Debtor Assets (log)| Unmatched | 16.970 | 14.821| 102.900| 6.34 | 0.000 |
|                   | Matched    | 16.877 | 16.396| 23.000 | 77.600 | 1.16 | 0.248 |
| Debtor Debts (log)| Unmatched | 17.856 | 15.724| 116.200| 7.18 | 0.000 |
|                   | Matched    | 17.544 | 17.095| 24.500 | 78.900 | 1.21 | 0.228 |
| Uns. Debt/All Debt| Unmatched | 0.546  | 0.457 | 32.200 | 2.12 | 0.035 |
|                   | Matched    | 0.509  | 0.459 | 18.200 | 43.600 | 0.87 | 0.389 |
| Debt/Assets       | Unmatched | 0.777  | 0.509 | 35.200 | 2.40 | 0.017 |
|                   | Matched    | 0.715  | 0.679 | 4.600  | 86.800 | 0.27 | 0.788 |
Business Rescue: Myth or Miracle?

Anneli Loubser
• Chapter 11 reorganizations
• Fresh start, rescue culture
• Liquidation culture
THE NEW INSOLVENCY ERA

- Germany – Insolvency Commission
- England – Cork Committee
- South Africa – Corporate reform
• Cultural context
• USA – forgiving
• Germany and South Africa - stigma
GERMANY

- Recommendations based on Chapter 11
- Insolvenzordnung of 1994
- Insolvency plan
- Self-administration
SOUTH AFRICA

- Business rescue plan
- Directors’ resolution
- Debtor in possession?
- Memorandum
- Business rescue practitioner
- Management control
ENGLAND v AMERICA

• Receiverships
• Chapter 11
• One size does not fit all
THE SOLUTION FOR GERMANY

- Integrated procedure
- Übertragende Sanierung
- Similar outcomes in liquidation and business rescue
• Protection in transfer as going concern
• Liquidation
• Acceptable in business rescue
• Retrenchments inevitable, but not inevitable

SAVING JOBS
BETTER RETURN FOR CREDITORS

- Selling business as going concern
- Also in liquidation
- Extra costs and time
- Shareholders ?!
AVOIDING THE STIGMA

- Separation essential
- Requirements result in the opposite
- Essentially the same
ADVANTAGES FOR ECONOMY IN GENERAL

- Socio-economic effects of failure
- Disadvantage to successful businesses
- Unfair advantage
AND THE ANSWER IS.....?

- A miracle
- And a myth
Israel’s Bonds Crisis: Has Reorganization Gone Bankrupt?

Dr. David Hahn,
Bar-Ilan University Faculty of Law
Israel’s Capital Market

- 638 listed corporations on the TASE
- 546 series of bonds
- Overall market capitalization:
  - 140 Billion USD worth of equity instruments
  - 160 Billion USD worth of bonds
Business Credit Supply

• 2008:
  – Bank financing – 55.28%;
  – Non-bank financing – 44.72%.

• 2003:
  – Bank financing – 71.91%;
  – Non-bank financing – 28.01%.
Holding of Bonds (End of 2008)

- Public – 51.2%
- Institutional Investors – 48.8%
Importation of the Global Crisis

- Losses of largest banks from investments in American SIVs, MBSs etc.
- Israeli real estate giants global operations and investments;
  - Decline in real estate in Eastern-Central Europe and North America hurt the firms’ value
    - Banks’ non-recourse loans covered by collateral
    - Bonds went underwater
Scope of Bonds’ Crisis

• Towards end of June 2009, Concern of default on approximately 25% of real estate firms’ bonds payments (estimation of the ISA)

• Bulk of bonds’ principals due between 2011-2014.
Proposals for Government Intervention

- Enlarging the government guarantee to banks for raising capital (MOF);
- Insuring the issuing of new bonds (ISA);
- Establishment of lever funds (MOF);
- Government finance of prepack reorganizations (Official Receiver).
Advantages of Gov’t Bailout

• Fair and equal treatment to investors of all firms (consistency of treatment per market crisis)
• Quickly implemented
• Media and public attention – positive news
  – Result: Stimulus for the economy
Costs of Gov’t Bailout

- Burden on taxpayers’ money;
- Exacerbating firms’ moral hazard
- Ad hoc legislation – inconsistency between crises

Possible alternative: Formal reorganization proceedings
The Aversion of Reorganization

• Reasons for avoiding reorganization:
  – Absence of acceleration clauses in debentures (triggering an event of default);
  – Cultural barrier/misconception of the role of reorganization proceedings;
  – Fear of loss of control by management and controlling shareholders;
  – Legal uncertainty (deficient legislation);
  – Expectation for government bailout.
Possible Reforms for Improvement

• Adopting a DIP regime (for dispersed holding of stock firms)
• Clarifying legal rights in reorganization:
  – Priority of reorganization financers;
  – Salvaging executory contracts.
• Suggestions for culture/attitude change??
Thank You!
Transfer of real security rights during traditional securitisation in South African law

Natania Locke
Introduction

• Definitions
  – Traditional securitisation
  – Synthetic securitisation

• History
Originator

Third Party Credit Enhancers

Rating agency

Letters of credit, insurance etc.

Claims

Servicing agreement

SPV

Bank

Security by means of claims and security cession of credit enhancement agreements

Liquidity facility

Trustee for Debenture-Holders

Trust deed

Securities

Investors
Outline (cont)

- Security by means of claims
- Instalment sale agreements

• Conclusion
Exemption Notice

• Ambit
• ‘True sale’ and ‘insolvency-remoteness’
  – Continued control
  – Risk transfer
  – Servicing
• Transfer must divest originator of rights and obligations
Duality of agreement

• Abstract system of transfer of rights
  – Obligationary agreement and transfer agreement
  – Requirements for transfer of real right
Method of transfer of claims

- **Delegation**
  - Form of novation
  - English law and American law position

- ‘Assignment’ distinguished
Delegation (cont)

• Reasons why delegation is not preferable
  – SPV liable for duties
  – Accessory security rights terminated
Delegation (cont)

- Reasons why delegation is not preferable
  - SPV liable for duties
  - Accessory security rights terminated
Delegation (cont)

- Reasons why delegation is not preferable
  - SPV liable for duties
  - Accessory security rights terminated
Accessory nature of real security

- Implications
- Exception – covering bond
- Real security does not follow principal debt automatically
- Transfer of real security
  - Real agreement
  - Publicity
Method of transfer of claims

• Cession
  – Transfer agreement
  – Delivery of document not required
  – Notice to debtor not required
  – Preferable as method of transfer
Transfer of security rights

- Mortgage and notarial bonds
  - Descriptions
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1 Introduction

Traditional securitisation is the pooling of a homogenous group of income-producing assets, the sale of these assets by the original holder (originator) to an insolvency-remote third party (a special purpose vehicle or SPV) and the issue by the SPV of marketable securities (typically debt instruments such as debentures) to finance the purchase of the assets.1 The transferred assets serve as security for the securities issued.

In this paper it is assumed that the assets transferred to the SPV are claims. The situation is evaluated where the claims transferred to the SPV is secured by mortgage, notarial bond, other claims or through retention of ownership.

Traditional securitisation must be distinguished from synthetic securitisation. In a synthetic securitisation the assets are not transferred to the SPV. Instead, the originator uses a credit derivative instrument to transfer the risk associated with the specified pool of assets to the SPV. The SPV issues securities to finance the transaction. The principal debt and interest on the securities must be paid from the cash flow arising from the assets that serve as collateral and from the fees or premium paid by the originator to the SPV for accepting the risk.2

The form and function of traditional securitisation schemes in South Africa have been modelled on the American and English methods. South African insolvency law, banking law and company law are in most respects similar to their counterparts in English law. The same cannot be said of South African private law, which governs the transfer of rights to the special purpose vehicle (SPV) during securitisation. South African private law is derived from Roman-Dutch law and therefore shares more similarities with modern civil law jurisdictions than with typical common law jurisdictions.

As will be explained, this private law heritage leads to very specific difficulties when it comes to the transfer of real security rights to the SPV during securitisation. The focus of this paper will be on South African law, but reference will be made to the position in American law and in English law to illustrate differences.

The paper starts with a discussion of the relevant parts of the Exemption Notice Relating to Securitisation Schemes.3 This Exemption Notice is applicable to all securitisation schemes where the SPV issues securities to the public. The potential methods of transfer of the claims to the SPV are discussed. This is followed by an overview of the accessory nature of real security rights in South African law. Each form of security is then considered in turn, taking into account the peculiarities that each form may present.

2 Exemption Notice Relating to Securitisation Schemes
The Exemption Notice Relating to Securitis ation Schemes is an exemption notice to the Banks Act 94 of 1990. It exempts an SPV of complying with the regulatory requirements of deposit-taking institutions, provided that the requirements of the Exemption Notice are met. Since the possibility of being classified as a deposit-taking institution only presents when money is received from the public, only SPVs that offer their securities to the public stand to be classified as such. Consequently, SPVs that will place their securities privately need not comply with the Exemption Notice.

The current Exemption Notice differs from its predecessors in that it attempts to define the circumstances in which a transfer of assets from the originator to the SPV will be considered a ‘true sale’. A ‘true sale’ in the context of securitisation refers to the ideal that the transfer of the assets from the originator to the SPV should be done in such a manner that the assets, from a legal point of view, will be permanently removed from the estate of the originator. The concept of a ‘true sale’ stands closely associated with the concept of ‘insolvency-remoteness’. An SPV is ‘insolvency-remote’ from the originator when the creditors of the originator cannot claim that the assets form part of the originator’s estate if the latter should be declared insolvent after the securitisation.

The Exemption Notice carries a paragraph devoted solely to the aspect of continued control of the assets by the originator and its impact on insolvency-remoteness. The transferor may not maintain any effective or indirect control over the assets after transfer to the SPV. The assets and the benefits flowing from those assets must be transferred to the SPV in such a manner that it is beyond the reach of the transferor (originator) even in the event of its insolvency. The transferor is deemed to have maintained effective control over the transferred assets when the transferor is able to repurchase the assets from the SPV in order to realise their benefits or if it is obliged to retain the risk relating to the transferred assets. The continued servicing of the assets by the transferor is expressly excluded as a form of indirect control of the assets.

The most important provision of the Exemption Notice for purposes of this discussion is the following:

The transfer of the assets to or acquisition of assets by a special-purpose institution shall totally divest the transferring institution and all its associated companies and, when the transferring institution is a bank, divest any other institution within the banking group of which such a bank is a member, of all rights and obligations originating from the underlying transactions and all risks in connection with the assets transferred or acquired (my emphasis).

The Exemption Notice does not allow the claims resulting from a relationship between a debtor and creditor to be transferred to the SPV, but for the duties to remain with the originator. Only if both the claims and the duties are transferred to the SPV will the transaction be considered a ‘true sale’ and will the transaction comply with the requirements of the Notice.

In South African law duties are transferred by way of delegation and claims are transferred by way of cession. The Notice therefore implies that the assets must be transferred to the SPV by way of cession and delegation.

3 Duality of Agreement

South African law follows an abstract system of transfer of rights. It is characteristic of such a system that a distinction is drawn between an obligationary agreement and a
transfer agreement. A real agreement coupled with proper publicity of the transfer of the right is sufficient to transfer the right to the transferee, regardless of any deficiency in the obligationary agreement from which the transfer resulted. The real agreement entails the expression by the transferor of the will to transfer the real right to the transferee and the acceptance by the transferee of the real right. The real agreement must still be valid at the time of publicity of the transfer for transfer of the real right to occur.

The distinction between the transfer agreement and the obligationary agreement must be made with regard to the transfer of all proprietary rights, including claims. However, the obligationary agreement and the transfer agreement need not be separated in time and can be contained in one document.

During a traditional securitisation transaction the obligationary agreement takes the form of a contract of sale. The essential elements of a contract of sale are that there must be agreement on the thing sold and that there must be a determined purchase price.

If claims and duties are transferred during the securitisation transaction, the transfer agreement will take the form of delegation. If only claims are transferred, the transfer agreement will be cession. The form of the transfer agreement by which the claims are transferred to the SPV is of the utmost importance for the possibility to transfer any security rights accessory to those claims.

3.1 Delegation

Delegation is a form of novation whereby one party is completely substituted for another. As such, it requires the full co-operation and consent of the original debtor and creditor and the third party that will substitute one of the parties to the original agreement. South African courts sometimes use the term ‘assignment’ to denote a complete substitution of one party to an agreement for another party. However, Christie argues convincingly that what is meant by the term in these instances is really a delegation. The term ought to be avoided in the South African context, because it also leads to confusion when compared with English law, where the term ‘assignment’ denotes only a transfer of the claims and not a substitution of parties.

In both English law and American law, although a possibility, novation is not preferred as the method of transfer of the claims to the SPV. The usual reason provided for this is that the parties do not want to obtain the debtors’ consent for the securitisation transaction. It is argued that obtaining such consent is time-consuming and costly.

This reasoning is also valid in South Africa, although it is probably possible to obtain such consent from the debtor as a standard term of most banking loan agreements. This is a practice widely followed in South Africa.

However, there are two further reasons why delegation is not a good method by which to transfer the assets to the SPV. First, it results in the SPV acquiring duties. In most cases an SPV is set up specifically as a vehicle for the securitisation scheme. It has no real capital of its own, nor does it employ any administrative staff or infrastructure to enable it to service duties. The objects of an SPV are limited to only include the securitisation scheme and functions that are ancillary to the securitisation scheme. If the SPV is one that needs to comply with the requirements of the Exemption Notice Relating to Securitisation Schemes, such a limitation of its objects, as well as adherence to such a limitation, is compulsory.
Despite requiring that the SPV’s objects be limited, the Exemption Notice contains several provisions that imply delegation as the preferred method of transfer. The Notice actually foresees the transfer of the duties in terms of ‘undrawn commitments’ to the SPV. In such a case the only possibilities for the transfer of the undrawn commitment allowed by the Notice are novation, assignment or any other means specified in writing by the Registrar. It is submitted that ‘assignment’ carries the meaning set out above.

The inclusion of a transfer of duties in The Exemption Notice might, rather than safeguard against a finding of a non-true sale, have the opposite result. Suppose the SPV raises the additional capital required to function as a lender and service the duties of undrawn commitments as foreseen by the Notice. The SPV will not have staff or the administration to manage these new loans and will most likely allow the originator, whether it is the servicer or not, to manage this relationship on its behalf. The retention of servicing rights by an originator is expressly excluded as a form of indirect control over the assets by the Exemption Notice. ‘Servicing agent’ is defined in the Notice as “an institution that acts as servicing agent in relation to the collection of the amounts due in terms of a traditional or synthetic securitisation scheme”. It is submitted that this definition only covers the collection of amounts due and does not make provision for the administration of ongoing lending activities.

The Exemption Notice contradicts itself by expecting, on the one hand, that all rights and duties be transferred to the SPV and, on the other hand, forcing the SPV by implication to leave the management and administration of those duties with the originator. A further contradictory provision of the Exemption Notice is the following:

The agreement between the institution transferring the assets in terms of a traditional securitisation scheme and the special-purpose institution shall be such that, in the event of the terms of an underlying transaction being amended, the special-purpose institution, and not the transferring institution, or any of the transferring institution’s associated companies or, when the transferring institution is a bank, any other institution within the banking group of which such a bank is a member will be subject to the terms so amended.

This paragraph assumes delegation. The amendment of the underlying agreement to the effect that the SPV, and not the originator, is bound assumes that the debtor consented to a substitution of lenders. Second, although it does not expressly state this, the paragraph suggests that the debtor will continue to deal with the originator. If this was not the case and the debtor dealt directly with the SPV, the amendment of the underlying transaction would be a new agreement between the debtor and the SPV and the paragraph would become superfluous. It seems then that the paragraph foresees that the debtor will amend the terms of the underlying agreement through negotiation with the originator, but that the SPV will be bound by the terms of the varied agreement.

The peremptory language used in the Exemption Notice to imply that the transfer of the assets must be in the form of a delegation is unfortunate. It ought to be possible for an originator to transfer the claims arising from the underlying transactions, but to remain liable for any outstanding duties, and to still qualify for the exemption provided for by the Notice. The current wording of the Notice suggests that cession will only be acceptable for the transfer of the assets to the SPV when there are no longer any duties owing to the debtor. This will be the case where the originator and the debtor’s business relationship has come to an end. This does not serve the
purposes of the originator, who usually wants to acquire financing while maintaining a business relationship with its borrowers.

The second reason why delegation is not the most suitable method to transfer the claims to the SPV lies in its effects on the accessory security rights that secure the claims.27

3.1.1 Accessory Nature of Real Security Rights

The accessory nature of real security rights entails that security rights are dependent on the existence of principal debts for their creation, continued existence and to determine the value to be extracted from the security on the default by the borrower.

The exception to this rule is a covering bond that complies with section 51 of the Deeds Registries Act.28 In terms of this section a mortgage bond or a notarial bond registered to secure a future debt will only give its holder a preference or priority if the bond specifically stipulates that it is intended to secure future debts generally or a particular future debt, and if there is an amount stipulated in the bond above which future debts shall not be secured by the bond. Since there is a continuous possibility of future claims, the bond in terms of section 51 will continue to exist even when the balance on a particular moment is zero.

The accessory nature of a real security right does not mean that it will necessarily follow the principal debt when the latter is ceded.29 In South African law there must be a separate transfer of the real security right to the cessionary of the principal debt. A valid transfer can only be affected through a new real agreement30 and by giving proper publicity to the transfer.31 The requirement of a new real agreement implies that the security grantor must cooperate for the transfer to take effect. The original holder of the security will not be entitled to transfer the real security rights without the cooperation of the security grantor.32

Provision is made in the Deeds Registries Act for the registration of a transfer of mortgages and bonds,33 which provides a transfer with proper publicity. Specific provision is also made for the registration of a cession of covering bonds.34 When the requirements of the Deeds Registries Act for the transfer of mortgages and bonds are met, the transfer will not affect the priority of the security taker. The same result is not possible for a transfer of a pledge, where the new pledgee will only have priority from the time that the requirements of the transfer of the pledge are met.35

When the principal debt is ceded without the requirements for the transfer of the security right being met, the security right will cease to exist.36 This is because a security right cannot continue to exist without the claim it aims to secure. Furthermore, if the claim ceases to exist, so will the security right.

Delegation is a form of novation. Novation brings an end to a claim and the claim is replaced with a new claim. During delegation the security rights that secured the original claim will cease to exist together with the claim. A new security right must be created with the creation of the new claim.

It is submitted that the insistence of the Exemption Notice that any outstanding duties of the originator towards the debtor must of necessity be transferred to the SPV, is an insistence on delegation. Since delegation is a form of novation, the real security rights that secured the original claims cannot be transferred to the SPV, but will cease to exist with the claims they secured. New security rights will have to be negotiated and registered to secure the new claim of the SPV against the debtor. This influences the priority that the security provides its holder, because priority is
determined according to the date of registration of the mortgage or special notarial bond.

It is therefore submitted that as far as possible only claims should be transferred to the SPV and not duties, and that the claims should be transferred by way of cession. As long as the requirements for the transfer of real security are met, it will be possible to transfer the real security rights to the SPV without a loss of priority.

3.2 Cession

Cession is an act of transfer whereby a creditor (the cedent) transfers his claim against his debtor to a third person (the cessionary) in such a way that the cessionary becomes the creditor of the debtor.37

There must be a valid transfer agreement between the cedent and the cessionary for the cession to take effect. In other words, the cedent must have the intention to transfer the claim to the cessionary and the cessionary must have the intention to receive the claim.38 It is not a requirement for a valid cession in South African law that a document that evidences the claim must be delivered to the cessionary.39

A cession is complete inter partes without notice to the debtor.40 In other words, the transfer of the assets from the estate of the cedent to that of the cessionary is affected by the agreement between them without the need to notify the debtor. However, before the debtor receives notice of the cession from the cedent41 the debtor is discharged by payment to the cedent.42

It is submitted that, as far as possible, cession should be used as the method to transfer the claims from the originator to the SPV.

4 Transfer of Security Rights to the SPV

The rest of this paper considers the transfer of accessory and non-accessory security rights to the SPV during traditional securitisation. In each case, a brief description will be given of the form of security followed by a discussion of the requirements for the transfer of the security right to the SPV. Pledge is generally not used as security during securitisation and is therefore not discussed.

4.1 Mortgage and Notarial Bonds

A mortgage provides a real security right to the creditor over the immovable property of the security grantor. Publicity of the creation of a mortgage is ensured by means of registration in the Deeds Office.43

A notarial bond provides security over the movable property of the security grantor, but publicity is provided by means of registration in the Deeds Office rather than by delivery as in the case of pledge.44 South African law recognises two forms of notarial bond, namely special notarial bonds and general notarial bonds.45

Special notarial bonds were introduced by the Security by Means of Movable Property Act 57 of 1993. It enables the creation of a security right over corporeal movable property specified and described in the bond in a manner that makes it readily recognisable. A special notarial bond provides the holder with a real security right in that property similar to pledge, even though no delivery of the property took place.46
General notarial bonds extend over all the movable property of the security grantor. Control of the security object is unnecessary to establish the bond and the bond may also cover claims and intellectual property rights of the security grantor. As such, it is the most comprehensive form of security that a company may grant over its assets in South African law. Most general notarial bonds contain clauses to the effect that the security taker may take control of the assets in specified circumstances, thereby converting the notarial bond into a pledge. This is referred to as perfecting clauses. However, unperfected general notarial bonds only provide their holders with a preference on the insolvency of the debtor and not with real security.

Mortgage and notarial bonds are accessory in nature and will terminate if the claims are transferred to the SPV by way of delegation. If the claims are transferred by way of cession, the requirements for the valid transfer are a real agreement to transfer the security rights to the SPV and registration of the transfer in the Deeds Office.

However, the transfer of covering bonds presents special difficulties that need to be considered separately.

4.1.1 Covering Bonds

A covering bond secures the balance of the claims that flow from, and the payments made during, an ongoing business relationship between the creditor and the debtor. The bond is not affected by a zero balance at any given time, because the contract between the debtor and creditor still has the possibility of creating new claims.

If the contract between the creditor and the debtor is terminated, the bond will change from a covering bond to a fixed bond, securing the claim that reflects the balance at the moment of termination of the contract. The cession of this claim and the transfer of its accessory bond will be executed in the manner explained above and poses few problems.

It is further possible that the rights and duties of the contract that gave rise to the business relationship between the original creditor and debtor are transferred. The covering bond can be transferred to the cessionary in terms of section 52 of the Deeds Registries Act, retaining priority at the date of registration of the bond. This also does not pose a problem generally, but does in the case of securitisation, as is explained below.

Most credit institutions will not want to end the business relationships with their clients after the securitisation. What they want to do is to cede the balance at a particular moment to the SPV, while retaining the possibility of future advances to the debtor by keeping the contract with the client. The credit institution will want to retain the bond to secure future claims against the debtor. The bond cannot be split to cover claims owed to two creditors, as this is prohibited by section 50(5) of the Deeds Registries Act. It would in effect be an illegal participation bond.

The only way in which it could be made possible for the mortgage to split, so that the mortgage could secure the fixed claim that is ceded to the SPV as well as future advances by the originator, is through legislation. However, even if the division of the bond is enabled by legislation, for instance through an amendment to the Deeds Registries Act, the ongoing relationship between the originator and the debtor leaves certain questions. Where the originator acts as servicer, it will have to be determined whether payments made by the debtor will serve first as payment of the transferred claims or as payment of debts owed to the originator. Furthermore, the fixed amount transferred to the SPV will have to be subtracted from the maximum amount that the
bond will cover; otherwise it will mean that the originator could again advance money to the debtor up to the maximum amount. The total amount owing will then be the ceiling amount plus the fixed amount transferred to the SPV, which will mean that the bond is not adequate to secure the full amount outstanding.

All of this could be addressed through careful planning. What is more problematic is whether the splitting of the bond in favour of two creditors should be allowed, or disallowed, based on policy considerations. The encumberment of the property of the debtor in favour of two creditors where there was previously only one, increases the burden of the debtor.\textsuperscript{56} Even if the debtor consented in the original bond agreement to the transfer of the bond, the debtor probably did not foresee that such a transfer could be only partial and that the bond could be split in favour of more than one security holder.

The registration of the transfer of the covering bond envisaged in section 52 seems to me to indicate a transfer of both rights and duties, since it makes provision for future advances. The SPV, however, does not have the capacity or the capital to conduct the business of a credit provider.\textsuperscript{57}

The originator could transfer the covering bond to the SPV and cede the claims that arise under its business relationship with the debtor to the SPV as they arise. In other words, the claims as they arise are ceded to the SPV, but the originator remains liable for the duties under the original agreement with the debtor. Under such an arrangement the originator should be aware that it no longer has secured claims against the debtors whose covering bonds were ceded. Since it sells those claims to the SPV, the risk it takes by transferring the bond is small.\textsuperscript{58} More problematic is the fact that the Exemption Notice does not make provision for the transfer of only the claims, but requires that the duties towards the debtors must also be transferred to the SPV. This arrangement is therefore not currently allowed in South African law for SPVs that offer securities to the public.\textsuperscript{59}

4.2 Security by means of Claims

Security by means of claims can be created by way of a pledge of claims or in the form of a fiduciary security cession of claims.\textsuperscript{60} If use is made of a pledge of claims, the claims remain in the estate of the pledgor. Consequently, the pledgee will not be able to transfer the claims as security without the consent of the pledgor. There is academic debate in South Africa on whether notice to the debtor is necessary to publicise the creation of a pledge of claims.\textsuperscript{61}

In accordance with the position relating to a pledge of things, a pledge of claims is also of an accessory nature.\textsuperscript{62} If the principal debt is transferred to the SPV by way of cession, the security by way of a pledge of claims will not automatically follow the principal debt into the hands of the cessionary. The SPV will have to enter into a new agreement with the pledgor if it wants to obtain the debt as security. However, it is possible for the pledgor to consent to the transfer of the security in the original agreement to pledge. Owing to its accessory nature, a pledge of claims will terminate on the extinction of the principal debt by way of delegation.

During a fiduciary security cession the claims are transferred to the estate of the cessionary and the cessionary undertakes to cede the claims back to the cedent after settlement of the secured claim.\textsuperscript{63} This agreement is a fiduciary agreement (\textit{pactum fiduciae}). Fiduciary security cession is not accessory in nature. The security does not automatically cease to exist on the termination of the principal debt, unless this is specifically provided for in the security agreement. It is the norm to include terms in
the security agreement to restrict the entitlement of the cessionary to cede the claims. In absence of such an agreement the cessionary can cede the claims to the SPV without the co-operation of the security grantor, because the latter only retains a reversionary interest in the claims.

4.3 Instalment Sale Agreements

In terms of an instalment sale agreement the purchaser agrees with the seller to pay for the purchased thing in instalments over a determined period. The seller retains ownership of the thing until full payment is received. Vehicle financing agreements in South Africa are often instalment sale agreements.

The retention of ownership as security for the claim of the seller is not an accessory form of security. In other words, it is possible for the seller to cede his rights to receive payment to a third party, whilst retaining ownership in the sold things. The ownership will not fall away, as is the case when the principal debt of an accessory security right ceases to exist. Delegation therefore does not bring the seller’s ownership to an end. However, usually the cessionary will want the security provided by the retention of ownership.

The cedent and the cessionary will have to enter into a new agreement to transfer the ownership in the thing to the cessionary. Ownership will not follow the claim automatically. The parties will have to comply with the requirements for the transfer of a real right, in this case ownership. Of specific importance is the requirement that the thing must be delivered to the new owner. Most instalment sale agreements contain a clause to the effect that the purchaser will hold the sold item on behalf of the seller’s cessionaries. It is submitted that the purchaser will be held to such consent.

However, there is a potential problem if the purchaser sells the thing and gives up control in favour of the new purchaser. The new purchaser will not have entered into any agreement to hold the thing on behalf of the original owner and his cessionaries. There is case law to the effect that under these circumstances the original owner will not succeed in transferring ownership, because he will not be able to deliver the thing to the other party. Under these circumstances it will not be possible for the SPV to gain ownership in the sold items. The SPV will take the claims against the purchasers without any security.

If ownership is transferred to the SPV, the SPV must accept the duty to transfer ownership to the purchaser by way of traditio brevi manu once full payment is received. The purchaser will have to consent to the transfer of such a duty, but such consent can be given in the original instalment sale agreement. Furthermore, the real agreement reached when the thing is delivered to the purchaser is enough to let ownership pass to the purchaser on fulfilment of the condition that full payment must be received. It is not necessary to enter into a new real agreement at the time when the final instalment is paid, nor is it necessary that a second form of delivery should take place at that time. This is the case even when the instalment sale agreement is transferred. The duty passed to the SPV to transfer ownership is therefore negligible.

5 Conclusion

It is submitted that the requirements for the transfer of the security rights that secure the claims transferred to the SPV during traditional securitisation in South African law have not been properly considered in practice so far. The consequence of this may
be that many of the current securitisation schemes in South Africa may have less security than initially thought.

All schemes that had to comply with the Exemption Notice would have made use of delegation as the method of transfer of the claims to the SPV, unless there were no further duties owed to the debtor. Delegation is a form of novation which leads to the termination of the original claim. On the termination of the principal debt the security rights accessory to that debt also cease to exist. The Exemption Notice ought to be amended so that cession will be allowed as the method to transfer claims to the SPV, even when there are still duties owing to the debtor by the originator.

Delegation as a method of transfer is furthermore not practical, because the SPV will not have the administrative capability, capital, staff or capacity to perform duties towards the debtor.

The current financial crisis is also felt in South Africa. When the claims transferred to the SPV come under stress due to economic factors, the security provided on those claims becomes more important. It is submitted that the transfer of security rights to the SPV will in many cases not withstand scrutiny if tested by a court.

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* The paper is based on research done towards the author’s thesis Aspects of Traditional Securitisation in South African Law (2008 thesis UNISA).

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2 Schedule, par 1 of Exemption Notice Relating to Securitisation Schemes.

3 Ibid.


5 ‘The business of a bank’ is defined in s 1 of the Banks Act 94 of 1990 as “(a) the acceptance of deposits from the general public … as a regular feature of the business in question; (c) the utilization of money, or of the interest or other income earned on money, accepted by way of deposit as contemplated in (a) … (iii) for the financing, wholly or to any material extent, by any person of any other business activity conducted by such person in his or her own name or through the medium of a trust or a nominee (my emphasis).” If the securities issued by an SPV will be privately placed with investors, these provisions do not apply, since it cannot be construed as constituting the business of a bank. See The Task Group of the Policy Board for Financial Services and Regulation Access to Finance in South Africa: A Supply-Side Regulatory Review (2001) at 164.

6 Schedule, par 4(2)(b).
therefore more correct to refer to ‘claims’ and ‘duties’ and the term ‘duty’ is used in this paper.

of Contract

right to claim performance. From the perspective of the debtor the obligation is a duty to perform. It is

creditor. See

law, English law does not recognise the transfer of a contractual liability without the consent of the

debtor is not a party to the transaction and his consent is not required. As is the case in South African

as a result of which the third party becomes entitled to sue the person liable under the contract. The

person entitled to the benefit of a contract, called the ‘assignor’, and a third party, called the ‘assignee’,

at 877G; Oranje Koöperasie Bpk 1990 (3) SA 848 (A) at 864E–G;

Supreme Court of South Africa Volume 2 Part 2

20 Edwin Peel

The Law of Contract


18 Telkom Ltd v Blom 2005 (5) SA 532 (SCA) at 537A–D; Noormohamed v Visser 2006 (1) SA 290 (SCA) at 295G.

19 Christie & McFarlane supra note 10 at 471.

20 Edwin Peel The Law of Contract 12 ed (2007) at 714 defines assignment as a transaction between a

person entitled to the benefit of a contract, called the ‘assignor’, and a third party, called the ‘assignee’,
as a result of which the third party becomes entitled to sue the person liable under the contract. The
debtor is not a party to the transaction and his consent is not required. As is the case in South African

law, English law does not recognise the transfer of a contractual liability without the consent of the

creditor. See Linden Gardens Trust Ltd v Lenesta Sludge Disposals Ltd [1994] 1 AC 85 (HL) at 103;

Peel supra at 747.

21 Phillip Wood Title Finance, Derivatives, Securitisations, Set-off and Netting (1995) at 51; Norton et

al International Asset Securitization (1995) at 54. Thomas W Albrecht & Sarah J Smith ‘Corporate


provides a further reason in American law. Novation terminates any security interest that attached
to the original agreement. Since the original agreement is terminated by novation, the security for the

claims resulting from that contract is also terminated. This has the practical effect that the newly agreed

security interest must be filed, which has an effect on the priority of the security and will mean that the

avoidance periods will start to run afresh.

22 Schedule, par 2(1)(c).

23 Schedule, par 4(2)(i). The term ‘undrawn commitment’ is not defined in the Notice, but it is

submitted that it refers to the duty to lend money to the borrower in future, which will give rise to

future claims against the borrower.


25 Schedule, par 1.

26 Schedule, par 4(2)(j).

27 Kilburn v Estate Kilburn 1931 AD 501 at 506: “It is therefore clear that by our law there must be a

legal or natural obligation to which the hypothecation is accessory. If there is no obligation whatever

there can be no hypothecation giving rise to a substantive claim.” This principle was subsequently

affirmed in Thienhaus v Metje & Ziegler Ltd 1965 (3) SA 25 (A) at 32F–G. For a detailed analysis of

the effects of the accessory nature of real security in South African law, see Natania Strydom Die

Most South African authors, as well as the Courts, seem to put the emphasis on the publicity of the transfer of the real right. See TJ Scott & Susan Scott ‘Wille’s Law of Mortgage and Pledge in South Africa’ 3 ed (1987) at 77; Scott supra note 15 at 130; De Wet & Van Wyk supra note 10 at 405–406; Shaw NO v Burger 1994 (1) SA 529 (C) at 534B–C; Lief v Dettmann 1964 (2) SA 252 (A) at 273H.

In accordance with the maxim “nemo plus iuris transferre potest quam ipse habet”, no one can transfer more rights to another than he himself has.

Section 52: “A cession of a mortgage bond or notarial bond passed to secure future advances may be registered and the registration of such cession shall not affect the provisions of the bond relating to future advances up to the amount stated in such bond or the amount as reduced.”

Strydom supra note 27 at 63–64. Pledge is not a form of security often used during securitisation and will not be further discussed.

This is also the opinion of Scott supra note 15 at 131 and Sonnekus supra note 29 at 779–780.

Scott supra note 15 at 1; Johnson v Incorporated General Insurance Ltd 1983 (1) 318 (A) at 331G–H.

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Susan Scott ‘Die Rol van Kennis van Sessie aan die Skuldenaar’ 2007 TSAR at 820. See also Nienaber supra note 17 at 5. The cedent retains nothing that can be ceded a second time and therefore a second cession should be invalid. See Scott supra note 15 at 141–146. However, this principle is not always adhered to by South African courts and there have been cases where notice to the debtor has been held to be a determining factor in who is entitled to the claim. This is probably due to erroneous interpretation of the old sources (see Scott supra note 15 at 142 for an example) and might also be due to confusion with the English law position in this regard. During the earlier part of the twentieth century most prominent South African judges received their education in England. In English law the rule in Dearle v Hall (1828) 3 Russ 1 provides that the assignee who first gives notice of the cession to the debtor has the strongest right to the claim, provided that the second assignee does not have knowledge of the prior assignment. For criticism on the rule in Dearle v Hall, see Gerard McCormack Secured Credit under English and American Law (2004) at 244; Fidelis Oditah Legal Aspects of Receivables Financing (1991) at 140–142; Fidelis Oditah ‘Priorities: Equitable versus Legal Assignments of Book Debts’ (1989) 9 Oxford Journal of Legal Studies at 525–527.

Notice must come from the cedent, because it is the only reliable confirmation to the debtor of the cession. Otherwise the debtor will need to verify every notification of a cession. See Scott supra note 15 at 107–108; Scott 1998 THRHR at 97 and 104.

Illings (Acceptance) v Ensor NO 1982 (1) SA 570 (A) at 578F. The courts provided two possible reasons why a debtor will receive discharge by payment to the cedent when he has not received notice of the cession, namely estoppel (Katz v Katzenellenbogen 1955 (3) SA 188 (T) at 191B) and good faith. Scott supra note 40 at 820–822 prefers the approach based on good faith as held in Brook v Jones 1964 (1) SA 765 (N) at 767D–F. A debtor makes payment to a cedent in good faith if he is under the impression that he must pay that person, whilst having reasonable grounds for such a belief. The debtor does not receive discharge because of the absence of formal notice, but because he was not aware of the cession. See further Nienaber supra note 17 at 38–39. The position is similar in English law where after an equitable assignment a debtor that has not received notice of the assignment will get a good
discharge for the debt when paying the original creditor. See Bence v Shearman [1898] 2 AC 367 at 382. Also in American law revised §9-406(a) of the Uniform Commercial Code provides that an account debtor on an account, chattel paper or payment intangible may continue to discharge his obligations by paying the assignor, until the account debtor receives notice that the claim has been assigned and that payment must now be made to the assignee. See also McCormack note 45 at 233–234.

43 Section 102 of the Deeds Registries Act 47 of 1937. On mortgage generally, see Scott & Scott supra note 30 at 48–52; Badenhorst supra note 15 at 358 et seq.

44 Section 61(1) of the Deeds Registries Act 47 of 1937. Companies need only register the notarial bond in the deeds registry for the area in which their registered office is situated (s 62(4)). See also Hare v Trustee of Heath (1884–1885) 3 SC 32 at 34.

45 ‘Notarial bond’ is defined in s 102 of the Deeds Registries Act 47 of 1937 as “a bond attested by a notary public hypothecating movable property generally or specially.” On notarial bonds generally, see GF Lubbe ‘Mortgage and Pledge’ in WA Joubert et al The Law of South Africa Vol 17 Part 2 ed (2008) at 287 et seq; Badenhorst supra note 15 at 384 et seq.


47 South African law does not allow the creation of a general bond over both the movable and immovable property of the security grantor. See s 53(1) of the Deeds Registries Act 47 of 1937.

48 Netherlands Bank of South Africa v Yull’s Trustee & The United Building Society 1914 WLD 133.

49 Rosenbach & Co (Pty) Ltd v Dalmonie 1964 (2) SA 195 (N); Hymie Tucker Finance Co (Pty) Ltd v Alloyex (Pty) Ltd 1981 (4) SA 175 (N). See further Lubbe supra note 45 at 360.


51 Section 102 of the Insolvency Act 24 of 1936. Also see Lubbe supra note 45 at 362.

52 Sections 3(f), 3(j) and 16 of the Deeds Registries Act 47 of 1937. See also the discussion in supra par 3.1.1.

53 Strydom supra note 27 at 74–75. Here it is argued that the balance is a new claim created by novation, which means that the individual claims resulting from the credit relationship no longer exist. See further GF Lubbe ‘Die Aksessoriteitsbeginsel en die Sessie van Dekkingsverbande’ (1987) 20 De Jure at 243; CG van der Merwe & Eric Dirix ‘A Comparative Law Review of Covering Bonds and Mortgages Securing Fluctuating Debts’ (1997) 8 Stell LR at 19.

54 The section reads as follows: “Save as authorized by any other law or by order of Court, debts or obligations to more than one creditor arising from different causes may not be secured by one mortgage bond or notarial bond.”

55 On participation bonds generally, see the Collective Investment Schemes Control Act 45 of 2002, ss 52–61. Van der Merwe & Dirix supra note 53 at 27 recognise this situation as problematic, but do not attempt to provide a solution.

56 Cession must not affect the debtor adversely. See Nienaber supra note 17 at 31.

57 See the discussion supra par 3.1.

58 The exception is where the bond secures all amounts owing to the originator “arising from any cause whatsoever”, and the debtor owes the originator considerable sums outside of the claims transferred to the SPV. See Van der Merwe & Dirix supra note 53 at 19.

59 Unless the SPV is prepared to register as a deposit-taking institution. This has immense capital requirements and is subject to strict supervision.


62 See Natania Locke ‘Aksessoriteit en Sekerheidstelling deur middel van Vorderingsregte’ 1998 TSAR at 486 et seq. See also Scott supra note 15 at 238–239; Scott 1997 THRHR at 182–183 and 448.

63 Lief v Dettmann 1964 (2) SA 252 (A); Trust Bank of Africa v Standard Bank of SA 1968 (3) SA 166 (A), although it may be argued that the Court’s pronouncement on cession in securitatem debiti in both
these cases were *obiter dicta* (Strydom *supra* note 27 at 116–117 and 119). On fiduciary security cession in general, see Scott 1988 *THRHR* at 434; Susan Scott ‘Algehele Sekerheidsessies’ (1989) 52 *THRHR* at 45; Scott 1997 *THRHR* at 197–201.

64 The National Credit Act 34 of 2005 defines ‘instalment agreement’ as follows: “a sale of movable property in terms of which – (a) all or part of the price is deferred and is to be paid by periodic payments; (b) possession and use of the property is transferred to the consumer; (c) ownership of the property either – (i) passes to the consumer only when the agreement is fully complied with; or (ii) passes to the consumer immediately subject to a right of the credit provider to re-possess the property if the consumer fails to satisfy all of the consumer’s financial obligations under the agreement; and (d) interest, fees or other charges are payable to the credit provider in respect of the agreement, or the amount that has been deferred.”

65 See also *Caledon & SWD Eksekuteurskamer Bpk v Wentzel* 1972 (1) SA 270 (A) at 274H–275A, where the Court remarks in an *obiter dictum* that the purchaser would not be allowed to change his mind after initially consenting to possess the thing on behalf of the transferee. See further *Trust Bank van Afrika Bpk v Bitzer* 1978 (4) SA 115 (O) at 122H.

66 For historical reasons, South African law does not require transfer of ownership of a thing as an essential requirement for a contract of sale. It is a *naturalia* of a contract of sale that the seller will transfer ownership if he has it or can obtain it, failing which, to warrant against eviction. See Kerr *supra* note 16 at 177 et seq; De Wet & Van Wyk *supra* note 10 at 329–332; Joubert *supra* note 15 at 329–331; *ABSA Bank Ltd v Myburgh* 2001 (2) SA 462 (W) at 467F–G.

67 *ABSA Bank Ltd v Myburgh* 2001 (2) SA 462 (W) at 466B–C.

68 See also *Labuschange v Denny* 1963 (3) SA 538 (A) at 544C–D.

69 *Info Plus v Scheelke* 1998 (3) SA 184 (SCA) at 190I–J.

70 *Info Plus v Scheelke* 1998 (3) SA 184 (SCA) at 191G–H.

71 See the facts of *Info Plus v Scheelke* 1998 (3) SA 184 (SCA) at 187I–189A.