CONCENTRATED OWNERSHIP AND CONTROL OF CORPORATE REORGANIZATIONS

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Abstract

Firms undergoing reorganization face various legal problems, all of which are derived from the uncertainty concerning the firm's actual value. The various claimants to the firm's value, creditors as well as equityholders, wish to exercise control over the managing of the firm in a manner consistent with their relative priority and risk preference. Under current bankruptcy law around the world, there are two leading models for governing a firm undergoing reorganization. One model allows the incumbent management to remain in office as a debtor-in-possession. The other mandates that an appointed trustee replace the management. This article examines the relative advantages of each model and links each model to a different type of corporation. The article argues that while the debtor-in-possession model suits the Berle-Means firm, whose ownership is widely dispersed, it is unfit for concentrated ownership firms. Reorganization of such firms requires an objective trustee. The article continues and refines the controlling model for concentrated ownership firms by proposing that the appointed trustee shall serve alongside the management rather than in lieu thereof. This co-determination model of control shall encourage the incumbent management to file for reorganization in a timely fashion and thus salvage any going concern value which otherwise is liable to be lost.
I. INTRODUCTION

Bankruptcy law addresses the financial difficulties of business entities by offering two distinct paths. Either the distressed firm liquidates or it reorganizes. The first path entails a process controlled by an appointed trustee, by the end of which all the assets of the firm are liquidated and the proceeds distributed to the firm's creditors following the absolute priority rule. By contrast, reorganization is intended to provide the firm with a framework in which it can continue to operate as a viable entity while negotiating with its creditors a plan for treatment of their claims. Under reorganization plans, creditors’ claims may be satisfied by the debtor firm through cash payments, the issuing of debt instruments or the conversion of claims into equity interests in the debtor. In the US, upon a voluntary act by their boards of directors financially ailing firms invariably turn to reorganization and file a bankruptcy petition under Chapter 11 of the Bankruptcy Code.1 Liquidation of such firms will take place only where the reorganization attempt fails.2 Although the desirability of reorganization under Chapter 11 has been subject to continuous questioning by many commentators from the academia,3 Chapter 11 has so far withstood the barrage and to

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1 A total of 176 bankruptcy filings was reported for public corporations during the year 2000. See http://www.bankruptcydata.com/. Stuart Gilson reports that the exact same figure is the total of all Chapter 11 filings for public corporations in that year. See SC Gilson, Creating Value Through Corporate Restructuring: Case Studies in Bankruptcies, Buyouts, and Breakups (New York, John Wiley & Sons Inc., 2001), 23, Exhibit 11.1.
2 The Bankruptcy Code provides for the conversion of failed reorganization cases to liquidation under Chapter 7 thereof. See § 1112(a).
date remains one of the hallmarks of US business law. Perhaps the most appealing feature of reorganization under Chapter 11 to a debtor firm is that the incumbent management remains in office and continues to control the firm during its attempt to reorganize.\textsuperscript{4} This management-friendly approach of Chapter 11 can explain its evolvement as the leading vehicle for treating the financial affairs of distressed firms.\textsuperscript{5}

Contemporary bankruptcy laws of other countries around the world follow the lead of the US. That is, whereas a few decades ago the laws of many foreign countries effectively forced failing firms to liquidate, modern bankruptcy statutes offer such firms the alternative of reorganization.\textsuperscript{6} However, unlike the US, the

\textsuperscript{4} Management runs the debtor corporation as the “debtor-in-possession”. See Bankruptcy Code § 1101(1). For purposes of this article, unless specified otherwise, the term “management” encompasses both the officers and the directors of a debtor corporation. Cf. Bankruptcy Rules 9001(5) (describing management as “the officers, directors, retained professionals and business management”); BL Zaretsky, “Trustees and Examiners in Chapter 11” (1993) 44 South Carolina Law Review 907, 908, n.1.

\textsuperscript{5} In a corporation, the board of directors is the primary decision maker for all strategic actions of the corporation. Thus, any board-friendly rule would obviously lure the board to opt for it whenever the board faces alternative options. Such considerations underlie the debate whether the freedom to choose the state of incorporation and its applicable corporations law creates a “race to the top” or “race to the bottom”. Indeed, the decision in which state to incorporate or reincorporate is believed to be strongly affected by the potential states’ rules concerning the flexibility of a board’s operation, the extent of liability to which the board may be exposed for breach of its fiduciary duties, and the degree of defensive measures it may employ against hostile takeovers. See WL Cary, “Federalism and Corporate Law: Reflections Upon Delaware” (1974) 61 Yale Law Journal 663; RK Winter, Jr., “State Law, Shareholder Protection, and the Theory of the Corporation” (1977) 6 Journal of Legal Studies 251; FH Easterbrook & DR Fischel, The Economic Structure of Corporate Law (Cambridge, Mass., Harvard Univ. Press, 1991), 222-227; LA Bebchuk, “Federalism and the Corporation: The Desirable Limits on State Competition in Corporate Law” (1992) 105 Harvard Law Review 1435; R Romano, “Competition for Corporate Charters and the Lesson of Takeover Statutes” (1993) 61 Fordham Law Review 843; LA Bebchuk & A Ferrell, “Federalism and Corporate Law: The Race to Protect Management from Takeovers” (1999) 99 Columbia Law Review 1168; LA Bebchuk & A Ferrell, “A New Approach to Takeover Law and Regulatory Competition” (2001) 87 Virginia Law Review 111.

statutes of many of these countries mandate that even in reorganization cases an appointed trustee or some other equivalent officer shall control the proceedings and supplant the firm’s management.\(^7\) Indeed, some have questioned whether reorganization under such regimes is anything more than lip service or dressing up the image of the law. The displacement of management discourages a voluntary filing for reorganization,\(^8\) and creditors invariably file for the liquidation of a debtor.\(^9\) Thus, it is unlikely that reorganization cases will commence in practice in such regimes. On the other hand, the employment of an objective and disinterested appointed officer may soften part of the major criticism which Chapter 11 attracted in the US concerning its potential abuse by management to the detriment of creditors.\(^10\)

This article finds each of the two leading bankruptcy regimes which are in effect around the world to possess relative strengths as well as weaknesses. Thus, none seems compellingly superior to the other. Rather, the desirability of a certain bankruptcy regime is dependent on external factors that are nation sensitive. In different markets the various players in the market, namely the corporate debtors, creditors and equityholders possess different bargaining power and leverage over one another in the prebankruptcy period. Moreover, countries differ in the structure of

\(^7\) See The Insolvency Act 1986 (hereinafter: The Insolvency Act), Schedule B1 § 10 (requiring the appointment of an administrator for reorganizing an English firm under the administration procedure); see also 3 COLLIER’S INTERNATIONAL BUSINESS INSOLVENCY GUIDE ¶ 29.04[4][a] (The Japanese Corporate Reorganization Law (Kaisha Kosei Ho) requires the appointment of an interim trustee who will take over the authority of the former management).

\(^8\) See DA Skeel, Jr., “An Evolutionary Theory of Corporate Law and Corporate Bankruptcy” (1998) 51 Vanderbilt Law Review 1325, 1343 (explaining that because of the displacement of management in reorganization, German and Japanese firms have a strong bias towards filing for liquidation). Note that the new German Insolvency statute does provide for a debtor-in-possession controlled reorganization. However, the determination whether the debtor is bound at all for reorganization or for liquidation is not in the hands of management but rather the creditors. See Paulus, supra n 6, 92.

\(^9\) See S. Block-Lieb, “Why Creditors File So Few Involuntary Petitions and Why the Number is Not Too Small” (1991) 57 Brooklyn Law Review 803, App. A (finding that of the total involuntary bankruptcy petitions filed by creditors in the US between the years 1979-1988, 83.47% (an average of 1178 petitions out of a total annual average of 1411 petitions) were filed under Chapter 7 of the Bankruptcy Code).
corporate governance of their corporations. Based on this understanding, the article
develops the proposition that the structure of corporate governance and the bargaining
power of the various players active in a national market strongly affect the desirable
model for reorganization law in that country. In jurisdictions where corporate law is
influenced by the Berle-Means corporate model,\textsuperscript{11} that is, where the control by
management is separated from the equityholders' ownership of the firm, management
can be relied on to continue controlling the debtor firm through the bankruptcy case
and cooperate with the creditors. On the other hand, in jurisdictions where the
equityholders closely control the firm, allowing management to keep control of the
debtor firm jeopardizes the creditors and leaves them vulnerable to equityholders’
manipulation. Accordingly, I call for the rejection of the Chapter 11 model of
management-controlled reorganizations for concentrated ownership firms. Rather, I
propose for such firms a new model which combats the equityholders’ manipulation
risk on one hand, yet does not automatically oust management from office upon the
inception of reorganization. Keeping management in office is the tax I am willing to
pay in order to ensure timely filing for reorganization by viable entities. Thus, I call
for a co-determination model of control in bankruptcy. Under my proposal, in
markets characterized by the close control of corporate groups dominated by majority
equityholders, an insolvent firm attempting to reorganize shall be managed by the
prebankruptcy management team in conjunction with an appointed trustee. The
trustee shall join the board and have a veto voice thereon. This co-determination
model of control may achieve a better representation of the interests of the various

\textsuperscript{10} For such criticism of Chapter 11 see particularly Bradley & Rosenzweig, \textit{supra} n 3; DG Baird
& RK Rasmussen, “Control Rights, Priority Rights, and the Conceptual Foundations of Corporate

\textsuperscript{11} In their seminal work, published in 1932, Adolph Berle and Gardiner Means shed light on the
most crucial factor in the development of large corporations in the US, namely the separation between
the dispersed and passive investors (the owners) and management (the controlling group). See A Berle
groups of claimants, creditors as well as equityholders, in the decision-making process.

This article proceeds as follows. Following this introduction, Part II describes the two leading models of corporate insolvency which can be found in the western world. The first model is the US reorganization law. As already briefly stated, Chapter 11 of the Bankruptcy Code allows the incumbent management of the reorganizing firm to maintain control of the firm in its role as debtor-in-possession. The second model is a reorganization scheme under which an appointed trustee controls the insolvent firm. This is the UK model. Under the English Insolvency Act, the court appoints an administrator for managing the insolvent corporation.

Part III follows by weighing the normative arguments supporting each of the two models and exposing their relative shortfalls. The weakness of the US model is that it is unfit for implementation in a market dominated by strong equityholders. The weakness of the UK model is that it deters management, the group possessing the crucial information concerning the corporation’s financial condition, from timely filing a petition for reorganization. Moreover, even in markets where credit is heavily dependent on few local banks with hardly any competition between them, the banks, as close monitors of their debtors, cannot be relied on to timely commence reorganization for the overall maximization of firm value because the banks act in their own self interests.

Based on the critique of the various corporate insolvency models in Part III, Part IV then proposes an alternative reorganization scheme for concentrated ownership markets. The proposal calls for a co-determination model of control of an

12 See supra n 4.
13 Insolvency Act, Schedule B1 § 10.
insolvent firm, under which an appointed trustee shall join the firm’s board of
directors and hold a blocking veto power over its decisions. The article concludes that
this model will better represent the interests of all interested groups, equityholders,
management and the various groups of creditors. Accordingly, the co-determination
model can mitigate most of the shortcomings of the existing models of reorganization
law.

II. CONTROLLING FIRMS IN BANKRUPTCY:
TWO MODELS OF CONTROL

Western countries employ different sets of laws to deal with an insolvent firm. Some are commonly labeled creditors-oriented, while others are perceived as
debtor-oriented. These labels imply whether the national law focuses primarily, if not
exclusively, on the collection rights of the creditors or on the survival of the
financially distressed firm and the continuance of its operations as well. Such
labeling represents the great ideological debate on corporate bankruptcy and its policy
goals.14 Believing that an ideological classification is too abstract, this part of the
article classifies the various insolvency laws differently. It focuses on the control of
the corporation once it files for bankruptcy as the prominent factor in any given
regime. This division of the various laws shows that there are two leading models of
corporate bankruptcy. The US model entrusts the control of the insolvent firm to the
incumbent management. The UK model employs the services of an outside trustee.15

Review 519, 519-521.
15 Sweden employs an insolvency regime which is considerably different from that of most other
western countries. Under Swedish insolvency law, upon the filing for bankruptcy an automatic stay is
imposed on all debt collection means, including the foreclosure on collateral. A court-appointed trustee
takes control of the firm for the purpose of arranging a cash-auction of the firm either as a
going-concern or of its assets in piecemeal. The consideration offered in the auction must be in cash.
The creditors are paid out of the auction’s proceeds in strict adherence to the absolute priority rule. See
This part outlines the mechanics of each of these models. A normative analysis of the relative advantages and weaknesses of each model then follows in Part III.

1. The US model: DIP

Corporate bankruptcy cases in the US take one of two major courses. Either the assets of the debtor\(^\text{16}\) will be liquidated\(^\text{17}\) or an attempt will be made to reorganize the business or affairs of a debtor while the creditors will receive value over time from the cash flow of the debtor’s business or affairs.\(^\text{18}\) Under Chapter 7 of the Bankruptcy Code, a liquidation case is controlled by an appointed trustee.\(^\text{19}\) The trustee takes control of all the business affairs and dealings of a corporate debtor. Once appointed, the trustee is the officer empowered to make all necessary decisions in connection with managing the assets of the newly created bankruptcy estate to the end of

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B Espen-Eckbo & KS Thorburn, “Overbidding vs. Fire-Sales in Bankruptcy Auctions” ¶ 3.1 available at <http://papers.ssrn.com/sol_3/papers.cfm? abstract_id=305619>. The Swedish mandatory auction regime, a longtime favorite model amongst prominent law and economics scholars, focuses primarily on the outcome of a bankruptcy case. (The classic papers developing an auction-based approach to corporate bankruptcy are Baird, supra n 3; DG Baird, “Revisiting Auctions in Chapter 11” (1993) 36 Journal of Law & Economics 633 (hereinafter: Baird, Revisiting Auctions); cf. TH Jackson, “Comment on Baird, ‘Revisiting Auctions in Chapter 11’” (1993) 36 Journal of Law & Economics 655) That is, rather than reorganizing the claims of creditors internally through the confirmation of a reorganization plan, in Sweden the final stage of bankruptcy is external, in that the firm’s assets are sold to the highest bidder on the market. This article, however, focuses on the identity of the controlling person upon the inception of a bankruptcy case and its effect on the incentives of the parties to timely commence reorganization proceedings. Thus, the Swedish law will not serve as an independent model, but rather will be considered as a trustee-controlled regime.

\(^{16}\) The debtor’s prepetition assets comprise the “bankruptcy estate” which eventually becomes available for distribution to the creditors. Bankruptcy Code § 541.

\(^{17}\) In liquidation cases, if the debtor is an individual she will receive a discharge for her prebankruptcy debts that remained outstanding after the conclusion of the liquidation process. If the debtor is a corporation, it will dissolve upon the conclusion of the liquidation.

\(^{18}\) The value the creditors will receive may be in cash installment payments or through the appreciation of equity securities they receive under the reorganization plan in exchange for their debt claims. See Bankruptcy Code § 1123(a)(5)(I), (J). However, when a reorganization plan is being confirmed over the dissent of a class of secured claims (a cramdown plan), that dissenting class must be paid in cash payments only and not through the issuance of securities. See Bankruptcy Code § 1129(b)(2)(A)(i)(II).

\(^{19}\) Once a bankruptcy case has commenced and the bankruptcy court has entered an order for relief, an interim trustee is appointed by the US Trustee. Bankruptcy Code § 701. Thereafter, at the first meeting of creditors, which is held under the mandatory provision of § 341 of the Bankruptcy Code, the creditors may elect a trustee. Bankruptcy Code § 702(b). If no trustee is elected at the meeting of creditors, the interim trustee serves as the trustee in the case. Ibid § 702(d).
liquidating the assets and distributing the proceeds thereof to the claimants and to examine and administer all proofs of claims filed by the creditors. Thus, under the mandatory regime of bankruptcy law, the management of a debtor firm is divested of its general powers under applicable state corporations law, is ousted from office and superseded by a trustee. The control and administration of a corporate debtor that is seeking to reorganize its business through Chapter 11 of the Bankruptcy Code is strikingly different. One of the fundamental principles underlying the mechanism of a Chapter 11 reorganization is that the prebankruptcy executive management of the corporate debtor remains in office and controls the reorganization process to the stage of confirming a reorganization plan. This principle is embodied in the concept of a debtor-in-possession (DIP). In its role as a debtor-in-possession, the management controls the daily operations of the debtor, its investment decisions and its financing decisions. Moreover, in this role the management also controls the ultimate decision concerning the corporation’s future. That is, management will get to decide whether the corporation is headed towards reorganization of its business or liquidation. It will also lead the negotiations between the corporation and the various groups of

20 Ibid § 704(1).
21 Ibid § 704(5).
24 Bankruptcy Code § 1107 provides that “a debtor-in-possession shall have all the rights … and powers, and shall perform all the functions and duties … of a trustee serving in a case under this chapter”.
25 In bankruptcy, a debtor enjoys new avenues for obtaining credit financing by allowing the lender to receive a superior priority for its postpetition financing. See Bankruptcy Code § 364(b), (c) and (d) (granting the postpetition financing the benefit of an administrative expense priority, a superpriority senior to all administrative expenses, or a secured claim, respectively).
26 A Chapter 11 plan may provide for the liquidation of the debtor’s assets and the distribution of the proceeds thereof to the holders of claims and interests. See Bankruptcy Code § 1123(b)(4); In Re Sandy Ridge Development Corp. 881 F.2d 1346, 1352 (5th Cir., 1989); In Re Ionosphere Clubs 184 B.R. 648, 654 (S.D.N.Y. 1995); In Re River Village Assocs. 181 B.R. 795, 805 (E.D. Pa. 1995).
claimants in structuring the reorganization (or liquidation) plan. The Supreme Court has explained that the acceptance of the debtor-in-possession “is premised upon an assurance that the officers and managing employees can be depended upon to carry out the fiduciary responsibilities of a trustee”. In short, Chapter 11’s concept of a debtor-in-possession is one which distinguishes the US reorganization law from corresponding laws in other countries.

The history of US reorganization law, as actually practiced, reveals that the idea of leaving the prebankruptcy management at the steering wheel and allowing it to navigate the corporate debtor through the reorganization case can be traced back to the late nineteenth century. Courts and later the legislature adopted this concept consistently save for a relatively brief statutory experiment involving an appointed trustee in certain reorganization cases. This short experiment started in 1938 upon the enactment of the Chandler Act, a statutory amendment to the Bankruptcy Act, 1898. The Chandler Act added to the Bankruptcy Act Chapter X, entitled “Corporate Reorganizations”. The most significant reform introduced by Chapter X was its

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27 The debtor is the only one who can file a plan until the expiry of 120 days after the date of the order for relief. Bankruptcy Code § 1121(b).
29 For other countries’ mandatory appointment of a trustee see supra n 7.
31 Ch. 575, 52 Stat. 840 (1938).
32 The Chandler Act was a culmination of the work and lobbying of various forces which pushed for the reform of bankruptcy law in the wake of the 1929 recession and as part of the New Deal reforms. The Chandler Bill was introduced to Congress by Senator Chandler of Tennessee, as the product of his collaboration with the National Bankruptcy Conference. At the same time, two other bills were introduced, one by Representative Sabath of Illinois, and the other sometime later by Representative Lea. The driving force behind the Lea Bill and, eventually, behind the enactment of the Chandler Act in Congress was no less than the SEC, chaired by William O. Douglas. Having drafted the Securities and Exchange Commission Report on the Study and Investigation of the Work, Activities, Personnel and Functions of Protective and Reorganization Committees, pts. 1-8 (1937-1940) (hereinafter: The Douglas Report), Douglas led the SEC’s campaign to reform bankruptcy law as part of the New Deal, to oust management and their Wall Street lawyers from the reorganization cases, and to introduce to such cases both outside trustees as well as the governmental intervention of the SEC. For an excellent account of the legislative history of the Chandler Act see DA Skeel, Jr., Debt’s Dominion: A History of Bankruptcy Law in America, (Princeton, NJ, Princeton Univ. Press, 2001), 101-127. For further description of Douglas’ role in the Chandler Act reform see W Jennings, “Mr.
requirement that a trustee be appointed in large-scale corporate reorganizations. However, this experiment proved unsuccessful, as the bankruptcy practice circumvented the effective operation of Chapter X. Advised by their lawyers, debtor firms filed for reorganization under Chapter XI of the Bankruptcy Act (entitled “Arrangements”). Chapter XI provided only for reorganizing unsecured claims and was originally intended for reorganizing rather expeditiously small corporations with few creditors. But it nonetheless allowed management to retain control of the debtor corporation. This made Chapter XI the popular choice of practice. Chapter X was effectively neglected. When the current Bankruptcy Code was enacted in 1978, the trustee controlled reorganization regime of Chapter X was put to rest by the legislature. The debtor-in-possession won the day and earned its primacy in corporate reorganizations.

2. The UK model: Trustee

The UK has traditionally approached corporate bankruptcy rather stringently. Before the legislative reform of 1986 statutory law effectively provided solely for the liquidation of corporations. In the common case of a corporation encumbering all

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Chapter X mandated the appointment of a disinterested trustee for any corporation that filed for bankruptcy with at least $250,000 in liabilities. Bankruptcy Act § 156. The Chandler Act intended to appoint trustees (via chapter X) for the large publicly-traded corporations, but not for the small closely-held ones (which were intended to reorganize by using chapter XI). See ES Adams, “Governance in Chapter 11 Reorganizations: Reducing Costs, Improving Results” (1993) 73 Boston Univ. Law Review 581.


Congress learned that by the mid 1970s less than 10% of all corporate reorganization cases were filed under Chapter X. See H.R. Rep. No. 95-595, at 222 (1977).

A mechanism limited in its practicality for reorganizing firms which preceded the 1986 reform of insolvency law was a compromise or arrangement between the corporate debtor and its creditors under general legislation pertaining to companies. Compare The Companies Act 1985, § 425. For a short description of the history of English insolvency law see F Tolmie, Introduction to Corporate and Personal Insolvency Law (London, Sweet & Maxwell, 1998), Ch. 5.
its assets to a major secured creditor as a floating charge, that creditor would take control of the assets and enforce its claim through the appointment of a receiver. Because the receiver would take control of an operating business, in practice this procedure was at times used to preserve the going concern value of the debtor and maximize the return to the secured creditor. But not every case of a financially distressed corporation necessarily involves a creditor secured by a floating charge. In order, inter alia, to address corporate failure in a comprehensive manner and facilitate the preservation of going concern values of corporations, Parliament enacted the Insolvency Act, 1986. This act introduced the administration proceeding, which is the primary English reorganization scheme. The administration procedure is triggered by the filing of a petition for an administration order with the court, or by the appointment of an administrator directly by a creditor secured by a floating charge, the corporation, or its directors. After a hearing on the petition, the court

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37 A floating charge was characterized, yet not defined precisely, by Lord Justice Romer in Re Yorkshire Woolcombers Assoc., Ltd. [1903] 2 Ch. 284, 295 as a charge that bears the following attributes: (a) it is a charge on a class of assets of a company, including both present and future assets, (b) the class is one which, in the ordinary course of business of the company, would be changing from time to time, and (c) it is contemplated between the debtor and chargee that until some future step is taken by the chargee, the company may carry on its ordinary course of business in respect of the class of charged assets. See also E Ferran, “Floating Charges – The Nature of the Security” (1988) 47 CLJ 213. For a general account of the floating charge see Report of the Review Committee, Insolvency Law and Practice, Cmd 8558 (June 1982), §§ 101-110 (hereinafter: The Cork Report).


39 This act was the legislative implementation of the recommendations of the Cork Report, supra n 37. At the outset of this report, the committee stated that English law at the time failed to adequately address the main problems of insolvency, individual cases as well as corporate cases, as the law was not “in tune with modern needs” but rather responsive “to the economic conditions and attitudes prevalent over 100 years ago”. Ibid, ¶ 8.

40 English law bifurcates the reorganization case. The procedure named “administration” governs the initial stage of reorganization, in a similar manner to Chapter 3 of the US Bankruptcy Code which covers case administration. The final stage of the case, the plan confirmation, is governed either under the Insolvency Act’s Company Voluntary Arrangements procedure or under Section 425 of the Companies Act 1985 (compromise or arrangement). See RM Goode, Principles of Corporate Insolvency Law (London, Sweet & Maxwell, 2d ed, 1997), 270-71.

41 A petition may be filed by a debtor corporation, its directors, or one or more of its creditors. Insolvency Act, Schedule B1 § 12(1).

42 Insolvency Act, Schedule B1 § 14(1).

43 Insolvency Act, Schedule B1 § 22(1).

44 Insolvency Act, Schedule B1 § 22(2).
may issue an administration order and appoint an administrator. The administrator is effectively a trustee-in-reorganization. The administrator takes control of the business, affairs and assets of the debtor and often works to propose and effectuate a reorganization plan. Upon the issuing of an administration order, a moratorium barring enforcement of all claims against the debtor and its assets takes effect. Recently, the legislature has bolstered the dominancy of the administration proceeding as the main course of dealing with financially distressed corporations by limiting the secured creditors' resort to the formerly alternative of administrative receivership.

45 Insolvency Act, Schedule B1 § 13(1).  
46 Unlike a winding-up order, an administration order does not act per se to oust directors of the firm from office. Directors of a corporation undergoing administration may remain in office and even be re-elected. Nonetheless, the exercise of their functions is entirely subject to the discretion of the administrator and the latter may also remove directors from office. Insolvency Act, Schedule B1 § 61; RR Pennington, Pennington’s Corporate Insolvency Law (London, Butterworths, 1991), 330; IM Fletcher et al., The Law and Practice of Corporate Administrations (London, Butterworths, 1994), 98-99.  
47 Insolvency Act, Schedule B1 § 59(1).  
48 Indeed, at the crux of the administration procedure is the desire to provide the corporation with a breathing space that will allow the administrator to devise a reorganization plan and propose it to the creditors. The English Court of Appeal summarized the nature of administration as follows: “[A]n administration is intended to be only an interim and temporary regime. There is to be a breathing space while the company, under new management in the person of the administrator, seeks to achieve one or more of the purposes set out in Section 8(3) (those purposes are the survival of the debtor as a going concern, the approval of a company voluntary arrangement or a court sanctioned compromise between the debtor and its creditors, or a more advantageous realization of the debtor’s assets as compared to liquidation-D.H.). There is a moratorium on the enforcement of debts and rights … against the company, so as to give the administrator time to formulate and lay them before the creditors …” Re Atlantic Computer Systems plc [1992] Ch. 505, 528 (CA).  
49 Insolvency Act, Schedule B1 §§ 41-43 (hereinafter: the “administration order moratorium”). A moratorium narrower in its scope takes effect earlier, upon the filing of the petition for an administration order (hereinafter: the “interim moratorium”). The main difference between the two moratoria is that the interim moratorium does not preclude the filing of a petition for a winding-up of the debtor or the appointment of an administrative receiver and the carrying out of such receiver’s functions, while the administration order moratorium bars even such actions. Compare Insolvency Act, Schedule B1 § 44(7) with §§ 41-42 thereto (applying to the interim moratorium and administration order moratorium, respectively). See also Goode, supra n 40, 295. But see G Lightman & G Moss, The Law of Receivers and Administrators of Companies (London, Sweet & Maxwell, 3rd ed, 2000), 431-32 (leaving open the question whether filing a petition for winding-up is permissible notwithstanding the administration order moratorium).  
50 This significant change was implemented through the enactment of the Enterprise Act 2002. See especially § 250 of that Act (inserting into the Insolvency Act the new Section 72A, entitled “Floating charge holder not to appoint administrative receiver”). Before the enactment of the Enterprise Act 2002, the Insolvency Act seriously impaired the effect of an administration proceeding in that a creditor secured by a floating charge could exercise its veto power to block any petition for administration by appointing an administrative receiver under the terms of the charge. See (old) Insolvency Act § 9(3).
Nonetheless, with respect to the balance of control between the corporation's old management and an appointed trustee, the new legislation hardly bears any effect.51

Like its US counterpart, the English legislature also expressed a policy facilitating reorganization of financially distressed corporations.52 However, the method it chose for reaching this goal involves the employment of an independent trustee who replaces management in office.53 The trustee is believed to be free from any prebankruptcy wrongdoing and necessarily is not part of the managerial group at fault for the corporation’s failure to the extent such wrongdoing or fault exists. The employment of an independent officer of the court is believed to ensure objective control of the reorganizing debtor, and fair and equitable proceedings for the creditors.54

III. IN SEARCH FOR THE OPTIMAL REORGANIZATION MODEL: THE NORMATIVE DEBATE

Commentators believe that the question of who should control a bankruptcy case of a corporate debtor is a key question in analyzing the desirability of any given


52 See Powdrill v. Watson, [1995] 2 A.C. 394, 442 (HL) (characterizing the administration procedure as a “‘rescue culture’ which seeks to preserve viable businesses”).

53 In 2000, the English legislature withdrew to an extent from its ideological requirement of an independent appointed trustee, and provided for reorganizations of “small companies” under the voluntary arrangement scheme coupled with a statutory moratorium. Insolvency Act 1986, § 1A & Schedule A1, as amended by the Insolvency Act 2000, § 1 & Schedule 1. The voluntary arrangement procedure is controlled by the debtor’s management, and in that respect is similar to a debtor-in-possession regime. As provided in the statute, this reorganization scheme is available for a “small company”, which is a company that meets at least two of the following qualifying criteria: (1) its annual turnover is not greater than 2.8 million pounds, (2) its balance sheet total is not more than 1.4 million pounds, and (3) it does not employ more than fifty persons. Insolvency Act 2000, Schedule 1, para. 3; Companies Act 1985, § 247(3).

54 Roy Goode has noted that “English insolvency law is predicated on the assumption that where a company becomes insolvent this is usually due to a failure of management and the last people to leave in control are those who were responsible for the company’s plight in the first place. Hence the requirement that the administration of the company be placed in the hands of an external manager, a
By entrusting control to a person who is less qualified to make business decisions or who is biased and unable to exercise independent business judgments wrong decisions will be made concerning the fate of the debtor corporation. Insolvent corporations that should be liquidated will unsuccessfully seek to reorganize while other corporations will be liquidated even though their value would have been maximized had they been reorganized. Thus, deciding the control issue erroneously creates a social cost and reduces the return to the debtor’s investors. In addition, the control dilemma bears significance for whether bankruptcy cases will be commenced voluntarily by the debtor corporation and if so – whether that commencement will be premature, timely or tardy.

A careful observation of the normative debate concerning reorganization schemes reveals that three primary factors affect the efficiency and fairness of such regimes. These three factors are, in what I believe to be descending order of importance, (a) the ownership structure of corporate debtors and its effect on the extent of independent judgment the debtor’s management is capable of exercising, (b) the effect of the respective regimes on the firm’s decision-making concerning the commencement of bankruptcy, and (c) the professional qualification of the person controlling the reorganization case. Surprisingly, while factors (b) and (c) have been explored extensively by lawmakers and commentators, until recently the effect of factor (a) has been somewhat overlooked. I argue that the agency factor of the separation between ownership and control plays a crucial role in designing the framework of any country’s reorganization law.

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qualified insolvency practitioner (almost invariably an accountant), working in cooperation with a creditors’ committee”. Goode, supra n 40, 274-75.

55 See Baird & Rasmussen, supra n 10; Bradley & Rosenzweig, supra n 3.

56 This factor shall be named “the bankruptcy commencement dilemma”.
1. Ownership structure of the debtor

(i) Dispersed ownership markets

Until recent years, the academic discussion on corporate reorganization failed to pay attention to the reciprocal effects which bankruptcy law and corporate law have on each other.\(^{57}\). Thus, discussion of bankruptcy policy and theory resulted in offering incomplete accounts of corporate financial distress. In the last decade, however, scholars began to examine the bilateral links between corporate and bankruptcy law. David Skeel explored the historical evolution of the structure of corporate governance side-by-side with the historical forces that shaped the US bankruptcy law. His argument is that the historical evolution of US reorganization law, with the debtor-in-possession in control, is one of the components which shaped the market-based capital structure of US corporations.\(^{58}\) Specifically, Skeel points to the effect which an appointed-trustee regime would have on managements of corporations which are also facing displacement as a result of potential hostile takeovers. In his opinion, the prospect of being replaced in bankruptcy would cause management to hesitate to employ a shark repellent in the form of leveraging the corporation with


\(^{58}\) Skeel, supra n 8. Skeel dubs the US regime as an ex post regime in the sense that its market corrective measures, including hostile takeovers and manager-controlled bankruptcy reorganizations, bear after-the-fact characteristics. By contrast, Germany and Japan are categorized as ex ante regimes in that their corrective measures apply in advance in the form of centralized control of corporations by large shareholders (including banks) and immediate displacement of managers upon bankruptcy. Ibid, 1328.
excessive debt.59 As a result, management would likely seek for large, stable shareholders who would promise them not to tender their shares to outside bidders. Thus, Skeel posits that a trustee-appointed regime would cause the corporate governance of a country to gravitate towards concentrated holdings of corporation stock.

Others examined the effects of corporate governance in bankruptcy from the perspective of accountability. Nimmer and Feinberg emphasized the change in the identity of the ultimate beneficiaries of a corporation’s actions.60 That is, while in the ordinary course of business a firm’s management is accountable primarily to its shareholders, in bankruptcy other stakeholders step to the fore and must be taken into account by the decisionmaker. Consequently, in reorganization the fiduciary duties of the controlling person are no longer owed exclusively to the shareholders of the corporation, but to the various groups of creditors as well.61 They further note that the task of complying with fiduciary duties in reorganization is far more complex than is ordinarily the case in corporate governance because the various groups of creditors and shareholders often have conflicting interests which are difficult to reconcile.62

59 See also LA Bebchuk, “Ex Ante Costs of Violating Absolute Priority Rule in Bankruptcy” (2002) 57 Journal of Finance 445 (suggesting that allowing deviation from the absolute priority rule in bankruptcy creates ex ante incentives for equityholders to engage the corporation in excessively risky projects).


61 Ibid, 30-31.

62 The problem of conflict-of-interests between different groups involved in bankruptcy in general, and between the public investors and management in particular, concerned the SEC the most and was the primary policy consideration for its pushing for the enactment of the Chandler Act in 1938, which required the appointment of a disinterested trustee. In its report, the SEC described this problem as follows: “[R]eorganizers and investors will at times have different objectives in reorganizations. Investors will be interested in an expeditious, economical, fair, and honest readjustment of their company’s affairs . . . Reorganizers at times have not been interested in fair reorganization, since fairness might seriously intrude into their own plans and affairs. Reorganizers at times have not desired honest reorganizations, in the investors’ sense of the word, because such reorganizations would be costly to them. They have been motivated by other factors. And they have endeavored -- in large measure with success -- to mould the reorganization process so as to serve their own objectives. Reorganizers’ objectives are significant largely in terms of control of the reorganization. The emoluments of control are the stakes of reorganization. Control means profits and protection. He who controls the reorganization controls in large measure the assertion of claims based on fraud or
Building on these analyses the proposition I wish to assert here is that in the US, as a result of the capital structure of publicly traded corporations, a debtor-in-possession may realistically be expected to successfully manage the reorganizing corporation while complying with its fiduciary duties to the creditors. However, while Skeel emphasizes the effect of a particular bankruptcy regime on the shaping of a country's corporate governance structure, I explain the US acceptance of the debtor-in-possession regime as a derivative of the principal characteristic of US publicly traded corporations, the separation of ownership and control. My argument is that this characteristic allows the debtor-in-possession to function and discharge its fiduciary duties satisfactorily.63

In the US, the corporate prototype which attracted the most attention from academics as well as lawmakers is the Berle-Means corporation.64 Seventy years ago, Professors Berle and Means shed light on the US phenomenon whereby the large corporations are financed by a widely dispersed group of shareholders while the actual control is concentrated in the hands of an oligarchy management.65 As a result of this structure, corporate law scholars spent substantial energy on searching for the optimal means to minimize the agency costs associated with the control of

63 Nonbankruptcy law mandates that upon insolvency of a corporation the decisionmaker, namely the board of directors, shall shift its fiduciary duties to the creditors. See, eg, Odyssey Partners, L.P. v. Fleming Cos. 735 A.2d 386, 417 (Del.Ch. 1999); Geyer v. Ingersoll Publications Co. 621 A.2d 784, 787 (Del.Ch. 1992) (“when the insolvency exception does arise, it creates fiduciary duties for directors for the benefit of creditors”). Courts, however, ruled that the creditors are not the exclusive beneficiaries of the fiduciary duties in insolvency and that directors continue to owe these duties to shareholders as well. See, eg, Commodity Futures Trading Commission v. Weintraub 471 U.S. 343, 355-56 (1985); In re Conchise College Park, Inc. 703 F.2d 1339, 1357 (9th Cir. 1983); In re Hampton Hotel Investors, L.P. 270 B.R. 346, 360-61 (S.D.N.Y. 2001); In Re The V Companies and V-S Architects, Inc. 274 B.R. 721, 726 (N.D. Oh. 2002).

management, the interests of which are not necessarily aligned with those of the shareholders and which is not genuinely concerned about being replaced by the weak owners.66 In the context of managing a reorganizing corporation, however, I argue that this strength, or rather relative independence, of management vis-à-vis the shareholders may serve the interests of a debtor-corporation’s creditors. In corporations where management is separated from the widely dispersed shareholders, management enjoys a relatively independent position that allows it to exercise its own business judgment. The traditional automatic association of management with shareholders’ interests gives way in the Berle-Means corporation to a management that will favor shareholders’ interests only if its self-interest directs it to do so,67 or if it is channeled to act in such a way by corporate law. Severing the identification of management with shareholders’ interests makes the normative shift of management’s fiduciary duties in bankruptcy compatible with reality.68 That is, because management, as a distinct group, aligns itself with shareholders’ interests not because of a bias but rather by virtue of legal norms, any change in the nature of these norms can reasonably be implemented by management. Thus, when bankruptcy law instructs management, in its capacity as a debtor-in-possession, to discharge its

65 Berle & Means, supra n 11. For an elaborate analysis explaining the evolution of this phenomenon of US corporate law more as a result of influential political forces than as an inevitable economic development see Roe, supra n 64.


67 Management’ self-interest will align with the shareholders’ interests either coincidentally in a certain transaction or more consistently as a result of the disciplining forces of the capital market and market for corporate control. See FH Easterbrook & DR Fischel, “The Corporate Contract” (1989) 89 Columbia Law Review 1416, 1419. Yet, on the margin, strong management is more likely to act to the detriment of weak shareholders than of strong shareholders.

68 Douglas Baird alludes to the practical problem of requiring this same shift of fiduciary duties in closely-held corporations where the interests of prebankruptcy management is closely aligned with the shareholders’. DG Baird, Elements of Bankruptcy (New York, Foundation Press, 3rd ed., 2001), 182.
fiduciary duties by catering to the creditors, management is fully capable of making the required switch and shifting its primary attention from the shareholders to the creditors of the corporation. In short, the separation of ownership and control creates a rift between management and the shareholders. While the corporation is solvent this rift is understood to be the major corporate cost which needs to be ameliorated. When the corporation becomes insolvent, however, this rift enhances the functioning of management vis-a'-vis the creditors of the corporate debtor. Management is likely to desert the shareholders and cooperate with the creditors in devising the reorganization plan for the corporation. By cooperating with the creditors, members of the management team can enhance the chances of retaining their jobs upon confirmation of the reorganization plan. After all, it is the creditors who eventually vote on the reorganization plan. Management would be wise then to

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70 To secure the attainability of this shift the law should also limit the ability of the shareholders to replace the directors of a corporation while in reorganization. See DA Skeel, Jr., “The Nature and Effect of Corporate Voting in Chapter 11 Reorganization Cases” (1992) 78 Virginia Law Review 461, 505-510 (arguing the same). But see AY Chou, “Corporate Governance In Chapter 11: Electing A New Board” (1991) 65 American Bankruptcy Law Journal 559 (arguing that the filing of a Chapter 11 petition should not terminate shareholders' interests or their state law rights to elect new directors); CJ Tabb, “Emergency Preferential Orders in Bankruptcy Reorganizations” (1991) 65 American Bankruptcy Law Journal 75, 77 (noting that creditors do have some effective influence over management by virtue of their potential threat to file a motion for the appointment of a trustee and the displacement of management).

71 MJ Bienenstock, “Conflicts Between Management and the Debtor-In-Possession’s Fiduciary Duties” (1992) 61 Univ. of Cincinnati Law Review 543, 545 (“Forward looking management … may be far less concerned with the debtor's directors and shareholders than with its creditors, if the debtor is insolvent and likely to extinguish shareholder interests under any Chapter 11 plan. If the creditors are likely to own or control the reorganized debtor, management desiring to continue in office will be quite sensitive to creditor concerns, one of which may be to extinguish all shareholder interests to maximize the return available to creditors”).

72 See TH Jackson, The Logic and Limits of Bankruptcy Law (Cambridge, Mass., Harvard Univ. Press, 1986), 222 (discussing the desirability of negotiations between the creditors and the
prove their adaptability to the risk preferences and business plans of these creditors.\textsuperscript{73} That management of a Berle-Means firm will tend to adjust to the creditors’ agenda upon insolvency is supported also by the empirical findings that the original and failing managers of these firms are often replaced by expert turnaround managers within the months preceding the filing for bankruptcy or during the bankruptcy case itself.\textsuperscript{74} This finding weakens the case against management-controlled bankruptcies.\textsuperscript{75}

In addition, leaving the newly appointed turnaround managers as the debtor-in-possession will not frustrate investigations to uncover any malign management that led to the firm’s financial distress. By contrast, in closely-held firms, where management is not subject to the disciplining forces of the market for corporate control and the market for managers, management displacement in bankruptcy seems more necessary to ensure efficient \textit{ex post} management of the firm for the benefit of the creditors’ interests.

\textsuperscript{73} See JC Coffee, Jr., “Unstable Coalitions: Corporate Governance As a Multi-Player Game” (1990) \textit{78 Georgetown Law Journal} 1495, 1539-42 (arguing that management shifts loyalties between shareholders and creditors according to its own self-interest). This hypothesis is consistent with the empirical study of LoPucki and Whitford, which found that in many publicly traded corporations undergoing reorganizations, management is inclined to represent the interests of creditors more than those of shareholders. See L LoPucki & W Whitford, “Corporate Governance in the Bankruptcy Reorganization of Large Held Companies” (1993) \textit{141 Univ. of Pennsylvania Law Review} 669, 742-47.

\textsuperscript{74} See E Hotchkiss, “Post-Bankruptcy Performance and Management Turnovers” (1995) \textit{50 Journal of Finance} 3 (finding that 70% of the sampled firms have replaced their CEO by the time a reorganization plan is implemented after bankruptcy); SC Gilson, “Management Turnover and Financial Distress” (1989) \textit{25 Journal of Financial Economics} 241 (finding that 52% of the sampled firms experience turnover if they are either in default on their debt, bankrupt, or privately restructuring their debt to avoid bankruptcy); LoPucki and Whitford, \textit{supra} n 73, 723-737 (finding that in the period starting eighteen months before filing and ending six months after confirmation, there was at least one change of the CEO of the debtor in 39 of 43 cases (91%)); SC Gilson & M Vetsuypens, “CEO Compensation in Financially Distressed Firms” (1993) \textit{48 Journal of Finance} 425 (finding that almost one third of all CEOs are replaced and those who keep their jobs often experience large salary and bonus reductions).

\textsuperscript{75} See GG Triantis, “A theory of the Regulation of Debtor-in-Possession Financing” (1993) \textit{46 Vanderbilt Law Review} 901, 917 (noting that because empirical studies have shown a significant turnover rate for management of reorganizing firms, both pre- and postpetition, “both prebankruptcy and replacement management are likely to be sensitive to the extent to which creditors participate in replacement decisions” generally, and to the creditors’ potential position as postreorganization owners of the firm particularly).
(ii) Concentrated ownership markets

The equity markets of most leading European countries, Germany, France and Italy to name but a few, are not as developed as the US market and the financing of their businesses is based more on bank financing than on public equity offerings. These countries are “concentrated ownership” markets.\(^76\) That is, many of even the largest corporations in such countries are closely controlled by strong shareholders.\(^77\)

In “concentrated ownership” systems management is closely associated with the strong shareholders. The controlling group nominates and appoints the directors to the board and through the board it appoints the top executives. Moreover, often the top executives of any corporation in the corporate-group come from the close circle surrounding the controlling person. In other words, not only does senior management consist of appointees of the controlling person, but these appointees are the flesh and blood of that controlling group. Their professional careers are tied closely to the controlling person. They are a team whose affiliation extends beyond the mere position in one specific corporation. Future employment of any executive in the group is dependent on her being loyal and performing in the best interests of the controlling person. As a result, leaving incumbent management to run the corporation while in bankruptcy plays into the hands of the strong shareholders and exacerbates the risk of loss to the creditors.\(^78\) Because the corporation is insolvent, shareholders


\(^78\) George Triantis takes this consideration to its extreme. He wonders whether the reputation of managers of a reorganizing corporation as being known to be faithful to the shareholders’ interest is
will tend to direct the management to engage in overly risky projects and gamble for a
yield with the creditors’ money. It follows then, that to neutralize this risk and
better represent the creditors’ interest in bankruptcy, management should be removed
from control of the firm. Thus, it is my view that the trustee-controlled model of
bankruptcy is more compatible with concentrated ownership systems.

(iii) The UK anomaly

In this regard, the UK model of reorganization law is somewhat awkward. Compared to perhaps every other country, the UK possesses a corporate governance
system which is the closest to that of the US. The UK also relies on a well
developed liquid equity market with more corporations listed per capita than any other
country. The stock holding in the listed corporations is widely dispersed, and

likely to drive management to favor the shareholders’ interest over that of the creditors despite the latter’s leverage over the reorganization outcome. That is, because managers of a reorganizing debtor are at a stage where they ought to contemplate new employment, their desire to gain the confidence of equity investors might override their apparent direct interest in appeasing the creditors of the reorganizing debtor. See Triantis, supra n 75, 917.

See RE Scott, “A Relational Theory of Secured Financing” (1986) 86 Columbia Law Review 901, 909 (noting that every debtor has a self-interest in engaging in riskier projects once the credit contract has been signed and the return to the creditor had been fixed therein, because the debtor is playing with that creditor’s rate of return). See also HA Garten, “A Political Analysis of Bank Failure Resolution” (1994) 74 Boston University Law Review 429, 436 (discussing the gamble, under former banking laws, initiated by shareholders with creditors’ money during the three-months grace period in which the shareholders of a financially troubled bank could choose whether to recapitalize the bank by an infusion of fresh equity capital or to liquidate it).

This agency problem is somewhat mitigated in markets such as Germany where the strong banks, which serve as the primary lenders, also hold substantial bulks of stock in their debtor-corporations. The same institutions, the banks, deal with management both in their capacity as creditors and as shareholders and by so diversifying their interest in the debtor reduce their exposure to the controllable risks of management. However, in other concentrated-ownership markets, such as Italy, Sweden and Israel, where the ownership is held primarily by wealthy families, the banks remain exposed to this agency problem. For a comparison of the identity of owners of firms in Germany, Italy and Israel – see LaPorta et al., supra n 77, 501 (Table V).

Armour, Cheffins & Skeel addressed the UK anomaly in terms of the "problem child". See Armour, Cheffins & Skeel, supra n 51.


As of 1996, Britain had 36 public corporations per one million people, while the US had 30. In other countries, the ratio is far lower. Japan had 18 public corporations per one million people, and France, Germany and Italy had 8, 5 and 4, respectively. In terms of the ratio of market capitalization of
management enjoys the lenient “hands-off” approach of their scattered shareholders.84 Yet, unlike the US, the UK employs a trustee-controlled reorganization regime as if it were a concentrated ownership system.85 Several plausible explanations can be suggested for this apparent anomaly. First, despite the first impression similarities between the US and UK equity holding in publicly traded corporations, some differences do exist. In the UK, the stock market is dominated by the institutional investors more than in the US. The aggregate holding of stock by the British institutional investors is higher than by their American counterparts. The number of such investors is considerably smaller than in the US with the result that a greater aggregation of controlling blocks of stock is held by fewer shareholders. Also, the British institutions are closely-knit and thus collective action costs are significantly reduced.86 Thus, compared to the US then, the British shareholders are still

traded stock to a country’s Gross Domestic Product, as of 1996 in Britain that ratio was 1.35, in the US 1.1, in Japan 0.66, and in major European countries – less than 0.35. BR Cheffins, “Putting Britain on the Roe Map: The Emergence of the Berle-Means Corporation in the United Kingdom” available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=218655.
85 Ironically, other commonwealth countries, which have traditionally followed the lead of Great Britain in their legal development, operate insolvency laws consistent with this article’s linkage between the structure of equity ownership and the control of the insolvent corporation. Much like Britain, Australia, and to a lesser extent also Canada, employ a trustee-controlled reorganization scheme. See PB Lewis, “Trouble Down Under: Some Thoughts on the Australian-American Corporate Bankruptcy Divide” (2001) 2001 Utah Law Review 189, 222-25 (describing the appointment of an administrator in Australia); 2 COLLIER’S INTERNATIONAL BUSINESS INSOLVENCY GUIDE ¶¶ 17.06[2][c][i], 17.06[3][g] (Lawrence P. King editor-in-chief, 2002) (Noting that in a reorganization case under the Bankruptcy and Insolvency Act in Canada a trustee is appointed to serve alongside the management. The trustee’s role is limited to reporting to the creditors and the court on the debtor’s financial situation and its proposal to the creditors. In a reorganization case under the Companies’ Creditors Arrangement Act, the debtor remains in possession, although a “monitor” is appointed to oversee the operation of the business). Yet, unlike their crown country, these countries are concentrated ownership systems rather than dispersed. See R Daniels & JG MacIntosh, “Toward a Distinctive Corporate Law Regime” (1991) 29 Osgoode Hall Law Journal 863; RK Morck, “On the Economics of Concentrated Ownership” (1996) 26 Canadian Business Law Journal 63; IM Ramsay, “Allocating Liability in Corporate Groups: An Australian Perspective” (1999) 13 Connecticut Journal of International Law 329, 365.
stronger.\textsuperscript{87} This might imply that British managements are concerned with appeasing their shareholders more than American managements. However, given the generally wide dispersion of stock in the British market and the relative passivity of the investors, including institutional investors, this explanation is far from convincing.\textsuperscript{88} An alternative explanation is that the apparent inconsistency between ownership structure in the UK and its reorganization regime is the result of a-synchronized transition in British legislation. Empirical studies show that Britain only became a dispersed ownership system in the mid twentieth century and arguably as late as the mid 1970s or even early 1980s.\textsuperscript{89} Legislation is always one or more cycles behind economic developments in the market.\textsuperscript{90} When the Cork Committee drafted its report on reform of the insolvency bill in the late 1970s and early 1980s,\textsuperscript{91} the British capital market was in the final stage of its transition from concentrated to dispersed ownership. The committee, however, was yet to acknowledge this transition.\textsuperscript{92} This explanation implies that a future reform in the British insolvency law might shift towards the US model of management–controlled reorganizations.\textsuperscript{93} Armour,

\begin{itemize}
  \item \textsuperscript{87} See Armour, Cheffins & Skeel, supra n 51, 1750-1751 (proffering a similar theory for explaining the UK's apparent off-base regime, which utilizes a trustee-controlled reorganization proceeding for dispersed ownership corporations).
  \item \textsuperscript{88} See Ibid, 1752-1754 (reaching the same conclusion).
  \item \textsuperscript{89} Brian R. Cheffins, "Does Law Matter? The Separation of Ownership and Control in the United Kingdom" (2001) 30 Journal of Legal Studies 459, 466-467; Coffee, supra n 76, 40.
  \item \textsuperscript{90} Specifically with respect to the UK, in 1950 Glanville Williams criticized English law as being out of date and not responsive to economic and social developments in society, due in large part to the lack of a Ministry of Justice, the task of which is to ensure that the law is kept current. See Glanville Williams, The Reform of the Law (London, Gollar, 1951), 9-15.
  \item \textsuperscript{91} Supra n 37.
  \item \textsuperscript{92} Armour, Cheffins and Skeel similarly point out that during the decades following World War II, "while ownership was taking on a strongly dispersed character, the U.K's bankruptcy regime retained its manager-displacing orientation". See Armour, Cheffins & Skeel, supra n 51, 1773-1774.
  \item \textsuperscript{93} Interestingly, a step indicating such a transformation in English insolvency law was made in the Insolvency Act 2000, which provides for a management-controlled company voluntary arrangements. However, contrary to the argument I make, only small companies qualify for this management-controlled procedure. Nonetheless, the ongoing transformation of English insolvency law is evident. In July 2001, the Ministry of Trade and Industry has proposed additional legal reforms that are intended to relax the traditional stringent pro-creditor approach. See Insolvency – A Second Chance (Presented to Parliament by the Secretary of State for Trade and Industry by Command of Her Majesty, July 2001), available at http://www.archive.official-documents.co.uk/document/cm52/5234/523405.htm.
\end{itemize}
Cheffins and Skeel offer yet another explanation for the UK anomaly, albeit casting doubt whether such explanation is sufficiently persuasive. They suggest that in fact many UK financially distressed corporations resort to the voluntary workout procedure known as the London Approach under which a syndicate of lending banks establish a moratorium, appoint an accounting firm on their own behalf to examine the economic viability of the distressed corporation, process all debt collections and negotiate a workout plan with the debtor corporation.\footnote{For an elaborate account of the London Approach, see J Armour & S Deakin, “Norms in Private Insolvency: The 'London Approach' to the Resolution of Financial Distress” (2001) 1 JCLS 21.} The point to emphasize is, that in a London Approach workout the debtor corporation's management remains in office and cooperates with the banks to the end of stabilizing the debtor. Armour, Cheffins and Skeel argued that the popular use of the London Approach workout may constitute a \textit{de facto} UK debtor-in-possession reorganization regime, which correspondingly eradicates the abovementioned anomaly.\footnote{Armour, Cheffins & Skeel, supra n 51, 1754-1762. Nonetheless, as indicated in the main text, these authors qualify this suggestion by highlighting certain differences between a US Chapter 11 debtor-in-possession and the management of a UK corporation undergoing a "London Approach" workout. Most notably, while the former enjoys a great degree of independence, the latter is subject to the actions and wills of its lender banks. Unlike Chapter 11, in the UK it is the lending banks that determine whether the corporation shall at all enter the London Approach workout, and they may, at any stage during the course of the workout negotiations decide to withdraw from them and resort to official manager-replacing insolvency proceedings.}

To summarize the ownership structure factor, it seems clear that the account of the Berle-Means corporation supports the consistent acceptance of the debtor-in-possession concept in US reorganization law.\footnote{Channeling the fiduciary duties of the controlling group towards the creditors of the corporation does not, however, resolve all conflicts of interest issues between the different groups of investors, senior creditors, junior creditors and shareholders. As a result of their relative distribution priority under the absolute priority rule investors differ in their risk preferences. Consequently, conflicts of interest inheres between the various groups of investors in any corporation. See Nimmer & Feinberg, supra n 60, 2-3. The point to appreciate is that in bankruptcy the conflicts of interest between the various groups of investors are far more difficult to resolve than in a solvent corporation. In the case of a solvent corporation, notwithstanding these inherent conflicts of interest, the primary beneficiary group of investors is the shareholders, because as the residual economic stakeholders, their personal interests are those that are most closely aligned with the interests of the corporation as a whole. See Easterbrook & Fischel, supra n 5. By contrast, in the case of a bankrupt corporation, the...} By contrast, in countries
characterized by concentrated equity ownership, control of the firm in bankruptcy should be relinquished in favor of a disinterested appointed trustee.

2. The bankruptcy commencement dilemma

Reorganization is not a “one suit fits all” path for insolvent firms. Some debtors are worth reorganizing while others are worth liquidating. The most troubling dilemma in this context is which corporations merit reorganization and which deserve liquidation. This question cannot be resolved in isolation from the question who makes the (initial) determination whether to pursue the former avenue or the latter avenue. As shall be established in this paragraph, the identity of the controlling person in reorganization affects the prebankruptcy choice whether to pursue reorganization or liquidation. Because some debtors merit liquidation while others merit reorganization, this prebankruptcy choice may potentially enhance the creditors’ return or reduce it depending on how correct is the choice made. Indeed, the bankruptcy commencement dilemma involves a decision-making preceding the filing of the bankruptcy petition. In other words, the second factor affecting the choice between a trustee or debtor-in-possession controlled reorganization is the ex ante impact of this choice in relation to the decision when to commence bankruptcy and its effect on the subsequent value of the debtor corporation.

(i) Effects of a DIP: a bias for reorganization

Opponents of the debtor-in-possession concept point to an inherent bias that affects the decision-making of the prepetition management whether and when to enter
bankruptcy. The decision to enter bankruptcy is invariably made by the debtor by filing a voluntary petition.97 Because management enjoys informational advantage over the corporation’s creditors concerning the corporation’s financial condition, filing a voluntary bankruptcy petition on behalf of the corporation will precede a potential move by creditors to file an involuntary petition for liquidation of the debtor. A bankruptcy law that provides for different controlling persons in liquidation cases and reorganization cases creates incentives for strategic filings by the debtor’s management. If the corporation is facing financial distress, its management needs to consider the various options available for the corporation and its creditors. These options include either arranging for an out-of-court workout with the creditors or resorting to bankruptcy. Opting for bankruptcy entails a choice between entering a liquidation procedure or making an attempt at reorganization. In a debtor-in-possession regime, because management faces immediate replacement by an appointed trustee in liquidation but remains in office and continues to control the corporation in reorganization it will customarily cause the corporation to file a petition for reorganization.98 The point to appreciate is, that regardless of who controls the debtor corporation after bankruptcy has commenced, it is in any event management which makes the prebankruptcy decision through which road to enter

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97 See S. Block-Lieb, supra n 9, Appendix A.
bankruptcy. Passing a resolution to file a voluntary petition for liquidation is tantamount to management signing its own pink slip. Such a willful abdication is not likely to happen so long as the controlling group can choose an alternative path in bankruptcy. Put differently, in a debtor-in-possession regime debtor corporations will choose reorganization because of the benefits this scheme offers management, even where liquidation is the better course of action for the creditors and the corporation as a whole. The decision-makers’ option to extend their tenure in office, combined with an expectation that they can use their control in bankruptcy to obtain some value for themselves in the reorganized corporation makes them inherently biased in favor of reorganization. This bias distorts the prebankruptcy choice management faces. Liquidation ceases to remain a viable bankruptcy alternative under such a regime. Put differently, the reorganization bias prevents the making of a genuine and undistorted choice as to the optimal bankruptcy proceeding for any particular corporate debtor. This results in a social cost.

99 Acknowledging their centrality in the proceedings, David Skeel refers to various reorganization regimes from the perspective of management. Accordingly, he classifies a trustee-controlled reorganization regime as liquidation. See Skeel, supra n 8, id.

100 See VS Armstrong & LA Riddick, “Evidence that Differences in Bankruptcy Laws Among Countries Affect Equity Returns”, available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=269709 (2000) (finding, based on examination of 168 US publicly listed corporations and 36 UK corporations, that in the US 95% of the bankruptcy filings were Chapter 11 filings, whereas in the UK 89% of filings were for liquidation). See also supra n 1.


102 One significant factor that undermines the merit of the “reorganization bias” argument concerns the empirical studies which have shown that over two-thirds of senior executives and directors are replaced in firms that enter Chapter 11. See SC Gilson, “Bankruptcy, Boards, Banks, and Blockholders: Evidence on Changes in Corporate Ownership and Control When Firms Default” (1990) 26 Journal of Financial Economics 355. Cf. supra n 74.

103 Some commentators have cast some doubt upon the conclusion that management-controlled Chapter 11 creates a bias for reorganization. See S Rose-Ackerman, “Risk Taking and Ruin: Bankruptcy and Investment Choice” (1991) 20 Journal of Legal Studies 277 (management tends to delay any type of bankruptcy filing as long as it can); LM LoPucki, “The Debtor in Full Control - Systems Failure Under Chapter 11 of the Bankruptcy Code” (1983) 57 American Bankruptcy Law Journal 247, 265 (finding in his study that “[t]he large majority of debtors delay filing under Chapter 11 until liquidation of the business through state remedies is imminent”).
By contrast, the UK model, under which a neutral and objective trustee is appointed in every bankruptcy case, eliminates the reorganization bias. In the UK, the self-interest driven management of a corporate debtor faces a similar fate regardless of whether the corporation enters liquidation or reorganization. Consequently, in the UK, from the corporation’s perspective the decision which bankruptcy proceeding to pursue is strategy free. A bankruptcy commencement decision by a debtor firm under such a regime can be expected to be premised on genuine business grounds, namely its valuation of the existence of a going concern premium or the lack thereof.104

(ii) Effects of a trustee I: management’s bankruptcy aversion

At the other side of this debate, supporters of a debtor-in-possession regime expose the major flaw of a trustee-controlled regime, namely, that the timing of the commencement of reorganization under such a regime is liable to be too late.105 A trustee-controlled regime obviates the bias in favor of reorganization when the firm’s management contemplates which course of bankruptcy to pursue. However, such a regime does not facilitate a voluntary resort to bankruptcy by these decisionmakers in the first place. Where the management of a debtor corporation realizes that any bankruptcy case that shall be commenced will terminate their days in office they will always delay the commencement of bankruptcy for as long as they can. While attempting to avoid bankruptcy, management is likely to engage the corporation in overly risky activity with the hope of rescuing the corporation from of its

104 But see Lewis, supra n 85, 225 (casting some doubt on the efficiency of a voluntary appointment of an administrator by the board of directors of a debtor corporation in Australia, because the directors are likely to appoint a friendly administrator).

105 H.R. REP. No. 595, 95th Cong., 1st Sess. 231 (1977) (“Proposed Chapter 11 recognizes the need for the debtor to remain in control to some degree, or else debtors will avoid the reorganization provisions in the bill until it would be too late for them to be an effective remedy.”)
difficulties. However, because this risky activity poses a dangerous gambling with the probabilities for massive losses, it may potentially dissipate any existing going concern value of the corporation’s assets. Such a decline in value may later frustrate any reorganization attempt and force the corporation to liquidate. In short, as a result of delaying the commencement of the bankruptcy case the creditors of the corporation will lose the going concern value premium otherwise available for recovery. Only the corporate debtor, not the creditors, is expected to initiate the reorganization case in a timely fashion. Yet, as shown above, the prospect of losing their office is likely to sway management away from any bankruptcy proceedings until it becomes impossible to continue operating the corporation outside of bankruptcy or until the creditors will finally file a petition. In the interim period, during which management struggles to avoid bankruptcy, the going concern premium of the corporation is at risk of being lost to the detriment of the creditors.

One method to combat management’s self-interest to delay the filing for reorganization is by threatening such conduct with a legal stick. Such approach was

Jensen & Meckling, supra n 66 (discussing this risk shifting activity in terms of asset substitution); Aghion, Hart & Moore supra n 98; Franks, Nyborg & Torous, supra n 98; Hart, supra n 98; White, supra n 98; A Shleifer & RW Vishny, “Liquidation Values and Debt Capacity: A Market Equilibrium Approach (1992) 47 Journal of Finance 1343.

Jochen Bigus argues that in the prebankruptcy era, the equityholders may form a coalition with either the senior or junior creditors, which coalition will drive the debtor to engage in under- or overly-risky projects, respectively. The various groups of creditors have heterogeneous interests and this leads to an additional agency cost. J Bigus, “Creditor Conflicts prior to Bankruptcy and Credit Rationing” available at: http://papers.ssrn.com/sol3/papers.cfm?abstract_id=249414 Timothy C.G. Fisher & Jocelyn Martel, “The Bankruptcy Decision: Empirical Evidence from Canada” available at: http://papers.ssrn.com/sol3/papers.cfm?abstract_id=249950 (discussing the effects of the formation of a coalition between the equity holders and the senior secured creditor on the corporation’s decision whether to file for liquidation or reorganization).

The problem of delaying the initiation of reorganization and the lost value it entails is particularly exacerbated in markets where many corporations are components of a corporate group enterprise. In such cases, where the various corporations of the group hold stock in one another, extend credit and sign cross-guarantees to each other, the demise of one corporation is often the writing on the wall for the other corporations in the group. In such markets, the timely initiation of reorganization often becomes critical not only for a particular corporate debtor but for the entire corporate group as well. For a general analysis of cross-guarantees amongst corporations comprising a corporate group see D Spahos, “Lenders, Borrowing Groups of Companies and Corporate Guarantees: An Insolvency Perspective” (unpublished manuscript, 2001, on file with the author), abstract may be found at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=294463.
taken by the English legislature. In England, directors of an insolvent corporation who continue its operation and avoid resorting to an official insolvency proceedings risk two cumulative penalties. First, they expose themselves to civil monetary liability under the wrongful trading provision of the Insolvency Act. Secondly, they risk being disqualified by the court from serving as directors on the board of any corporation for a period of between two to fifteen years. France, and in the past Germany, have followed the U.K model of having a court-appointed trustee control a reorganization case. In an attempt to mitigate the risks posed by tardy commencement of reorganization cases, these countries’ reorganization statutes penalize the corporate management for a delay in filing for bankruptcy. Michelle White, however, has doubted whether such a penalizing policy serves its cause. Her empirical findings concerning the low rate of return enjoyed by unsecured creditors in Germany weaken the justification for management's penalties. Indeed, absent a severe penalty it is not likely that this measure will prove effective in combating delayed filings. But, paradoxically, the more severe a penalizing statute, the harsher its **ex ante** effects on management's performance might be. Risk-averse

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109 See Insolvency Act § 214. It has been argued that this provision has a broad impact on the business culture in the U.K, as lawyers advise their corporate clients on its effect should they fail to meet its standards. See LS Sealy, “Personal Liability of Directors and Officers for Debts of Insolvent Corporations: A Jurisdictional Perspective (England)”, in JS Ziegel (ed), *Current Developments in International and Comparative Corporate Insolvency Law* (Oxford, Clarendon Press, 1994), 485, 497-98.

110 See Company Directors Disqualification Act 1986, §§ 6, 10. It has been suggested that one of the bases for disqualification under this Act is allowing the corporation to continue trading while insolvent. See C Bradley, “Enterprise and Entrepreneurship: The Impact of Director Disqualification” (2001) 1 JCLS 53, 65-66. For an opinion that this Act's primary goal is to deter managers from failing to meet the corporation's tax obligations, see JW Barnard, “When is a Corporate Executive ‘Substantially Unfit to Serve?’” (1992) 70 North Carolina Law Review 1489, 1501-03. Professor Sally Wheeler has expressed some skepticism regarding the effective operation of this Act, as she believes that its interpretation is liable to expose some discrepancies. See S Wheeler, “Disqualification of Directors: A Broader View”, in H Rajak (ed), *Insolvency Law – Theory and Practice* (London, Sweet & Maxwell, 1993) 187, 198.

111 For discussion of penalizing management of debtor banks or insurance companies for tardy filings for bankruptcy see DA Skeel, “The Law and Finance of Bank and Insurance Insolvency Regulation” (1998) 76 Texas Law Review 723, 746-748.

management may become less motivated to work hard under a strictly enforcing regime which not only removes them from office upon business distress but also severely penalizes them as a “bonus” if they are later found to have effectively resigned too late.114

As a matter of policy then, in order to encourage timely commenced reorganizations lawmakers must coax, not threaten, the relevant decisionmakers in corporations to file early for bankruptcy. In other words, given the shortcomings of the stick, handing management a carrot may prove more effective. To accomplish this, it should be openly accepted that some “tax” needs to be paid to those decisionmakers. Leaving management in control of the debtor corporation while the reorganization case is pending is precisely that tax. It is a deliberate concession made in the US by Congress, which facilitates the utilization of the reorganization proceedings. Under the alternative regime, which employs appointed trustees to supersede management, reorganization law, although existing as black letter law, would be utilized by managements in far less cases.115 As for the reorganization bias created by enacting a debtor-in-possession statute, supporters of this regime point to other constraints that are implemented in Chapter 11 to monitor the decision-making and behavior of management of the corporate debtor. These measures include the creation of creditors committees,116 the creditors’ right to request that the

114 This paradox builds on White’s general argument concerning the ex ante costs of penalizing management by forcing the termination of their employment upon bankruptcy. Ibid, 479-83. See also Skeel, supra n 111, 748. Cf. Easterbrook &. Fischel, supra n 5, 61-62; A Hutchinson, “Looking for Direct Results – Current Legislation Does Not Serve the Needs of Directors or Their Companies” (1993) 90 Law Society’s Gazette, No. 45, p. 19.
115 Some of the trustee-appointing regimes do not automatically terminate management’s employment upon reorganization. For example, in the UK, directors may stay in office while the corporation is undergoing administration. Their employment is exclusively at the discretion of the administrator. See Insolvency Act, Schedule B1 § 61. However, from an ex ante perspective, because management cannot predict the administrator's future approach, it shall remain relatively reorganization-averse.
116 Bankruptcy Code § 1102(a)(1).
debtor-in-possession be replaced by a trustee\textsuperscript{117} or even that the case be converted to liquidation,\textsuperscript{118} the creditors’ right to propose a reorganization plan\textsuperscript{119} and management’s fiduciary duties to the creditors.\textsuperscript{120} Another measure takes the form of incentives, such as the approval of stock options packages in reorganization for turnaround managers appointed shortly before the filing for bankruptcy.\textsuperscript{121}

\textbf{(iii) Effects of a trustee II: the myth of the dominant creditor}

The policy concern for a timely filing for reorganization by management is, arguably, counterbalanced by other factors. Certain creditors enjoy informational advantages and serve as close monitors of their borrowing firms. Such lenders exist especially in markets where corporate financing is concentrated among strong and dominant banks. These banks are capable of detecting a firm’s financial distress at a sufficiently early stage and drive it into a timely and efficient bankruptcy.\textsuperscript{122}

Specifically, in England, Armour and Frisby have argued recently that because a floating charge hovers over all or substantially all of the debtor’s assets, the lending bank is a close and efficient monitor of the debtor’s business. Thus, allowing the bank

\begin{itemize}
  \item \textsuperscript{117} Ibid § 1104(a).
  \item \textsuperscript{118} Ibid § 1112(b).
  \item \textsuperscript{119} Ibid § 1121(c). This right has been significantly circumscribed because it is effective only upon the expiration of the debtor’s exclusivity period for proposing a plan. Nonetheless, the concerns of exploitation of the exclusivity period by management have been reduced by the Supreme Court’s ruling in \textit{Bank of America National Trust and Savings Assoc. v. 203 North Lasalle St. Partnership} 526 U.S. 434 (1999) that a debtor’s plan which proposes to allocate value to old equityholders terminates the exclusivity and triggers an auction. For a discussion of the implications of the LaSalle decision, see BE Adler & GG Triantis, “Absolute Priority in the Aftermath of North LaSalle Street” (2001, Forthcoming) \textit{Univ. of Cincinnati Law Review} 15\textsuperscript{th} Annual Corporate Law Symposium Issue.
  \item \textsuperscript{120} For a detailed summary of these measures embodied in the Bankruptcy Code and in case law see supra n. 33. “Chapter 11” (1993)\textit{Yale Law Journal} 103:787-834. For a specific analysis of the implications of the debtor-in-possession’s fiduciary duties to creditors, see Nimmer & Feinberg, supra n 60.
  \item \textsuperscript{121} See Gilson, supra n 1, 236-37.
  \item \textsuperscript{122} Michelle White argued that a lending institution has influence over a corporation’s decision whether and when to commence bankruptcy if that lending institution is the likely financier of any prospective bankruptcy proceeding. See M White, “The Corporate Bankruptcy Decision” (1989) 3 \textit{Journal of Economic Perspectives} 129.
\end{itemize}
to privately enforce its collateral through the appointment of a receiver is an efficient measure.123

Admittedly, it is likely that the bank will be one of the first, outside the internal framework of the corporation, to discover that the corporation is facing financial difficulties. As the corporation’s major supplier of finance the bank will be the first address to which management will turn asking for additional financing. This request will lead to an inquiry by the bank and a discovery of the corporation’s financial position. Nonetheless, for several reasons creditors should not be relied on to timely initiate a collective reorganization effort.124 First, banks have their own ways and means of addressing their debtors’ financial distress once revealed. Because of its advantageous position in corporate financing a bank can demand additional collateral or guarantees in exchange for fresh financing.125 The bank can use its easy access to the corporation’s bank accounts, which are often maintained with that same bank, and control the disbursement of cash by this financially distressed debtor based on the bank’s contractual rights vis-a'-vis the debtor.126

In addition, even where financial distress has been detected by the bank, the debtor’s management is likely to continue, to the extent possible, to make the scheduled payments on the debts due the bank and avoid default so that the bank will

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124 But see GG. Triantis & RJ Daniels, “The Role of Debt in Interactive Corporate Governance” (1995) 83 California Law Review 1073, 1091-1103 (arguing that the net benefits of close bank monitoring and bank action against the debtor once debtor-misbehavior is detected outweigh the costs of inter-creditor and creditors-equityholders conflicts).


not disrupt management’s ordinary operation of the business of the corporation.\textsuperscript{127} The more management succeeds in appeasing the secured lender the more likely that the latter will remain inactive and abstain from taking any action against the corporation. Thus, even at times when the corporation is facing financial distress and preservation of any remaining going concern value for the benefit of other creditors is imperative, the early detector of this distress, the bank, may be put to sleep by management by the latter’s adherence to the payments schedule on this particular debt.

Third, even where the corporation defaults and the bank roars, such reaction cannot be expected to protect the position of other creditors, investors, employees and management. A creditor who decides to act against a financially strained debtor is inclined to exercise nonbankruptcy law collection rights rather than file a petition for the debtor’s bankruptcy.\textsuperscript{128} While nonbankruptcy law allows a creditor to collect its claim in full from the debtor, bankruptcy law imposes limitations on a creditor’s collection efforts and subjects the creditor to a collective distribution scheme pursuant to the absolute priority rule. In short, creditors are not likely to commence an early reorganization of a viable corporation.\textsuperscript{129} Moreover, I disagree with Armour and Frisby\textsuperscript{130} and would argue that even a senior creditor secured by all or substantially all the debtor’s assets, such as the holder of a floating charge in England, is not to be relied on as the efficient early detector and enforcer of rights for the collective benefit of the creditors. Such a creditor can appoint a receiver to enforce its collateral.

\textsuperscript{128} See Susan Block-Lieb, supra n 9.
\textsuperscript{129} Ibid, App. A (presenting empirical data which reveals that a mere 0.36% of the total bankruptcy cases filed in the US between the years 1979 to 1988 were filed involuntarily, i.e. by the creditors. Of the total involuntary petitions filed, only 16.46% were filed under Chapter 11).
\textsuperscript{130} Supra n 123.
However, when appointing a receiver the creditor acts out of self-interest. The creditor’s action is in the end an individual collection effort. The appointing creditor, through the receiver, gains effective control over the entire business of the debtor even though its claim amounts to far less than the value of the debtor’s business. Junior creditors might be under-compensated if receivership were to be relied on for recovery from the debtor. Indeed, the goal of receivership is to enforce the rights and collect the claim of the secured creditor appointing the receiver, not to serve as a comprehensive collective proceeding.

In short, because a major creditor is not the sole claimant whose economic interests are at stake, allowing that creditor alone to determine the corporation’s fate and forcing it into (premature) liquidation might come at the expense of other creditors and investors. Thus, major financing creditors are not to be relied on as the solution for timely commencement of reorganization efforts.

131 Shleifer and Vishny warned that large investors, equityholders as well as major lending creditors, who have leverage and control over a corporation’s operations tend to take advantage of that influence to advance their own interest at the potential expense of firm-specific investors such as management and employees. A Shleifer & RW Vishny, “A Survey of Corporate Governance” (1997) 52 Journal of Finance 737, 758.


133 See Insolvency – A Second Chance, supra n 93, §§ 2.2-2.3. See also EB Leonard & E Kupka, "The Coming Revolution in U.K. Insolvency Law: Part II", (June, 2003) 2003 American Bankruptcy Institute Journal Lexis 113 (“The [Enterprise] Act will effectively eliminate the private (i.e., out-of-court) receivership remedy. This is a seismic shift for the country that invented and perfected the concept of privately appointed receivers. The UK government concluded that receivership was no longer the preferred remedy in cases of insolvency because it tended to hand effective control of insolvency proceedings to a single secured creditor. The elimination of private receiverships is intended to favor the administration process... The government viewed administration as a more balanced approach to insolvency proceedings because it reflects the interest of a wider group of creditors.”)

134 A dominant investor, such as the bank, is also able to transfer wealth to itself from the employees as a result of its absolute control of the corporation’s future. This bears an adverse ex ante incentive for those employees and discourages them from investing their firm-specific human capital in the corporation. See K Schmidt, “The Costs and Benefits of Privatization” (1996) 12 Journal of Law, Economics & Organization 1; J Cremer, “Arm’s Length Relationships” (1995) 110 Quarterly Journal of Economics 275 (making a similar argument with respect to the potential expropriation of value by a strong equityholder).

135 The conflict of interests between the various groups of creditors and other investors also exposes the inefficiency of the former UK insolvency law, pursuant to which a creditor secured by a floating charge was legally empowered to veto any reorganization (administration) proceeding by appointing its own receiver. Insolvency Act, § 9(3). This veto power allowed the secured creditor to
3. **Professional qualification**

Depending on the nature of the proceedings selected to deal with a financially distressed corporation, the bankruptcy case may be either a relatively straightforward process or one which is much more complex. When the debtor corporation enters liquidation the process is streamlined. In liquidation, the business of the corporation is in the process of being terminated and therefore the volume of activity and operations is thus reduced significantly, whether abruptly or gradually. The focus of a liquidation case is on selling the assets of the debtor corporation, distributing the proceeds among the debtor’s creditors based on their respective priority and dissolving the corporate shell.\(^{136}\) The control of a corporation in liquidation is substantially limited in scope. Moreover, controlling a debtor in liquidation entails conducting certain investigations regarding the history of the operation of the corporation, the decisions of its officers and directors and the corporation's relationship with its investors, shareholders and creditors. Such investigations may lead to subsequent litigation which challenges certain actions taken and transfers made prepetition based on bankruptcy law causes of action.\(^{137}\) Administering the claims of the debtor’s creditors, conducting investigations and litigating voidable actions, liquidating the estate’s assets and distributing the proceeds thereof to the creditors all require the skills of a trained, knowledgeable and competent practitioner. Yet this is not a role which necessarily requires the expertise and experience of a business executive. The controlling person need not engage herself in decisions

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\(^{136}\) Bankruptcy Code § 704(1) requires a trustee to “collect and reduce to money the property of the estate for which such trustee serves, and close such estate as expeditiously as is compatible with the best interests of parties in interest”.

\(^{137}\) See, eg, Bankruptcy Code §§ 547, 548 (preferences and fraudulent transfers, respectively).
concerning long term investments and operations or those aimed at achieving the optimal capital structure for that corporation. Thus, appointing a trustee (often, a lawyer or accountant) to take over the estate of a debtor in liquidation is a practice widely accepted throughout the world and has not been seriously challenged by the academia.

Reorganization cases are strikingly different. When a corporate debtor enters reorganization it contemplates the survival of the corporation as a going concern. The ultimate goal of reorganization is to confirm a reorganization plan for the corporate debtor, under which the claims of its creditors shall be satisfied, in whole or in part, while the corporation maintains its core business. Because reorganization consumes time, any attempt to preserve the debtor’s business upon confirmation of the plan is liable to fail if the business is not operated on an ordinary and continuing basis during the preceding reorganization proceedings and the negotiation of the plan. In other words, the preservation of a debtor’s business is predicated on the underlying assumption that upon confirmation there will be a viable business for operation in the postconfirmation era. This calls for keeping the ongoing operations of the debtor intact, notwithstanding the commencement of the reorganization case and requires the utilization of a professional management for the debtor while in reorganization.138

The management of the business involves maintaining an ongoing relationship with the debtor’s trade suppliers, arranging for fresh financing of the debtor, reviewing executory contracts and leases to which the debtor is a party, dealing with the debtor’s

But see BL Zaretsky, “Trustees and Examiners in Chapter 11” (1993) 44 South Carolina Law Review 907, 944-45 (suggesting that in certain cases a third-party “examiner might, in addition to investigating the debtor's operations, provide management consulting advice that could assist the debtor in running the business without replacing the debtor-in-possession. This less drastic alternative may be appropriate when management is somewhat weak, but neither dishonest nor grossly incompetent. In such cases, the Code's preference for leaving the debtor in possession of the business and retaining the debtor's exclusive right to propose a reorganization plan may be well served by assigning an examiner an advisory role that does not displace the debtor.”)

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employees and selling unnecessary assets. Business opportunities that are introduced to the debtor need to be examined and explored. In short, the operational aspects of the business of the debtor are essential if the projections of any successful reorganization are ever to materialize. Thus, it is imperative to secure a competent management of the debtor while in reorganization. The employment of the prepetition management in the capacity of the debtor-in-possession is intended to achieve precisely this objective. Unlike in liquidation, professional administrators, whose primary profession is financial analysis of corporate performance or legal counseling and litigation, are less worthy candidates for this managerial task. Moreover, the prepetition management enjoys informational advantages over a potential trustee or a new team of management. Appointment a new person or group to control the business of the debtor while in reorganization would mean spending time and economic resources gathering information and learning the business of the debtor. This learning cost might further deplete the assets of the debtor’s business at a time when that business is perhaps in greatest need of quick and efficient

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139 One commentator suggested that creditors will often prefer dealing in reorganization with the familiar management of the debtor rather than bothering to educate a novice third-party, such as a trustee, about the business and its difficulties. See PF Coogan et al., “Comments on Some Reorganization Provisions of the Pending Bankruptcy Bills” (1974) 30 Business Lawyer 1149, 1156.

140 George G. Triantis, supra n 75, 918 (suggesting that bankruptcy courts defer to debtor-in-possession’s (i.e. management’s) business judgment in connection with a DIP financing decision because management enjoys advantages in information and expertise).

141 CORPORATE BANKRUPTCY: ECONOMIC AND LEGAL PERSPECTIVES (Jagdeep S. Bhandari & Lawrence A. Weiss editors, Cambridge University Press, 1996), in the Foreword by the Honorable Richard A. Posner, xi-xii (“The reason for giving [the right to continue the operation of the firm] to management is that only management, and not a committee of creditors or a trustee, auctioneer, or venture capitalist or other acquirer has the know-how to continue the firm in operation, as distinct from reviving it (maybe) after an interruption for a change in control.”)

142 KA Kordana & EA Posner, “A Positive Theory of Chapter 11” (1999) 74 New York Univ. Law Review 161, 222, note 163 (“Courts feel that liberal appointment of trustees would undercut Chapter 11’s seeming commitment to the operation of bankrupt firms by prebankruptcy management (the ‘debtor in possession’), presumably based on the idea that the current management has better knowledge of how to operate the firm.”)

143 See JS Heuger & MH Vogel, “Airlines in the Wake of Deregulation: Bankruptcy as an Alternative to Economic Reregulation” (1991) 19 Transportation Law Journal 247, 270 (suggesting that the debtor-in-possession is the most fit to manage a firm in reorganization).
decision-making. Thus, leaving the prepetition management at the helm of the corporate debtor promotes efficient and professional operation of the debtor at a lower cost than would ensue from its replacement.

In short, the professional qualification factor clearly implies that allowing a debtor-in-possession to operate the firm is preferable to the appointment of a trustee.

**IV. INTEGRATED CO-DETERMINATION: A PROPOSAL FOR CONTROLLING CONCENTRATED OWNERSHIP FIRMS IN REORGANIZATION**

The various reorganization models examined in this article are inadequate for concentrated ownership countries. I have shown that the two major policy considerations affecting the choice of the optimal controlling person for a debtor steer in opposite directions. On one hand, reorganization law should strive to secure an independent decisionmaker who will manage the corporation while in reorganization. Such independent decisionmaker will be free of biases in favor of a particular group of creditors or stockholders and will promote the overall efficiency of the proceedings for the collective benefit of all groups. Accordingly, choosing a debtor-in-possession regime, while perfectly compatible with the Berle-Means corporation, seems unsuitable for concentrated ownership systems. Where the identities of management and the equityholders merge, retaining management at the helm adversely affects the creditors’ interest. Thus, a trustee-controlled reorganization would appear to be more appropriate. On the other hand, reorganization law should encourage the effective

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144 An alternative measure to reduce the costs of the information gap is to require the outgoing management to provide all necessary information to the appointed trustee upon the latter's demand. Such a measure is in force in the UK. See Insolvency Act § 235. However, while such a measure may address satisfactorily the information needs of a trustee it does not solve the professional deficiency the trustee suffers from with respect to managerial competency.
and timely commencement of reorganization cases. The law should create an impetus for timely filings of reorganization petitions lest the filings prove to be too late and futile. That is, any reorganization law that deters timely filings for reorganization will drive a debtor firm to risk-shifting activity and consumption of its (remaining) going concern surplus in an attempt to avoid bankruptcy. This activity may also be accompanied by the appeasing treatment of strong creditors who hold leverage over the debtor firm. Such activity is to the detriment of the creditors as a whole, who will end up collecting less than would have been possible had a collective reorganization scheme been commenced in a timely fashion. Displacement of management, the group most suited to file for reorganization, by a disinterested trustee is a recipe for the delay in filing and missing an opportunity to rehabilitate the corporation. By contrast, a debtor-in-possession regime provides sufficient incentives for management to file in a timely manner. Management’s control of the proceedings is the allure of the debtor-in-possession regime. In short, the two policy considerations are in conflict and thus fail to provide a convincing model for concentrated ownership countries. Devising the optimal reorganization law calls for an attempt to reconcile these policy considerations. A proposal for such reconciliation is laid out below.

1. **The proposal: an integrated co-determination model of control**

   In order to reconcile the conflicting policy considerations, for concentrated ownership markets I propose the adoption of a reorganization law which entrusts the control of the debtor corporation to the hands of both management and an appointed trustee. Under this proposal, the filing for reorganization and the appointment of a trustee would not oust management. Rather, the trustee will operate the debtor

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145 See also discussion of the history of railroad equitable receiverships (with same policy of leaving management at the helm) in Baird & Rasmussen, *supra* n 10.
corporation, negotiate with the creditors and draft a reorganization plan in conjunction with management.

The basic idea of this proposal is no innovation. Adams proposed a similar framework to supplant Chapter 11 in the US.146 Yet while Adams proposed a co-determination model of control for US firms, including the Berle-Means firms, my proposal applies specifically to concentrated-ownership firms. In addition, the mechanics of my proposal differ from those of Adams. Adams proposed a bifurcated governance system for a corporation in reorganization.147 Under that proposal, management would retain the exclusive power to operate the business of the debtor and make all investment and financing decisions. Thus, decisions involving obtaining of credit or selling or leasing the debtor's assets would be made by management in its role as debtor-in-possession. Concurrently, the exclusive power to negotiate with the creditors and draft a reorganization plan would be vested in the trustee. Should the trustee conclude that the debtor does not merit reorganization, the trustee would have the exclusive power to decide on the debtor’s liquidation.148

My proposal calls for an integrated co-determination model of control rather than a bifurcated one. It would work as follows: upon the commencement of a reorganization case, a trustee would be appointed and would join the controlling team of the debtor. Ex officio, the trustee would take a seat on the debtor’s board of directors. This seat on the board would carry a veto vote over any matter voted upon by the board.149 The chairman of the board and the CEO would be required to report to the trustee on all business matters of the corporation. The summoning of board members

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146 Adams, supra n 33
147 Ibid, 621.
148 Ibid, 634.
149 A similar mechanism also exists in the context of protecting national interests in a privatized corporation through the use of golden shares held by the national government. See A Pezard, “The Golden Share of Privatized Companies” (1995) 21 Brooklyn Journal of International Law 85.
meetings would be coordinated with the trustee. Thus, the trustee would be involved in all business decisions of the debtor while in reorganization, except decisions involving ordinary course of business activities that did not reach the board.

Unlike the bifurcated co-determination proposal, under the integrated co-determination proposal the scope of the trustee’s role in the reorganization case would exceed mere oversight of the operation of the debtor. Through membership on the board and its executive committee, as well as through its formal and informal communication with the debtor’s top executives, the trustee would participate in the actual decision-making as an active player. This level of involvement cannot be achieved through the mechanics of the bifurcated co-determination proposal. Under that proposal, the trustee is left outside the boardroom.\(^\text{150}\) Under the integrated co-determination proposal, however, the trustee is invited inside.

At the other end of the reorganization proceeding, the integrated co-determination proposal improves the crafting of the reorganization plan. Unlike the bifurcated proposal, the integrated proposal causes management to participate alongside the trustee in the negotiations, bargaining and drafting of a reorganization plan. Preparing reorganization plans requires not only a sound mastering of the legal rights of all creditors and equityholders and an understanding of the comprehensive structure of reorganization law, but also a close familiarity with the business of the debtor.\(^\text{151}\) No reorganization plan can be effectuated if it deals only with the business projections of the debtor and neglects the legal adjustment and treatment of the creditors’ claims. Conversely, a reorganization plan which merely allocates value to the various

\(^{150}\) Also, such familiarity with and monitoring of the operation of the debtor firm cannot possibly be expected to be achieved through the formal oversight of a presiding judge. Judges’ time is constrained and their involvement in the case must be limited to whatever information they are supplied in their courtroom through pleadings.
claimants based on their respective legal rights and fails to address the operational and financing plans of the debtor is destined to result in liquidation. A feasible reorganization plan must map both the business prospects of the debtor and the legal treatment of claims based thereon. While a trustee, as an independent objective party, contributes to the integrity of the process of bargaining with the creditors and to the proposal of a balanced treatment of claims under the plan, it is management which has the advantage in business planning for the debtor. A reorganization plan that is the joint work-product of the trustee and management is one which enjoys the relative advantages of each.

2. The reconciliatory virtue of the proposal

In my opinion, the integrated co-determination proposal for controlling a bankrupt debtor can effectively reconcile the conflicting bankruptcy goals. It enjoys several advantages. On one hand, the proposal can facilitate adequate representation of the divergent interests of creditors and equityholders. On the other hand, it is attractive enough for managements to encourage timely filings for reorganization.

(i) Effective interest representation

The integrated co-determination proposal is an effective tool for addressing the inherent conflicts of interests between the equityholders and the various groups of creditors of an insolvent firm. Earlier in this article I showed that in concentrated ownership countries the automatic alliance between management and equityholders

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151 See Baird, Revisiting Auctions, supra n 15, 638 (noting that firms in Chapter 11 face two conceptually different problems: (a) how to use the firm’s assets (i.e. a business plan), and (b) how to untangle their capital structure (i.e. the treatment of claims)).

152 My proposal is normative and general, in that it is proposed for concentrated ownership corporations regardless of the acting law of a particular jurisdiction. Obviously, adoption of this proposal may require corresponding reforms in a certain jurisdiction's insolvency laws. For example,
negates their ability to effectively and adequately consider the risk preferences and interests of the creditors. 153 Indeed, biased individuals not only cannot overcome the bias, but often are unaware of the fact that they are biased at all. 154 A collective decision-making scheme remedies this shortfall. 155 Moreover, collective decision-making allows better representation of the divergent interests of the respective decisionmakers’ constituents. 156 Under the integrated co-determination proposal, it is expected that management will effectively represent the interests of equityholders and the trustee those of the creditors. 157 Under this proposal,

under current insolvency law in the UK, equityholders have no interest in the insolvent corporation and thus are entitled to no representation whatsoever.

153 See infra, section C.1(b).
155 See MJ Roe, “Some Differences in Corporate Structure in Germany, Japan, and the United States” (1993) 102 Yale Law Journal 1927 (suggesting that the German and Japanese corporate governance systems of shared authority between management and large financial intermediaries carries certain benefits, including the improvement of the process of decision-making (because more individuals and organizations participate in the process and no single individual may overcome her personal biases and because the complex decisions facing firms in the modern world would require a command of information which no individual can possibly possess alone) and facilitating better information-flow to large investors). For a discussion of possible employees' involvement in decision-making in UK firms see R Hyman, “The Future of Employee Representation” (1997) British Journal of Industrial Relations 309.

Normative support for equity-labor co-determination has been offered by several scholars. See, eg, SM Bainbridge, “Participatory Management Within a Theory of the Firm” (1996) 21 Iowa Journal of Corporation Law 657 (supporting an enabling law on co-determination boards of directors); MA O’Connor, “The Human Capital Era: Reconceptualizing Corporate Law to Facilitate Labor-Management Cooperation” (1993) 78 Cornell Law Review 899 (calling for the mandating of employee participation committees and the expansion of the board's fiduciary duties to encompass also employees' interests); D Kershaw, “No End in Sight for the History of Corporate Law: The Case of Employee Participation in Corporate Governance” (2002) 2 JCLS 34 (supporting co-determination governance and arguing that its rejection on the basis of inefficiency is too simplistic as the notion of efficiency is flexible and can accommodate an employee role in strategic participation). See also J Michie & C Oughton, “Employee participation and Ownership Rights” (2002) 2 JCLS 139.


157 To be effective, the proposed system of interest representation also requires that the fiduciary duties of the (joint) decisionmakers be redefined. Because the insertion of the trustee is intended to represent the interests of the creditors, one might argue for some relaxation of the fiduciary duties of management towards creditors of the debtor firm. See LW Hunter, “Can Strategic Participation be Institutionalized? Union Representation on American Corporate Boards” (1998) 51 Industrial & Labor Relations Review 557 (discussing the link between the fiduciary duties of labor-union-appointed-directors and their ability to adequately express the voice of labor in the boardroom).
management will be accountable to the trustee during all stages of the reorganization case. The trustee will thus become involved in business decision-making early in the case, long before the time becomes ripe to make the ultimate decision whether to reorganize or liquidate the debtor. By assuming a key role on the debtor’s board of directors the trustee can participate hands-on in the business decision-making while the firm undergoes reorganization. This close involvement, and particularly the trustee’s powerful veto power within the boardroom, will reduce the costs of risk-shifting activity in reorganization driven by the equityholders-biased management at the expense of creditors. Management would not be able to engage the debtor in risky projects without first obtaining the approval of the trustee. The trustee’s independent position will provide the necessary counterbalance against management’s inclination to gamble with the creditors’ money.

(ii) Neutralizing bankruptcy aversion

A central element in this proposal is that management remains in office while a reorganization case is pending. In this sense, this proposal is a variant of the US reorganization model. This element of the proposal serves two goals. First, it helps to enhance the professional administration of the reorganization case by involving the business experts, management, in the control of the debtor’s operations. Secondly, and more importantly, this element is a sweetener which encourages management to file in a timely fashion for reorganization and avoid any further wasting of the debtor’s value.158 Leaving the debtor outside bankruptcy and operating it subject to individual collection actions by the creditors undermines the debtor’s value. A timely

158 See JJ White, “Harvey’s Silence” (1995) 69 American Bankruptcy Law Journal 467, 471; DR Korobkin, “The Unwarranted Case Against Corporate Reorganization: A Reply to Bradley and Rosenzweig” (1993) 78 Iowa Law Review 669, 675 (both noting that one of the primary goals of
resort to reorganization facilitates the preservation of this value. By making the reorganization case more appealing from the vantage point of management the co-determination proposal encourages management to enter bankruptcy voluntarily. Thus, the co-determination proposal mitigates the problem of the wasteful delay of bankruptcy. Indeed, the co-determination proposal is less management-friendly than the US Chapter 11. However, because the problem of management’s bias in favor of equity is exacerbated with respect to concentrated ownership firms, a trustee-free regime is not desirable. On the other hand, when compared to the UK reorganization model, under which a trustee supersedes the debtor’s management, the co-determination proposal is far less draconian from management’s perspective. When facing the choice whether to delay bankruptcy and risk liquidation or to file for reorganization and participate in the turnaround efforts, management in a co-determination reorganization regime is more likely to opt for the latter alternative.

3. Combating costs of the proposal

The integrated co-determination proposal mitigates the problem of timing the commencement of the bankruptcy case and provides a means of closely monitoring management’s action while the debtor is in bankruptcy. However, this proposal comes at a price. Rather than having a sole decisionmaker the proposal utilizes a dual decision-making system. Obviously, any splitting of authority or decision-making creates a new apparatus for clashes of opposing egos and interests. Where, under Congress in adopting the debtor-in-possession regime was to encourage the timely resort to reorganization).

For a short description of the UK reorganization scheme, see infra, section B.2.

Cf. Adler, supra n 127, 331 (using the lower extent of agency costs under his Chameleon Equity firm proposal as compared to those costs in a traditional firm, to reject criticism that his proposal cannot eliminate agency costs).

This cost is part of what Henry Hansmann calls (in the context of labor participation in corporate management) “governance costs”. Governance costs result from the involvement of...
my proposal, the trustee primarily represents the interests of the creditors and management the interests of the equityholders, apparently the efficiency of co-determination may be questioned on two grounds. First, one of the fallibilities of shared authority and collective decision-making is human miscommunication. The flow of information between the various decisionmakers is susceptible to errors, miscommunication and hence distortion. Secondly, between management and the trustee, the former enjoys superior access to information concerning the debtor. Because the two decisionmakers represent different interest groups, management has an incentive to withhold information from the other representative (the trustee), undermine the latter’s effective decision-making and thus tip the scale of power and risk-taking in favor of its own constituency, the equityholders. Practically, the withholding of information may be accomplished by stalling the coordination of board meetings or by diverting most decision-making to executive sub-committees.

While the dual-control regime I suggest entails the costs of shared authority, such costs do not undermine the efficacy of this proposal. The state of insolvency of a debtor entails an inherent conflict of interests between the various groups of creditors.
Any decisionmaker in a debtor corporation will be required to take into account the diverse and conflicting interests of the different groups involved. Thus, while the dual decision-making system under my proposal is subject to the problem of clashes between the trustee and management, such clashes may simply represent different approaches to risk of the various groups interested in any financially distressed corporation. Because even a sole decisionmaker in bankruptcy cannot avoid facing the groups’ diverse approaches to risk, disagreement between the trustee and management over business matters comprises a cost which is not attributable to the structure of this controlling system but rather to the inherently complex nature of insolvency.

Nonetheless, there remains the problem of information-withholding tactics by management intended to thwart the trustee’s ability to adequately represent the creditors’ interests. Combating such tactics can be both simple and effective. Two measures should be employed to complement the integrated co-determination proposal and ensure its efficient operation. First, in order to frustrate any circumvention of the trustee in the decision-making process, the trustee should be made *ex officio* a member of the executive subcommittee of the board. Second, in order to combat stalling tactics and leaving the trustee out to dry, I propose that the trustee hold a stick over the heads of management. That is, the total time period to propose a reorganization plan should be limited by statute. Under such circumstances,

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164 See Triantis, *supra* n 75, 910-918 (discussing the repercussions of the equity-debt conflict in insolvency).

165 See Nimmer & Feinberg, *supra* n 60, 32 ("As a fiduciary to both [the creditors and equity investors – D.H.], the operating officers of the DIP must inevitably make choices in cases where the interests of one require sacrificing the interests of the other"); Lopucki & Whitford, *supra* n 73, 683-688 (elaborating on the various conflicts of interests concerning the operation of the insolvent firm, investment decisions, and the deployment of its assets).
any stalling by management would return to haunt them as they would risk missing
the statutory deadline, with the result that liquidation would supplant the
reorganization proceedings and management would be ousted from office. This stick
ought to encourage management to disclose the information it possesses to the trustee
so that together they can propose a reorganization plan within the statutory
timeline.167

V. CONCLUSION

The identity of the controlling person of a firm in bankruptcy is a central
element in evaluating both the efficiency and fairness of the proceedings. The
repercussions of this identity cannot be overstated. First, determining the controlling
person of a debtor firm directly affects the crucial issue whether the firm is likely to
resort to bankruptcy on time, when there is still some value available for a successful
reorganization. Secondly, different controlling persons owe different loyalties, either
to creditors or to equityholders. Thus, the identity of the controlling person affects the
balance of power between the various owners of the debtor firm. This article has
argued that sound policy requires devising a control regime which both encourages
timely filing for reorganization and ensures adequate representation for the divergent
groups of owners of the firm. Furthermore, the article has identified the
prebankruptcy ownership structure of the firm as the major factor which affects the

166 See also White, supra n 122, 230 (“[T]he basic problems of bankruptcy are not caused by
design flaws in the bankruptcy system, so that tinkering with the design of bankruptcy procedures will
not ‘solve’ them”).
167 A statutory deadline seems too rigid and cannot possibly fit all cases. There will be complex
cases where it would be justified for the court to grant an extension for proposing a reorganization plan.
However, preserving the court’s power to extend the statutory period for proposing a reorganization
plan will be of no avail to managements which contemplate stalling. The court should be empowered to
grant extensions for proposing reorganization plans only if the motion is filed by the trustee (alone or
together with management). Whenever management stalls and withholds information from the trustee,
the trustee will obviously refuse to join the filing of a motion to extend the statutory period and
management’s tactics will fail.
controlling person’s decision-making in bankruptcy. Thus, it concludes that, contrary to the policy reflected in the US Chandler Act\textsuperscript{168} and in the modern UK Insolvency Act, 2000,\textsuperscript{169} the management of concentrated-ownership firms is so dependent upon equityholders that it is precluded from satisfactorily controlling the debtor firm to the end of maximizing the return to creditors. Thus, for such firms an independent trustee is more suitable. However, because the displacement of management by a trustee chills the former from filing for bankruptcy in a timely manner, this article proposed an integrated co-determination control regime, under which both a trustee and management would jointly control the debtor firm and draft a reorganization plan. This regime would establish adequate representation of the various groups of owners and yet remain friendly enough to management so that they would still be induced to file for reorganization on time. It is rather the Berle-Means corporation where management’s relative independence and separation from the equityholders allows management to successfully control the debtor firm as a debtor-in-possession with the interests of creditors close to its heart. Appointing a trustee for such a firm is unnecessary.

Keywords: Reorganization, concentrated ownership, control, co-determination, interest representation, fiduciary duty to creditors, timely filings.

\textsuperscript{168} See \textit{supra} nn 31-33 and accompanying text.
\textsuperscript{169} See \textit{supra} n 53.