NEW YORK LAW SCHOOL

NYLS Journal of International and Comparative Law

Volume 17
Number 2 *THE SIXTH ANNUAL ERNST C. STIEFEL SYMPOSIUM*

Article 18

1997

# HARMONIZING THE BUSINESS BANKRUPTCY SYSTEMS OF DEVELOPED AND DEVELOPING NATIONS: SOME ISSUES

Jean Braucher

# HARMONIZING THE BUSINESS BANKRUPTCY SYSTEMS OF DEVELOPED AND DEVELOPING NATIONS: SOME ISSUES

*Jean Braucher*[*]

By comparing the bankruptcy reorganization systems of emerging nations with the system in the United States, this symposium raises two interesting questions: whether a country's stage of economic development is a major factor influencing its business bankruptcy law and whether it should be. These questions are important to the consideration of whether it would be desirable in the long run to harmonize bankruptcy reorganization systems of developing and developed nations, for example in the North American Free Trade Agreement (NAFTA) countries or in Europe. A country's bankruptcy reorganization system should be viewed as part of its law and policy of economic development,[1] but this does not necessarily mean that a country's stage of development is or should be the predominant concern when designing a business bankruptcy system.

The NAFTA countries, Canada, the United States and Mexico, provide a good example for thinking about these questions. Harmonization of business bankruptcy law in the NAFTA countries is at best a long-range proposition, so the questions can be considered at leisure.[2] The U.S. and

---

* Gustavus H. Wald Research Professor of Law, University of Cincinnati College of Law.

1. Jean Braucher, *Bankruptcy Reorganization and Economic Development*, 23 CAP. U. L. REV. 499 (1994).

2. The American Law Institute's Transnational Insolvency Project is proceeding on the assumption that "harmonization of the insolvency laws" of Mexico, Canada and the United States is not "likely to be achievable in the near future." TRANSNATIONAL INSOLVENCY PROJECT: INTERNATIONAL STATEMENT OF UNITED STATES BANKRUPTCY LAW 1 (Discussion Draft, April 17, 1996). Rather, the project seeks to "develop cooperative procedures for...cases involving companies with assets or creditors in more than one of the three NAFTA countries." *Id. See also* Harold S. Burman, *Harmonization of International Bankruptcy Law: A United States Perspective*, 64 FORDHAM L. REV. 2543, 2561 (1996) (Burman, a U.S. State Department lawyer, argues that some procedural harmonization is achievable by "foregoing the temptation to deal with so-called substantive issues . . .").

Canada, although both developed nations, have bankruptcy systems that produce significantly different outcomes, with Canada's system offering a much more restricted opportunity for reorganization than in the U.S.[3] Mexico, a developing nation, looks increasingly to global credit markets but has resisted toning down its highly debtor-protective bankruptcy reorganization system, which permits insolvent enterprises to linger for years under court protection.[4] In bankruptcy policy as in geography, the U.S. occupies a position between Canada and Mexico, but it is doubtful that this is a result of the differences in each country's stage of development.

Professor George Triantis argues that economic imperatives will create a convergence in the systems of similarly developed nations despite differences in social, political and cultural contexts.[5] If this is right descriptively, however, complete convergence is a process that takes a long time (maybe forever).[6] The convergence thesis is more convincing as a

---

3. Lynn M. LoPucki & George G. Triantis, *A Systems Approach to Comparing U.S. and Canadian Reorganization of Financially Distressed Companies*, 35 HARV. INT'L. L. J. 267, 339-342 (1994).

4. *See generally* Thomas S. Heather, *Mexico's Bankruptcy and Suspension of Payments Law in* DEALING WITH FOREIGN WORKOUTS AND INSOLVENCIES 1993: PRACTICAL STRATEGIES FOR LENDERS AND INVESTORS 121 (PLI Commercial Law and Practice Course Handbook Series No. 671, 1993). For press accounts, see for example, Craig Torres, *'Vulture' Funds Find That Mexico Isn't Letting Go of Its Bad Loans*, WALL ST. J. EUR., Aug. 15, 1995, *available in* 1995 WL-WSJE 9086033; *Mexico Begins Study of Bankruptcy Law Reform*, Dow Jones Int'l News Serv., June 30, 1995, *available in* WESTLAW, Dow Jones Int'l News Plus File.

5. George G. Triantis, *The Careful Use of Comparative Law Data: The Case of Corporate Insolvency Systems*, 17 N.Y.L. SCH. J. INT'L & COMP. L. 193 (1997); *see also* LoPucki & Triantis, *supra* note 3, at 342:

> Our thesis is that because both countries [the U.S. and Canada] have market economies and share the same assumptions and broad objectives for formal reorganization, it was highly likely, if not inevitable, that the two countries would develop reorganization systems that function in essentially the same way. The functional aspects of these systems were shaped not by culture or politics, but by necessity.
>
> An implication of our Article, therefore, is that the functional aspects of judicially supervised reorganization systems tend to converge. If we are correct, any country that opts for court supervised reorganization against a similar economic background is likely to arrive at the same functional solutions. *Id.*

6. The argument that bankruptcy systems are products of economic imperatives is reminiscent of the argument that the common law is efficient. *See, e.g.*, RICHARD A. POSNER, ECONOMIC ANALYSIS OF LAW (4th Ed. 1992); John C. Goodman, *An Economic Theory of the Evolution of Common Law*, 7 J. LEGAL STUD. 393 (1978); George L.

normative proposition, that a proper balance of economic and political concerns *should* eventually result in bankruptcy systems that look more similar than different.[7] This normative argument, I believe, applies to emerging as well as developed nations in a global economy. Treating the point as normative rather than positive underscores that if harmonization is to occur, for example in the NAFTA countries or in Europe, difficult political actions will be necessary; economics will not be destiny by means of the invisible hand, without politics.

To the extent that bankruptcy reorganizations or workouts negotiated in the shadow of the law succeed in keeping business concerns going, a bankruptcy system helps to maintain a country's economic base.[8] This is why bankruptcy reorganization law is properly seen as serving a preservation function in the law and policy of economic development.[9] A developing nation, which typically is struggling to promote enterprise formation, is likely to be particularly concerned about protecting existing concerns. Every business preserved is one less that needs to be created.

---

Priest, *The Common Law Process and the Selection of Efficient Rules*, 6 J. LEGAL STUD. 65 (1977); Paul H. Rubin, *Why is the Common Law Efficient?*, 6 J. LEGAL STUD. 51 (1977). Both arguments underplay, among other influences, history, politics and serendipity.

7. My differences with Triantis, developed in the text *infra*, are matters of emphasis. In their groundbreaking and impressive comparative study of U.S. and Canadian bankruptcy systems, Professors Triantis and Lynn LoPucki found convergence and divergence in the two systems, but they chose to emphasize convergence in the two systems' functional devices. LoPucki & Triantis, *supra* note 3. Whether the similarities or differences of the systems are more important probably depends on one's purpose in making the comparison. I believe the differences (in light of the similarities) are most important to one considering reform of either system. LoPucki and Triantis explain this well:

> . . . [T]he United States and Canada have struck different balances between their common policies of assuring protection to viable businesses and preventing use of the system by nonviable ones. Presumably, there is an optimal balance to be reached between the two conflicting objectives. Given the difference between the two systems in this respect and the similarity between them in virtually all others, it should be possible to determine the relative merits of the two approaches through an empirical comparison of the outcomes of reorganization in the two countries.

*Id.* at 342. Unfortunately, there may be too many variables to do such an empirical comparison in a rigorous way. *See infra* text following note 27.

8. Hon. Samuel L. Bufford, *What is Right about Bankruptcy Law and Wrong about its Critics*, 72 WASH. U. L.Q. 829, 836 (1994) (noting that bankruptcy reorganization "prevents secured creditors from collectively starting a downward spiral of foreclosures and bank failures that could result in the failure of the entire economy").

9. Braucher, *supra* note 1, at 499.

Developed nations in economic crisis are also likely to make the choice to bend over backwards to protect existing enterprises.[10]

On the other hand, any nation—developed or developing—may wisely be concerned if its bankruptcy system is overly protective of existing businesses. Keeping corpses breathing on expensive life support technology will adversely affect credit markets, constricting credit to create and expand businesses. A long-term view will favor a middle-of-the road position, allowing a reasonable, controlled chance for reorganization of insolvent concerns that may be viable, but not making liquidation of nonviable ones nearly impossible. It is hard, however, to take the long view in the middle of a financial crisis, as recent Mexican experience shows.[11]

At a minimum, comparative law offers a valuable perspective on one's own legal system. Comparisons are certainly eye-opening in the bankruptcy field. By comparing the U.S. bankruptcy system to that of emerging nations, one sees that the relative health and stability of our economy seem to give us the luxury of a bankruptcy and insolvency system in which the government typically plays a passive role. The U.S. system, sometimes portrayed as involving meddlesome social engineering,[12] seems positively laissez faire when one learns that: in the Ukraine, the government files most bankruptcy cases;[13] in Hungary, prior to a 1993 change in the law, an insolvent debtor was required to file for bankruptcy to avoid sanctions;[14] and in Mexico, the government is frequently a crucial

---

10. *See* Bufford, *supra* note 8, at 836-38 (making this observation about the origins of U.S. federal reorganization law in the Depression of the 1930s).

11. *See generally* Kimberly Krawiec, *Corporate Debt Restructurings in Mexico: For Foreign Creditors, Insolvency Law Is Only Half the Story*, 17 N.Y.L. SCH. J. INT'L & COMP. L. 481 (1997). For a press account of Mexico's financial crisis, which has included much business failure, see Christopher Whalen, *A Look at Mexico's Meltdown*, WASH. POST, Jan. 21, 1996, *available in* 1995 WL 3059830 (reporting on Mexico's financial crisis and resulting business failures).

12. Michael Bradley & Michael Rosenzweig, *The Untenable Case for Chapter 11*, 101 YALE L.J. 1043, 1088 (1992).

13. I am indebted for this information about the Ukraine to the Hon. Samuel Bufford, who discusses bankruptcy law in Eastern Europe generally in *Bankruptcy Law in European Countries Emerging from Communism: The Special Legal and Economic Challenges*, 70 AM. BANKR. L.J. 459 (1996).

14. *See* Pamela Bickford Sak & Henry N. Schiffman, *Bankruptcy Law Reform in Eastern Europe*, 28 INT'L LAWYER 927, 934 & n.19 (concerning mandatory filing aspect of Hungarian law as the cause of 14,000 filings in 1992, before the law was changed in July 1993). *See id.* at 933 (concerning Polish law which also required filing for debtors ceasing to pay their debts).

player in litigated cases and in the negotiation of corporate workouts, sharing the burden by forgiveness and rescheduling of tax obligations.[15] In contrast, the U.S. system leaves the initiative in bankruptcy reorganizations and in workouts to private parties, with rare exceptions such as the Chrysler bailout.[16] In the U.S., business insolvency and failure are not viewed as political problems in need of political solutions to the degree that they are in developing nations.

More ambitiously, comparative law can attempt to identify those aspects of the legal order that are universal and those that are responses to the particular context. Professor Triantis warns, however, that too much emphasis on context makes this more ambitious sort of comparative law impossible.[17] This argument seems to me to set up a false dichotomy. Rather than seeing the study of the universal and the contextual as in tension, I would argue that one cannot see one without identifying the other. The study of the two must go hand in hand, and in the process one can find many ideas for reform of any given system.

A survey of various countries' bankruptcy systems suggests that the universal elements, though central, are small in number, yet there are astonishingly diverse variations in the refinements. In the variety produced by context, we are more likely to find useful ideas to reform our own system.

The universals include (1) a seemingly inevitable choice in any system between shutting down an insolvent enterprise and selling its assets piecemeal, as opposed to continuing and reorganizing it,[18] and (2) a tilt in the system favoring one or the other of these choices.[19] These features appear even when a system does not formally provide both choices. Even in countries without a legal mechanism for reorganization, workouts can and do occur, but of course such a system involves a tilt favoring liquidation over reorganization. Comparative law study, like law study generally, is only worthwhile if it looks not just at formal law on the

---

15. Heather, *supra* note 4, at 137.

16. *See* Bufford, *supra* note 8, at 835 (noting that tax collectors often precipitate bankruptcy filings by levying on or garnishing assets, but it is ultimately the debtor who decides whether to resort to bankruptcy).

17. Triantis, *supra* note 5, at 200.

18. These options do not necessarily line up with legal options. In the U.S., for example, Chapter 7 can be used to sell a business as a going concern, and a liquidating plan can be adopted in Chapter 11.

19. *See* Triantis, *supra* note 5, at 203 ("bankruptcy is . . . about enhancing the value of firm assets").

books, but at how people and businesses actually interact in light of that law.[20]

Triantis, in his search for universals, may de-emphasize context unduly and overplay economics as a universal, imperative influence. As an example demonstrating his argument that economic imperatives cause systems to converge despite social, political, and cultural differences, he describes how the Canadian "guillotine" rule, which ends the chance of reorganization when creditors vote down a plan, led to the practice of conducting straw polls so that plans could be informally proposed and amended.[21] He suggests that economic imperatives will lead a reorganization system to develop a mechanism, formal or informal, for amending plans.

But the variations caused by the influence of context, rather than the universals, offer what may be more important lessons for reformers. Triantis's own prior work, with Professor Lynn LoPucki, shows the importance of context.[22] The differences between the U.S. and Canadian reorganization systems are more interesting to reformers than the similarities. Canadian judges run a very tight ship, using aggressive judicial administration to weed out cases of questionable viability early.[23] The comparison of this system to our own highlights that what is wrong with ours may be more administrative than formal substantive rules. Triantis has raised the possibility that our system is administered the way it is because bankruptcy judges have incentives to lure big, prestigious cases to their courts by giving debtors breathing room, thus developing pro-debtor reputations.[24] While in general the laxity of U.S. bankruptcy judges has increased,[25] some have been experimenting with more rigorous administrative practices,[26] seeing an obvious need and perhaps also an

---

20. RUDOLPH B. SCHLESINGER ET AL., COMPARATIVE LAW 884-890 (5th ed. 1988).

21. Triantis, *supra* note 5, at 201; LoPucki & Triantis, *supra* note 3, at 315, 342.

22. LoPucki & Triantis, *supra* note 3.

23. *Id.* at 283-87, 311-15.

24. George G. Triantis, *The Interplay Between Liquidation and Reorganization in Bankruptcy: The Role of Screens, Gatekeepers, and Guillotines*, 16 INT'L. REV. L. & ECON. 101, 114 (1996) (contrasting the U.S. and Canadian bankruptcy judiciary and reporting that the Canadian judges who hear bankruptcy cases are overwhelmingly concentrated in one court in Toronto, where peer pressure can operate strongly).

25. *See generally* Lynn M. LoPucki, *The Trouble With Chapter 11*, 1993 WIS. L. REV. 729.

26. Hon. Samuel L. Bufford, *Chapter 11 Case Management and Delay Reduction: An Empirical Study*, 4 AM. BANKR. INST. L. REV. 85, 93 (1996) (empirical study of the impact of adopting a case management system by one bankruptcy judge in California, Hon.

opportunity to make a reputation in this way or a means to head off formal changes in the law that they might not like. In the U.S., it is likely to be a long time, if ever, however, before these experiments lead to the same sort of widespread screening of bankruptcy cases that Canadian judges use.

With the divergence of U.S. and Canadian judicial approaches in mind, Triantis's example of the Canadian straw vote practice to avoid the guillotine rule is better seen as revealing contextual response rather than the universality of economic imperatives. The universals are that reorganization is always possible, even when not formally provided for or when disfavored by restrictive rules (such as the guillotine rule), and that systems will have a tilt toward more or less reorganization. The context creates different tilts, and there is a normative question about which tilt is better. The U.S. system allows debtors to try again (and again) to come up with an acceptable plan, even after creditors reject a plan. The Canadian system in action also allows for amended plans, but only before a vote and thus during a much shorter time than in the U.S. This significant difference is a result of the different tilts created by context. The identification of universals—the reorganization option and a tilt toward or against it—helps us to see the contextual response. The contextual response here is ultimately most interesting to a reformer. It reveals that plan amendment can occur even if not formally provided for, highlighting the question whether reorganization should be liberally encouraged by allowing debtors a long time and multiple votes to come up with an acceptable plan, as is generally the case in the U.S., or restricted by a guillotine rule that will allow much less time for amending a plan using the straw poll practice, as in Canada. Presumably the Canadian system involves fewer reorganizations and less delay before liquidation. Which system is better depends on their relative consequences,[27] most significantly their rates of business preservation and their impact on credit prices and credit availability for comparable enterprises in the two countries. Given the many influences on business success and on credit markets, however, it may not be feasible to isolate the consequences of the differences in the two countries' bankruptcy systems. Even if rigorous empirical evaluation were possible, actors in these countries' political systems might still prefer to rely on hunches rather than social science when making policy choices.

Comparing the systems of two developed nations such as the U.S. and Canada shows significant divergence and calls into question the strength

---

Geraldine Mund); *see also* Samuel L. Bufford, *Chapter 11 Case Management*, AM BANKR. INST. J., Dec.-Jan. 1996, at 35.

27. *See supra* note 7.

of economic imperatives in shaping the systems. A comparison of various developing nations' bankruptcy systems also raises doubt that economic imperatives are a universal. Mexico's very debtor-protective system encourages workouts rather than actual use of the formal system.[28] Many observers are concerned that the system is too pro-debtor, inhibiting extensions of credit.[29] The concern for preserving going concerns in the short term in Mexico is understandable, given its economic crisis, but Mexico may pay a price in restricted credit availability, especially as it turns to foreign creditors. It is interesting to learn that Ukraine, Poland and Hungary, which are also looking for outside credit, have tried systems that force debtors into bankruptcy.[30] It would be revealing to compare the economic development progress of developing nations with differing tilts in their systems, whether toward breaking up or preserving troubled businesses. Of course, as with comparisons among developed nations, it may be hard to ascribe differences in the development records of emerging countries to differences in their bankruptcy systems, given all the other differences among developing nations. Still, the current lack of convergence in their business bankruptcy systems—in light of the hope in all of them of attracting foreign credit—should make us question how dominant economic imperatives are in the design of bankruptcy systems, even if as a normative matter economics should be more salient. International harmonization of business bankruptcy systems will require the development of shared political visions of what the systems can and should achieve.

28. Heather, *supra* note 4.

29. *See* Torres, *supra* note 4.

30. *See* notes 13 and 14 *supra* and accompanying text.