

# TheDeal Magazine

Voice of the deal economy

## American exceptionalism

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In cross-border restructurings, consideration is often given to whether local insolvency proceedings are necessary or desirable as an alternative to stalled workout negotiations. In that context, U.S. lawyers often discuss with their clients how a particular type of foreign insolvency proceeding is similar to Chapter 11.

For example, U.S. lawyers will refer to "voluntary administration" as being Australia's version of Chapter 11, to a "scheme of arrangement" as permitting the U.K. equivalent of a prepackaged Chapter 11, and to "concurso preventivo" as Argentina's Chapter 11.

While making such comparisons is convenient, it is also fraught with peril. Even if a foreign insolvency proceeding looks, walks and talks like Chapter 11, it simply is not "their version of Chapter 11." A U.K. scheme of arrangement is not even an insolvency proceeding.

The issue isn't whether businesses can be reorganized under other countries' laws -- of course they can. Fundamentally, however, Chapter 11 is a unique beast, for three primary reasons.

**Court-driven process.** In general, the U.S. is a court-driven society when it comes to resolving disputes. Chapter 11 is no different. Debtors are required to submit many routine matters for court approval, just to ensure that all parties have notice of a proposed action and the ability to object to it. In effect, the U.S. bankruptcy court is an active participant in the Chapter 11 process.

In most other countries, there is very little court involvement in insolvency proceedings. There is almost always a court in the background, but generally an administrator (or trustee, syndic, commissioner, etc.) simply gets on with the business of running the proceeding.

An administrator can borrow money, sell assets, admit or reject claims and make other key business decisions with little or no court involvement. This often comes as a shock to U.S.-based creditors, which are accustomed to full, real-time transparency on a debtor's actions in a Chapter 11 case.

**Multiple active constituencies.** In Chapter 11, any creditor is deemed to be a "party in interest" entitled to raise and be heard on any issue in the case, and many creditors do precisely that. Chapter 11 also empowers an "official committee of unsecured creditors" that appoints legal and financial professionals who are paid out of the estate and who actively participate in all aspects of the case. In other countries, while creditors usually have the theoretical right to seek a court order challenging an administrator's decision, this very rarely happens. There can be committees of creditors in many countries, but typically their role is purely consultative -- a sounding board of sorts -- and they seldom engage any professionals of their own. This also comes as a shock to U.S.-based creditors, who expect that creditors, or at least creditors' committees, should be entitled to play a very active role given that it is their own recoveries that are at stake.

**Culture, culture, culture.** Perhaps the biggest shock to U.S.-based creditors, however, is the overwhelming tendency of foreign insolvency proceedings to be liquidations. The liquidation can often be a going-concern sale, but it is a liquidation nonetheless.

This liquidation mindset is a creature of cultures that view insolvency proceedings as the hospice for the dying business rather than the hospital for curing the sick business. Local financial creditors, which almost always means local banks, would typically rather monetize their recoveries than risk reinvestment in the debtor via new debt and equity securities. Again, most foreign insolvency laws permit the possibility of reorganization -- but most foreign insolvency cultures do not accept reorganization as the preferred solution.

Our point is not that Chapter 11 is better. While Chapter 11 is considered to be better in the U.S., given our reorganization culture, it does not make it better for other countries where a bird in the hand (a cash distribution) is almost always preferred to two in the bush (a combination of equity and new debt securities). It also does not mean that most troubled companies do not reorganize internationally. Instead, if reorganization is desired, it is almost always achieved through informal out-of-court negotiations rather than via a formal insolvency process.

Don't be misled by a reference to another country's "version of Chapter 11" -- there is no such animal. But also do not be misled into believing that other countries' processes are inferior to ours or that they can't or won't reorganize businesses that are worthy of rescuing. They just do it in different ways. When in Rome ...

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