

Is Chapter 11 Too Favorable to Debtors? Evidence from Abroad

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IS CHAPTER 11 TOO FAVORABLE TO DEBTORS? EVIDENCE FROM ABROAD

Theodore Eisenberg† & Stefan Sundgren††

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INTRODUCTION

Chapter 11 is widely believed to be among the industrialized world's most debtor-oriented reorganization laws. Critics assert that Chapter 11 is too easily available and that it allows debtors too much control by, inter alia, not requiring appointment of a trustee. One criticism of Chapter 11, low returns to unsecured creditors, resonates with an important theme of this Symposium, the Bebchuk-Fried proposal to reduce secured creditor priority in insolvency proceedings.¹ The Chapter 11 criticisms and the Bebchuk-Fried proposal raise the question whether less easy access to Chapter 11, reduced debtor control, diminished secured creditor priority, or other changes could reduce filings and delays, improve performance, and reduce costs.

Directly exploring such issues without repealing or changing Chapter 11 is not possible. Social experiments could help supply an answer.² Given political and practical reality, however, such experiments are unlikely to be conducted. Second-best empirical evaluation methods will have to suffice.

One method is to compare Chapter 11's performance with that of a reorganization system similar to Chapter 11, but differing in some crucial respects, such as whether a trustee or other official must be appointed. Comparing Chapter 11's results with those of the second system should yield insights into Chapter 11's efficacy. This Article presents the results of such an empirical study. It compares data from prior Chapter 11 studies with new data on Finnish reorganizations.

Finnish reorganization law is in many important respects similar to Chapter 11. But it contains two central features that are less favorable to debtors. The first feature is its early detection and termination of cases inappropriate for reorganization. A de facto presumption underlying Chapter 11 is that nearly all firms should be given a chance to try to reorganize. Creditors wishing to terminate a case be-

¹ Lucian Arye Bebchuk & Jesse M. Fried, *The Uneasy Case for the Priority of Secured Claims in Bankruptcy*, 105 YALE L.J. 857 (1996).

² Imagine a Chapter 11-like system except that trustees were appointed randomly in one-half of filings and were not required to be appointed in the other half of filings. Differences in outcome could be attributed to the presence (or absence) of a trustee. For discussion of such an experiment and its limitations, see THEODORE EISENBERG, CREATING AN EFFECTIVE SWEDISH RECONSTRUCTION LAW 63-64 (Studieförbundet Näringsliv och Samhälle (SNS), Occasional Paper No. 75, Dec. 1995) (published in Swedish as KONKURS ELLER REKONSTRUKTION: HUR SKAPA EFFEKTIVA LAGAR (SNS Förlag 1995)). See generally James J. Heckman & Jeffrey A. Smith, *Assessing the Case for Social Experiments*, 9 J. ECON. PERSP., Spring 1995, at 85 (discussing the use of social experiments to evaluate social programs).

cause they believe the debtor cannot successfully reorganize face a considerable burden of proof. Finland and many other countries take a different approach.³ When a debtor files a reorganization petition, creditors may immediately challenge the case's eligibility for reorganization.⁴ Most cases do not survive this initial screening.

A second noteworthy difference is the U.S. debtors' greater influence over the reorganization plan and the information communicated to creditors. In the typical Finnish case, an appointed outside official, called here an "administrator," oversees the case, provides creditors with information, and proposes a reorganization plan.⁵ Creditors nominate the administrator, who is thus likely to act in their interest.⁶ In the United States, the debtor's management usually performs the Finnish administrator's tasks. U.S. reorganizations are therefore likely to be more debtor oriented than Finnish reorganizations. Chapter 11's minimal involvement of an external administrator is a distinctive feature of U.S. law. "The United States is probably the only developed nation that leaves the debtor in unsupervised possession of the estate during a reorganization."⁷

This Article examines whether differences in the countries' reorganization laws affect their reorganization systems' performance. In particular, one expects Finnish reorganization proceedings to be more selectively employed, to be quicker, to be less likely to devote time and energy to hopeless firms, and to generate results more favorable to creditors.

Our comparative analysis indicates that a greater portion of insolvent firms reorganize in the United States than in Finland. These findings are consistent with the hypothesis that Chapter 11's prodebtor features attract more filings and induce debtors to file at an earlier stage of financial difficulty.

We also compare the likelihood that firms emerge from reorganization with plans allowing them to stay in business. Generally, even controlling for differences in firms' solvency, the likelihood is lower

³ See, e.g., PHILIP R. WOOD, *PRINCIPLES OF INTERNATIONAL INSOLVENCY* § 11-7 (1995) (discussing issues associated with commencing bankruptcy proceedings); Christian Van Buggenhout & William Nauwelaerts, *Corporate Insolvency Law in Belgium*, in *EUROPEAN CORPORATE INSOLVENCY: A PRACTICAL GUIDE* 23, 33 (Harry Rajak et al. eds., 2d ed., John Wiley & Sons 1995) (1992) (describing the procedure for filing reorganization petitions in Belgium).

⁴ See, e.g., Theodore Eisenberg & Shoichi Tagashira, *Should We Abolish Chapter 11? The Evidence from Japan*, 23 J. LEGAL STUD. 111, 117 (1994) (noting that a neutral, court-appointed examiner recommends whether a Japanese composition proceeding should commence).

⁵ See *infra* Part I.A.2.

⁶ See *infra* Part I.A.2.

⁷ Lynn M. LoPucki, *Chapter 11: An Agenda for Basic Reform*, 69 AM. BANKR. L.J. 573, 576-77 (1995). For a similar view from abroad, see WOOD, *supra* note 3, §§ 11-37 to 39.

under the Finnish Code, though the effect is small and not statistically significant. Thus, despite widespread beliefs that confirmation rates in the United States are unduly low,⁸ a similar group of firms, operating under a similar reorganization law, failed to achieve higher plan confirmation rates.

Finland's stricter early screening of cases reduces the time elapsed between the filing and termination of unsuccessful reorganization cases—those which never confirm a plan. Such Finnish cases consume, on average, 3.7 months, compared to 8.6 months for U.S. firms.⁹ The time pattern is less clear for firms that achieve confirmation of reorganization plans. The average time elapsed between filing and plan confirmation is 10.9 months for the Finnish firms and 10.7 months for the comparable U.S. sample,¹⁰ indicating no notable time difference between the systems. Other studies, however, suggest that current U.S. proceedings are considerably slower.¹¹

Surprisingly, we find no evidence that the U.S. system leads to reorganization plans that are more favorable to debtors. U.S. debtors propose to pay unsecured creditors a higher percentage of their claims than Finnish debtors propose to pay, and also propose a faster payout. We present evidence that the U.S. law's much-debated absolute priority rule ("APR") induces debtors to propose plans requiring substantially higher repayments than Finnish reorganization plans require. Under the APR, a debtor's owners may not retain an ownership interest in the reorganized firm unless the reorganization plan proposes to pay creditors in full.¹² Thus, while Finnish reorganization mechanics are more procreditor, a substantive rule requiring full payment to creditors for owners to retain ownership may generate U.S. plans that are more favorable to creditors. We confirm the favorable treatment of U.S. unsecured creditors by briefly examining results from Canada, Japan, and Australia.

⁸ See Eisenberg & Tagashira, *supra* note 4, at 113; Edith H. Jones, *Chapter 11: A Death Penalty for Debtor and Creditor Interests*, 77 CORNELL L. REV. 1088 (1992).

⁹ See *infra* Part III.C.

¹⁰ See *infra* Part III.C.

¹¹ See Samuel L. Bufford, *Chapter 11 Case Management and Delay Reduction: An Empirical Study*, 4 AM. BANKR. INST. L. REV. 85, 100-05 (1996); Lisa Hill Fenning & Craig A. Hart, *Measuring Chapter 11: The Real World of 500 Cases*, 4 AM. BANKR. INST. L. REV. 119, 145-52 (1996); Susan Jensen-Conklin, *Do Confirmed Chapter 11 Plans Consume? The Results of a Study and Analysis of the Law*, 97 COM. L.J. 297, 327 (1992); Ed Flynn, *Statistical Analysis of Chapter 11*, at 23-28 (Oct. 1989) (unpublished manuscript, on file with authors).

¹² See 11 U.S.C. § 1129(b)(2)(B)(ii) (1994). Junior classes may participate if they invest new value in the firm in connection with the reorganization. See *In re Bryson Properties*, XVIII, 961 F.2d 496, 503-04 (4th Cir. 1992). The Supreme Court has left open the question whether a new value exception to absolute priority exists under the Bankruptcy Code. See *U.S. Bancorp Mortgage Co. v. Bonner Mall Partnership*, 513 U.S. 18, 20 n.1 (1994).

Finnish unsecured creditor results are of special interest in light of the Bebchuk-Fried proposal. As we describe elsewhere,¹³ Finnish law establishes two types of secured creditors: creditors with a fixed charge on assets and creditors with a floating charge. Creditors with a floating charge have a security interest in the changing assets of the firm, including inventory and receivables, and enjoy partial priority. They receive 50%¹⁴ of the proceeds remaining after creditors with a fixed charge on assets and administrative expenses have been paid.¹⁵ Secured creditors with a fixed charge on a firm's assets have full priority.¹⁶ In the United States, secured creditors enjoy full priority, with different qualifications.¹⁷

If there were a simple relationship between levels of secured creditor priority and repayment rates to unsecured creditors, one might expect Finnish unsecured creditors to fare better than U.S. creditors. We find, however, no hard evidence that partial secured creditor priority necessarily leads to different payout patterns. The greatest effect of a partial priority rule may be on *ex ante* lending behavior to the mass of firms, most of which do not resort to insolvency proceedings.

Part I of this Article reviews U.S. and Finnish reorganization laws' similarities and differences, and concludes that they can be compared meaningfully. It then sets forth predictions about the effects of the differences in the reorganization schemes. Part II describes the data used, Part III presents the empirical results, and the Conclusion summarizes our main findings. As with any comparative legal study, caution must be exercised in concluding that any aspect of the systems is in fact the same or different.

I

UNITED STATES AND FINNISH REORGANIZATION LAWS

We present a detailed comparison of Finnish and U.S. reorganization laws elsewhere¹⁸ and summarize only the highlights here. After briefly describing the laws, we formulate hypotheses about how the reorganization systems should compare.

¹³ See Theodore Eisenberg & Stefan Sundgren, Chapter 11 Reorganizations, Debtor Control, and Absolute Priority: A Comparative Empirical Study 6 (Aug. 26, 1996) (unpublished manuscript, on file with authors).

¹⁴ The priority was 60% until January 1995, which includes the period studied here.

¹⁵ See Eisenberg & Sundgren, *supra* note 13, at 6.

¹⁶ See *id.*

¹⁷ See, e.g., THEODORE EISENBERG, BANKRUPTCY AND DEBTOR-CREDITOR LAW 583 (2d ed. 1988).

¹⁸ Eisenberg & Sundgren, *supra* note 13.

A. Reorganization Laws

We divide reorganization law into rules governing commencement of a case and preserving firm value, rules governing communication of information to help formulate reorganization plans, and rules governing plan formulation and confirmation. Eligibility for commencement, the need to stay creditor collection efforts, deciding whether to leave the debtor in control, and determining whether a reorganization is likely to succeed are crucial early issues. Interested parties then need information about the debtor to assess reorganization prospects and to help formulate and evaluate plans. The power to propose a plan and the rules governing its confirmation determine the outcome of the reorganization process.

1. *Commencing the Case and Preserving Firm Value*

The automatic stay protects U.S. debtors' property from collection efforts during the reorganization. As described below, under Finnish law, the stay takes effect after the case passes the initial eligibility screening.¹⁹ Although this screening process may take a couple of months, the Finnish debtor may apply to the court for a temporary stay.²⁰ Finnish Reorganization Law ("FinRL") § 6 includes the solvency requirement rules.²¹ The debtor need not be insolvent if the debtor, together with creditors representing at least one-fifth of the debtor's known debts, file the petition jointly.²² The court is likely to stay creditors almost immediately after the filing, if there is reason to expect that creditors will undertake collection actions and the firm has even a remote chance of survival.

Staying collection actions helps preserve firm value. A firm's most important assets include its web of contractual relationships. Both U.S. and Finnish law allow a debtor to preserve most contractual relationships during the reorganization process.²³ Both also authorize borrowing on a priority basis to fund post-filing operations.²⁴

2. *Appointment of a Trustee or Administrator*

Finnish courts must appoint an administrator unless no creditor requests it,²⁵ and the court finds appointment to be unnecessary. The

¹⁹ See Lag om företagsanering 25.1.1993/47 § 7 [hereinafter Fin. Reorg. L.].

²⁰ See *id.* § 22.

²¹ *Id.* § 6.

²² See *id.* § 6.3.

²³ 11 U.S.C. § 365 (1994); Fin. Reorg. L. §§ 27.1-27.3.

²⁴ 11 U.S.C. § 364 (1994); Fin. Reorg. L. § 34.

²⁵ Major creditors who the court permits to challenge the debtor's eligibility may also nominate an administrator, who must be a disinterested party. The court then appoints the administrator. For a description of the rules regulating the nomination and appointment of the administrator, see Fin. Reorg. L. § 83.

administrator, whom the creditors nominate, oversees the debtor's operations, keeps creditors informed about the debtor's business, and, if necessary, audits operations prior to the reorganization filing.²⁶ The administrator also is responsible for preparing a reorganization plan. But the administrator does not replace the debtor-in-possession's management. Incumbent management can, and usually does, continue to operate the firm in the ordinary course of business.²⁷ Chapter 11 allows for the appointment of a trustee or examiner, but in practice this is rarely done.

3. *Terminating Cases Inappropriate for Reorganization*

Finland, like many other countries, aggressively screens cases early in the reorganization process. Shortly after a reorganization filing, the court must send a notice of the filing to the major creditors.²⁸ If any of these creditors asserts that the case is unsuitable for reorganization, the court must determine the debtor's eligibility. The court then uses various ineligibility criteria to determine whether reorganization proceedings should continue.²⁹ In the United States, immediately after the filing, any party in interest may, for cause, request dismissal of the case or conversion to Chapter 7.³⁰ Early in a reorganization, however, the standards for conversion or dismissal are stringent: the movant must show that prospects of rehabilitation are "hopeless and unrealistic."³¹

²⁶ See *id.* § 90. Fin. Reorg. L. § 8 lists the administrator's main duties.

²⁷ See Eisenberg & Sundgren, *supra* note 13, at 9.

²⁸ The court has some discretionary power in deciding which creditors have claims large enough to be heard. See Fin. Reorg. L. § 70.1; see also PAULINE KOSKELO, YRITYS-SANEERAUS 79 (1994) (containing additional details on the initial screening of cases).

²⁹ The key ineligibility criteria are that: (i) it is likely that a reorganization plan cannot avoid insolvency; (ii) it is likely that the debtor's assets will not satisfy the administrative expenses of the case; (iii) it is likely that the debtor will be unable to pay debts arising after initiation of the reorganization; (iv) the main purpose of the filing is to delay creditors from collecting their claims; (v) there are reasons to expect that creditors will not approve a reorganization plan; and (vi) the firm's bookkeeping is not reliable. See Fin. Reorg. L. § 7.

³⁰ The grounds for conversion or dismissal include continuing losses, the inability to implement a reorganization plan, and unreasonable delay. See 11 U.S.C. § 1112(b)(1)-(3) (1994).

³¹ 4 WILLIAM L. NORTON, JR., NORTON BANKRUPTCY LAW AND PRACTICE 2d § 82:4, at 82-9 to -10 (1994) (quoting cases); see also *In re Dark Horse Tavern*, 189 B.R. 576, 580 (Bankr. N.D.N.Y. 1995) (conversion or dismissal is a "drastic measure") (citing *In re Sal Caruso Cheese, Inc.*, 107 B.R. 808, 817 (Bankr. N.D.N.Y. 1989)); *In re Asbridge*, 61 B.R. 97, 102 (Bankr. D.N.D. 1986) ("Some courts feel that any doubt arising in a section 1112 dismissal motion ought to be resolved in favor of allowing the debtor to continue with reorganization efforts.").

4. *Monitoring the Debtor & Information Disclosures*

Information is formally disclosed to interested parties in three ways: by officers the court appoints, by committees, and by the debtor. The Finnish administrator is responsible for two important disclosures to the creditors. First, immediately after appointment, the administrator must furnish to the court comprehensive schedules, including the debtor's assets, liabilities, and current and expected financial position.³² Second, the administrator must submit a disclosure statement with the reorganization plan to help creditors make an informed judgment about the plan.³³ In contrast, the U.S. system relies more on information disclosure by the debtor's management and committees.³⁴

5. *Preparing, Voting on, and Confirming Reorganization Plans*

Chapter 11 debtors have the exclusive right, for 120 days, to file a plan. The court may extend the exclusivity period,³⁵ which is a common practice.³⁶ Often, no single creditor has the resources and incentives needed to develop and confirm a plan.³⁷ Thus, the debtor's management often prepares the plan even after the exclusivity period expires. In comparison, the Finnish administrator is mainly responsible for preparing a reorganization plan, although other parties may propose plans.³⁸ Generally, the administrator must submit a plan within a court-specified time period, normally not more than four months.³⁹

Under both Finnish and U.S. law, reorganization plans can be confirmed in more than one way. Under the Finnish Code, a plan that all classes approve may be confirmed.⁴⁰ Absent approval of all classes, at least one class of creditors along with creditors representing at least one-fifth of the amount of all debts must vote for the plan.⁴¹ A plan cannot be confirmed if a disapproving creditor shows that it would receive more in liquidation.⁴² In the United States, approval of all impaired classes also supports confirmation. As in Finland, un-

³² See Fin Reorg. L. § 8.1.

³³ See *id.* § 41 (listing the types of information that the disclosure statement should provide).

³⁴ See FED. R. BANKR. P. 1007(b)-(c).

³⁵ See 11 U.S.C. § 1121(d) (1994).

³⁶ See DOUGLAS G. BAIRD, *THE ELEMENTS OF BANKRUPTCY* 244 (rev. ed. 1993).

³⁷ See *id.* at 245; Eisenberg & Tagashira, *supra* note 4, at 139 (showing that average claim size affects the outcome of Japanese compositions).

³⁸ See Fin. Reorg. L. § 8.

³⁹ See *id.* §§ 40, 73.

⁴⁰ *Id.* § 51.

⁴¹ See *id.* § 54. A third way to have a plan approved is by the consent of all known creditors. See *id.* § 50.

⁴² See *id.* § 53.1(5).

secured creditors must receive at least what they would receive in a liquidation.⁴³ Absent approval by all classes, the debtor can "cramdown" a plan over a dissenting class's objection if the plan is "fair and equitable."⁴⁴ If unsecured claims are not proposed to be paid in full, the fair and equitable requirement mandates that junior classes (usually equity) not receive any distribution or retain any ownership in the firm.⁴⁵

B. Similarities and Differences

The two countries' laws are alike in many important respects. Although involuntary filings by creditors are possible under both codes, filings by debtors dominate in both systems. Both countries' codes provide for an immediate or near immediate stay of creditors during the reorganization proceedings. Both countries allow debtors to preserve pending contracts and obtain post-filing credit on a priority basis. Both allow reorganization plans to affect secured creditors' rights. Both require that payments under a plan at least equal what creditors would receive in liquidation. And both codes allow for plan approval without the consent of all creditor classes. Table 1 summarizes the principal similarities and differences between the codes.

TABLE 1. PRINCIPAL SIMILARITIES AND DIFFERENCES:
U.S. AND FINNISH REORGANIZATION LAWS

A. Similarities

- Debtor almost always commences proceedings
- Automatic or temporary stay against creditor actions routinely granted
- Debtor may preserve pending contracts
- Reorganization plan is the centerpiece of both systems
- Plan must pay at least what creditors would receive in liquidation
- Plan may modify rights of secured and unsecured creditors
- Debtor may borrow on a priority basis
- Creditors vote on plan after disclosure of material information
- Plan may be confirmed despite dissenting class of creditors ("cramdown")

B. Differences

- Administrator appointed in Finland; managers usually control U.S. proceedings
- Finnish creditors may object, early in the proceedings, to commencement; U.S. standards for early dismissal or conversion are more pro-debtor
- Finnish administrator prepares plan and information disclosures; U.S. debtors are responsible
- Finland provides only partial priority for claims secured by a floating charge
- "Cramdown" standards: United States requires absolute priority; Finland requires 20% approval

⁴³ See 11 U.S.C. § 1129(a)(7)(A)(ii) (1994).

⁴⁴ *Id.* § 1129(b).

⁴⁵ See *id.* § 1129(b)(2)(B)(ii). For references to the new-value exception to absolute priority, see *supra* note 12.

Two main differences between the countries' codes are Finland's more substantive early screening of cases, and its routine appointment of administrators.⁴⁶ Finnish creditors may immediately challenge a case's eligibility for reorganization, and the court then determines whether the case is eligible. U.S. law allows creditors to seek dismissal of the case or its conversion to liquidation. It is, however, difficult to convert cases early in the proceedings. In practice, the Finnish screening process proves more stringent.

Finland's use of an administrator may be the most important difference between the two countries' laws. The administrator is responsible for early dissemination of information, investigation of the debtor, preparation of the reorganization plan, and disclosure of information about the plan. In the United States, the debtor typically performs these functions. Finland thus provides a natural setting in which to test the effect of early screening and reduced debtor control.

A third difference, the effect of which is difficult to project, is the standard for confirming a plan over the objection of unsecured creditors, the cramdown. The U.S.'s APR requires that the firm pay objecting unsecured creditors in full if owners are to retain control of the firm. Finland requires only that one-fifth of creditors approve the plan. This difference's impact is difficult to project because studies show that absolute priority is often violated,⁴⁷ and because it is not clear how easy it is to satisfy Finland's one-fifth rule.

C. Predictions Based on Reorganization Law Differences

1. *The Decision to File and Solvency at the Time of Filing*

Looser screening and greater debtor control should make Chapter 11 more attractive to U.S. debtors than Finnish reorganization is to Finnish debtors. The U.S. debtor's four-month exclusive right to propose a plan is a valuable advantage.⁴⁸ Lenient treatment of managers

⁴⁶ See *supra* Parts I.A.1-2.

⁴⁷ See Allan C. Eberhart et al., *Security Pricing and Deviations from the Absolute Priority Rule in Bankruptcy Proceedings*, 45 J. FIN. 1457, 1468 (1990); Lynn M. LoPucki & William C. Whitford, *Bargaining Over Equity's Share in the Bankruptcy Reorganization of Large, Publicly Held Companies*, 139 U. PA. L. REV. 125, 126 (1990); Lawrence A. Weiss, *Bankruptcy Resolution: Direct Costs and Violation of Priority of Claims*, 27 J. FIN. ECON. 285, 286 (1990).

⁴⁸ Game theoretic models of bargaining over a shrinking pie suggest that the party making the first proposal will capture a little more than its proportionate share of the pie. See ROBERT GIBBONS, *GAME THEORY FOR APPLIED ECONOMISTS* 68-71 (1992); Ariel Rubenstein, *Perfect Equilibrium in a Bargaining Model*, 50 *ECONOMETRICA* 97 (1982). Baird, Gertner, and Picker claim that the debtor's management can propose reorganization plans under which creditors receive only the liquidation value of the assets, leaving the debtor's owners with the reorganization surplus. See DOUGLAS G. BAIRD ET AL., *GAME THEORY AND THE LAW* 235 (1994).

increases the incentive to file a timely petition.⁴⁹ Thus, a greater proportion of financially troubled U.S. firms should file for reorganization, and they should file earlier than Finnish firms.

Easier access and more lenient treatment in the United States may induce weaker firms to file petitions. Weak Finnish firms may not even try to reorganize because they know that an ineligibility criterion may apply. This should lead to some U.S. filings with weaker financial characteristics. This effect may offset the greater incentive in the United States to file early, which should lead to filings by firms at a healthier, earlier stage.

2. *Probability of Confirming a Plan*

The probability of confirming a reorganization plan depends both on the financial profiles of firms that file and on how the countries' different reorganization systems process filings. The additional U.S. firms that a more pro-debtor regime attracts should be relatively poor prospects for reorganization. The earlier expected filings by U.S. firms, however, could temper this effect. Firms that file earlier are presumably in better financial condition than firms that file later. They may, *ex ante*, have better-than-average prospects of confirming a plan. The expected financial profiles of firms that file thus provide ambiguous guidance in forecasting plan confirmation rates in the two countries.

Given firms in equivalent financial condition, differences in case processing point toward higher U.S. plan confirmation rates. The literature suggests two reasons why debtors may successfully enjoy confirmation of plans that ought to be rejected. First, creditors are not well enough informed to identify which firms should reorganize and which ones should not. In the United States, unlike Finland, the debtor prepares most of the information disclosed about the debtor and the reorganization plan.⁵⁰ Debtors have an incentive to bias the presentation of information and to make a reorganization appear as favorable as possible. U.S. creditors may not be well-informed when

⁴⁹ See Michelle J. White, *Corporate Bankruptcy as a Filtering Device: Chapter 11 Reorganizations and Out-of-Court Debt Restructurings*, 10 J.L. ECON. & ORG. 268, 277-78 (1994) [hereinafter White, *Filtering*]; Michelle J. White, *Survey Evidence on Business Bankruptcy*, in CORPORATE BANKRUPTCY: ECONOMIC AND LEGAL PERSPECTIVES 298, 301 (Jagdeep S. Bhandari & Lawrence A. Weiss eds., 1996).

Congress accepted the view that routinely replacing the debtor's management would reduce the incentive to file timely petitions. See H.R. REP. NO. 95-595, at 233-34 (1977). For a summary of empirical results suggesting that U.S. managers in Chapter 11 do not fare as well as believed, see Theodore Eisenberg, *Baseline Problems in Assessing Chapter 11*, 43 U. TORONTO L.J. 633, 663 n.142 (1993).

⁵⁰ See FED. R. BANKR. P. 3016(b) (disclosure statement must be filed with reorganization plan).

voting on the plan. As a consequence, U.S. creditors may erroneously approve many reorganization plans.⁵¹

Second, valuation procedures in cramdown situations are not rigorous. It has been asserted that U.S. courts may cramdown reorganization plans prescribing continued operations even where creditors would have received more in liquidation. "Given the costs of asserting its rights [in a cramdown], a creditor may be better off consenting to a plan, even if it would have done better in Chapter 7."⁵²

Finnish law reduces these biases towards reorganization. A creditor-nominated outside administrator proposes the plan and discloses information about the plan. Administrators who fail to satisfy creditors reduce their future appointment opportunities.⁵³

We thus expect that, holding financial condition constant, U.S. firms will achieve plan confirmation at greater rates than Finnish firms. Expected differences in the financial profiles of firms that file in the two countries may obscure this effect.

3. *Time in Reorganization Proceedings*

Time is money in reorganization proceedings for several reasons. Administrative expenses are likely to increase with case length.⁵⁴ Lengthy proceedings delay the movement of assets to more productive uses for economically inefficient firms. Losses during reorganization consume value that otherwise could be distributed to creditors.

The very pendency of reorganization proceedings may affect the likelihood of successfully conducting business. During the reorganization, the firm's future is uncertain. Warranties and expectations of future services are of little value. This may make buyers reluctant to engage in business with the firm.⁵⁵ Uncertainties about the firm's future decrease when reorganization proceedings end.

⁵¹ See White, *Filtering*, *supra* note 49, for a game theoretical model in this spirit.

⁵² BAIRD, *supra* note 36, at 255. "Moreover . . . the valuation procedures under [cramdowns] are not rigorous." *Id.*

⁵³ Fama argues that markets and reputation solve agency problems between principals (creditors in our framework) and an agent (the administrator). Eugene F. Fama, *Agency Problems and the Theory of the Firm*, 88 J. POL. ECON. 288, 289 (1980). However, this can be only partly true when interests of different creditors may conflict. The agent may then act only in certain creditors' interests. Moreover, Holmström shows that markets do not solve all agency problems and that effective contracts are needed. If contracts between the agent and creditors are imperfect, suboptimal behavior may emerge. Bengt Holmström, *Managerial Incentive Problems—A Dynamic Perspective*, in *ESSAYS IN ECONOMICS AND MANAGEMENT IN HONOR OF LARS WAHLBECK* 209 (Björn Wahlroos et al., eds., 1982).

⁵⁴ See LoPucki, *supra* note 7, at 576.

⁵⁵ Titman presents a model in which customers who need servicing of their products will buy only at lower prices when liquidation is likely. Sheridan Titman, *The Effect of Capital Structure on a Firm's Liquidation Decision*, 13 J. FIN. ECON. 137 (1984). The value of warranties is also low if there is a high risk that the firm will go out of business.

Finally, the time spent in reorganization may be costly because the incentives of managers (acting in the interest of owners) may be inappropriate. During reorganization, corporate owners are in a position to benefit from increases in firm value, but creditors bear the losses from decreases in firm value. Thus, owners and managers may have an incentive to undertake risky projects even if the expected payoff is negative.⁵⁶

U.S. law gives the debtor considerable control over the timing of various stages of the reorganization, particularly through the right to propose the first reorganization plan. Finnish law gives the administrator, and thus indirectly the creditors, more control over timing. If all parties were well informed, controlling the timing of the proceedings might not matter. To minimize costs, the party in control would propose a plan as soon as possible after filing, and claimholders would share the gains from prompt proceedings.

In practice, however, it takes considerable time to reach an agreement. This may result from asymmetric information. Uncertainty exists about the firm's true situation and it takes time to evaluate information and proposals.⁵⁷ Information problems should be reduced in the Finnish system, where the administrator, nominated by creditors, prepares the plan and information disclosures. Creditors may more readily rely on information disclosed, and plans are more likely to be feasible. U.S. proceedings may also be slower because pressure on management to operate the firm efficiently may diminish during reorganization. During that time, no payments on unsecured debt, and reduced payments on secured debt, may be made. This implies that managers need to make a lesser effort to meet the current obligations of the business than if a reorganization plan were approved. Finally, firms that should liquidate, given the available information, benefit from delaying liquidation. If a firm stays in business, a remote chance exists that conditions will improve and that it will become optimal to continue to operate the firm.

⁵⁶ See Lynn M. LoPucki, *The Trouble with Chapter 11*, 1993 Wis. L. Rev. 729, 732-39, for a discussion of agency problems during reorganization proceedings. Reorganization law limits management opportunities to take actions that increase the value of equity, but reduce firm value. Both U.S. and Finnish Codes specify that the debtor's management may, without court approval, undertake certain activities only in the ordinary course of business. 11 U.S.C. §§ 363(b)(1), 364(a) (1994); Fin. Reorg. L. § 27. Further, monitoring activities by the administrator in Finland and creditor committees in the United States further reduce this risk. But monitoring activities do not eliminate the problem. Management is likely to be better informed than the monitors about the riskiness and payoffs of projects.

⁵⁷ Game-theoretic models of sequential bargaining under complete information suggest that an agreement is reached without delay. An agreement is not necessarily reached during the first round of negotiations if parties are asymmetrically informed, see GIBBONS *supra* note 48, at 68-71, 218-24, which is likely to be the case in a bankruptcy reorganization.

In addition, Finnish reorganization law contains a rule to expedite cases. It specifies that the administrator must propose a plan within a court-specified time limit—usually not more than four months.⁵⁸ U.S. law lacks a similar provision. We thus expect Finnish reorganization proceedings to progress more quickly than U.S. proceedings.

4. *Terms of Reorganization Plans*

Finnish creditors nominate the administrator, who prepares the reorganization plan. One expects Finnish plans to be more creditor-oriented, leaving the debtor's owners with a smaller share of the going concern's surplus. One qualification to this prediction is necessary because of different cramdown standards. Under the U.S.'s APR, owners should not retain any interest in the reorganized firm unless the reorganization plan proposes to pay creditors in full. Thus, debtors wishing to retain ownership interests may be forced to propose paying creditors in full.⁵⁹

The pro-creditor tenor of Finnish law should route value towards creditors and away from debtors. The limited priority of Finnish secured creditors should further increase payment rates to unsecured creditors over the rates paid to U.S. unsecured creditors.

In summary, we expect U.S. law to attract more firms, and U.S. reorganizations to perhaps produce higher confirmation rates, take longer, and generate plans more favorable to owners and managers, and less favorable to unsecured creditors.

II

DATA DESCRIPTION

Empirically testing the effect of early screening and reduced debtor control requires data from both countries about similar reorganizing firms. Firm size and industry substantially affect the prospects for, and outcome of, reorganization.

In the United States, differences in firm size translate into different rates of payment, confirmation, and completion of reorganization plans. The confirmation rate for firms with at least \$100 million in public debt is over 90%.⁶⁰ More than one-third of the firms with as-

⁵⁸ Fin. Reorg. L. §§ 40, 73.

⁵⁹ In the United States and other systems, debtors may be able to avoid the APR and discharge unsecured debts through bargain sales to insiders, see LYNN M. LOPUCKI, STRATEGIES FOR CREDITORS IN BANKRUPTCY PROCEEDINGS § 11.11.2 (2d ed. 1991), and through tacit agreements with secured creditors. See EISENBERG, *supra* note 2, at 13-14, 39-43. The impact of such techniques on reorganization law is beyond the scope of our data.

⁶⁰ See Lynn M. LoPucki & William C. Whitford, *Patterns in the Bankruptcy Reorganization of Large, Publicly Held Companies*, 78 CORNELL L. REV. 597, 600 (1993).

sets greater than \$1 million have their plans confirmed and less than 20% of the firms with assets of less than \$1 million receive confirmation.⁶¹ Comparison with other countries also suggests that firm size affects reorganization prospects. In both Canada and Japan, larger firms comprise a greater fraction of reorganizing firms than in the United States, and both countries have higher plan confirmation rates than the United States.⁶²

A firm's line of business may also affect reorganization chances. For example, bankruptcy and reorganization filing rates may be high in a depressed industry. Bankruptcy studies show industry effects in reorganization.⁶³

Given the need to control for firm size and industry, a tradeoff arises between using a representative sample of firms in both countries and using a less representative sample of firms that match by size and industry. We use here a fairly complete sample of Finnish firms and compare them with data on U.S. firms that share the size and industry characteristics of the Finnish firms. Where appropriate, we also refer to other studies of U.S. firms.

A. The Finnish and U.S. Samples

The Finnish data we use are from documents in district courts, courts of appeal, and the Finnish Supreme Court. Complementary data come from the files of Asiakastieto Oy, a Finnish credit bureau. The data cover ten of the nineteen Finnish district courts in which debtors file reorganization petitions. The data include cases filed from February 1993 to February 1994. Filings in the covered districts constituted about 73.5% of all reorganization filings during 1993.⁶⁴ The sample consists only of nonpublic, nonfarm firms.⁶⁵ A total of 362 reorganization cases were identified. Of these, 102 firms emerged from reorganization proceedings with a confirmed plan.

⁶¹ See EISENBERG, *supra* note 2, at 57 tbl.5; Flynn, *supra* note 11, at 34 tbl.31. For a review of studies showing reorganization success rates, see STEFAN SUNDGREN, *BANKRUPTCY COSTS AND THE BANKRUPTCY CODE: A CASE STUDY OF THE FINNISH CODE 68-71* (1995).

⁶² See EISENBERG, *supra* note 2, at 56-58. *But see* TIMOTHY C.G. FISHER & JOCELYN MARTEL, *SHOULD WE ABOLISH CHAPTER 11? EVIDENCE FROM CANADA, 13-14* (CIRANO, Sci. Ser. No. 96s-22, 1996) (presenting evidence that firm size does not influence the Canadian confirmation rate).

⁶³ See SUNDGREN, *supra* note 61, at 130-32 (manufacturing dummy variable statistically significant in modeling reorganization and sale as a going concern); Eisenberg & Tagashira, *supra* note 4, app. at 156-57 tbls.A1-A2 (showing significant industry effects in denial of confirmation of Japanese composition plans).

⁶⁴ See Statistical Office of Finland, *Bankruptcies 1993*, JUSTICE, Apr. 12, 1994, at 5, 28.

⁶⁵ All nonpublic firms, except one very large one, EKA, that filed a petition during the sampling period are included in the sample. EKA was omitted because of its very different characteristics.

For U.S. firms, two studies published detailed data about nonpublic firms in Chapter 11. Lynn LoPucki studied all Chapter 11 cases filed in the Western District of Missouri during the first year after the effective date of Chapter 11—October 1979 to October 1980.⁶⁶ Jerome Kerkman examined a random sample of 48 of 152 Chapter 11 filings in the Eastern District of Wisconsin during 1982.⁶⁷ He followed LoPucki's methodology and collected data similar to LoPucki's.⁶⁸ Eliminating farm filings reduces Kerkman's sample to 44 firms and LoPucki's sample to 45 firms. Unless otherwise indicated, references to U.S. data are to the combined LoPucki and Kerkman samples.

B. Comparability of the Samples

We first examine whether the Finnish and U.S. data contain firms of comparable size, with similar distributions across industries. Table 2, panel A, shows the similarity of the industry distribution of the firms. Retail and wholesale firms constitute about 30% of both samples, manufacturing firms make up 23% of the Finnish sample and 29% of the U.S. sample, and construction firms make up 11% of the Finnish sample and 9% of the U.S. sample. One cannot reject the hypothesis that the distribution of firms by industry in the Finnish and U.S. samples is the same.⁶⁹

⁶⁶ Lynn M. LoPucki, *The Debtor in Full Control—Systems Failure Under Chapter 11 of the Bankruptcy Code?*, 57 AM. BANKR. L.J. 99, app. at 118-26 (1983) (containing charts with information on debtors' assets, shareholders' equity, type of business, time elapsed in reorganization, and terms of plans proposed to unsecured creditors).

⁶⁷ Jerome R. Kerkman, *The Debtor in Full Control: A Case for Adoption of the Trustee System*, 70 MARQ. L. REV. 159, 163 (1987).

⁶⁸ *Id.* The Kerkman data used here come from *id.* app. at 201-09.

⁶⁹ Pearson $\chi^2(5) = 6.170$, with a corresponding significance level (or p-value) = .290. The p-value provides a measure of the probability that one would observe by chance differences as large or larger than those reported in the industry distribution of the United States and Finland.

TABLE 2. INDUSTRY AND SIZE DISTRIBUTION OF FIRMS BY COUNTRY

	FINNISH FIRMS		U.S. FIRMS	
	<i>N</i>	%	<i>N</i>	%
<i>A. Distribution by Industry</i>				
Manufacturing	84	23.2	26	29.2
Construction	39	10.7	8	9.0
Retail trade/wholesale	111	30.5	27	30.3
Transportation	39	10.7	4	4.5
Real estate	39	10.7	7	7.9
Other services & unknown	50	13.7	17	19.1
Total	362		89	
<i>B. Distribution by Size (assets in thousands of 1992 U.S. dollars)</i>				
Mean	2,100		2,257	
Median	601		530	
First quartile less than:	180		161	
Third quartile greater than:	1,791		1,483	
Minimum	.12		.51	
Maximum	88,528		48,097	
<i>N</i>	331		88	

Table 2, panel B, describes the firms' assets. U.S. asset values are inflated to reflect the later time period, and corresponding increases in price levels, covered by the Finnish data.⁷⁰ No significant differences between the asset distributions emerge. The mean of the assets of the Finnish firms is \$2.10 million and the mean of the assets of the U.S. firms is \$2.26 million. The median of the assets of the Finnish firms is \$601,000 and the median of the assets of the U.S. firms is \$530,000. About 25% of the Finnish firms have assets below \$180,000 and about 25% have assets above \$1.79 million. The corresponding figures for the U.S. firms are \$161,000 and \$1.48 million, respectively. Statistical tests reveal no significant difference in the distributions of assets across the Finnish and U.S. firms.⁷¹

Corporations, partnerships, and businesses run by individuals may file a petition under both Codes. Of the Finnish debtors, 222 (62%) are corporations, 104 (29%) are partnerships, and 31 (9%) are businesses run by individuals. In the U.S. data, 74 debtors (83%) are corporations and 15 (17%) are individuals.

⁷⁰ Amounts were inflated with Consumer Price Indices, taken from U.N. DEP'T OF INT'L ECON. & SOC. AFFAIRS, MONTHLY BULLETIN OF STATISTICS, Nov. 1986, at 218, U.N. Doc. ST/ESA/STAT/SER.Q/167; U.N. DEP'T FOR ECON. & SOC. INFO. & POLICY ANALYSIS STATISTICAL DIV., MONTHLY BULLETIN OF STATISTICS, Dec. 1994, at 196, U.N. Doc. ST/ESA/STAT/SER.Q/264. Finnish Reorganization Law requires that annual financial statements, or interim ones if the annual are more than four months old, be included with the reorganization filing. F. om företagsanering [Ordinance on Reorg.] 25.1.1993/55 § 1.4. Asset amounts are taken from these filings. Given that most of the financial statements are from 1992, U.S. amounts were inflated to reflect 1992 prices.

⁷¹ The Kruskal-Wallis test of distribution of assets by country ($p = .55$), the one-way analysis of variance of assets by country ($p = .831$), the one-way analysis of variance of logarithm of assets by country ($p = .603$), and the Kolmogorov-Smirnov test of the equality of distributions ($p = .919$) support this conclusion.

Although the Finnish data are representative of the year covered, we lack a representative sample of U.S. firms or districts. Our U.S. sample comes from two districts, not from a random sample of districts or from a comprehensive sample of many districts; U.S. reorganization results are known to vary by district.⁷² But our purpose is not to portray the complete, current U.S. experience. We wish to study the performance of the two reorganization systems as they apply to comparable firms. We have, in two important dimensions, size and industry, comparable groups of firms. The U.S. and Finnish data also correspond in another important dimension. The Finnish reorganization law is new, and thus all debtors and lawyers need not necessarily have learned about the possible advantages of reorganization. Both the LoPucki and Kerkman data come from a time period shortly after the enactment of the new Chapter 11. Thus, the same learning-curve issue applies to the U.S. data used here. Whether reorganization results for similar U.S. firms would differ in other districts, or results for both countries would differ in other years, is beyond this study.

We can, however, test whether the studied U.S. districts achieve results comparable to Finland's. This is important because it can help isolate whether problems with U.S. reorganizations are structural ones inherent in Chapter 11 or are of a localized nature.

III EMPIRICAL RESULTS

The assertion that Finland's reorganization law is more procreditor depends in large part on greater participation by outsiders in the reorganization process. We thus first check for the more regular appointment of administrators in Finland than the appointment of trustees in the United States. Table 3, which contains appointment rates for administrators and trustees, as well as summary statistics for other variables, confirms our assumption. An outside administrator was appointed in 154 of 156 cases (98.7%) that passed the initial screening. An administrator was appointed in all cases that passed the initial screening but were later terminated. For the firms successfully reorganized, an administrator was appointed in 96 of the 98 Finnish cases (98.0%).⁷³ The percentage is much lower in the United States. A trustee was appointed in 10.2% of the U.S. cases and an examiner in 5.7% of the cases.⁷⁴

⁷² See Flynn, *supra* note 11, at 14-34.

⁷³ The two remaining cases were unusual because they had very few creditors: one bad two and the other bad four. Appointment information was unavailable in three terminated cases and five successfully reorganized cases. An outside administrator is not appointed if the case fails the initial screening.

⁷⁴ A trustee was appointed in five, and an examiner in four, of the forty-five LoPucki study cases included in our sample. A trustee was appointed in four, and an examiner in

TABLE 3. SUMMARY OF REORGANIZATION CASE CHARACTERISTICS

	U.S. CASES			FINNISH CASES			SIGNIFICANCE
	Mean	Median	N	Mean	Median	N	
Trustee or administrator appointed	.102	—	88	.987	—	156	<.001
Solvency	-16.3	-2.25	88	-2.24	-.29	331	.064
Adjusted solvency**	-1.83	-3.26	87	-2.52	-3.47	329	.075
Confirmation rate (non-liquidating plans)	.318*	—	89	.276	—	362	.362
Time for confirmed cases (months)	10.7	10.0	34	10.9	10.0	102	.867
Time for cases not confirmed (months)	8.6	7.0	45	3.7	2.5	251	<.001
Proposed repayment % (unsecured)	64.0	80.0	33	42.9	37.0	85	<.001
Proposed time for repayment (months)	34.2	36.0	33	72.9	66.0	82	<.001

*Note: If the four pending U.S. cases were treated as confirmed, the confirmation rate would be .365.

**See *infra* note 82.

A. The Decision to File and Solvency at the Time of Filing

Chapter 11 attracts firms at a higher rate than Finland's law. In 1993, the year Finland's reorganization law took effect, reorganization filings constituted 8.5% of business insolvency filings.⁷⁵ In 1994, they constituted 7.7%.⁷⁶ The United States has a higher rate of reorganization usage. Indeed, U.S. reorganization use is among the highest in the world.⁷⁷ In fiscal 1991, reorganization proceedings comprised about 45% of U.S. business insolvency filings.⁷⁸ Throughout the

just one, of the forty-four Kerkman study cases included in the sample. In one case, no information was provided.

⁷⁵ To make Finnish and U.S. figures more comparable, Finnish involuntary bankruptcy liquidation filings that were interrupted before any further proceedings took place, usually due to the debtor having paid the creditor who filed the petition, were omitted. Such Finnish filings are more akin to U.S. state-law collection actions. Farmer filings were excluded from the Finnish reorganizations. Farmers can file under a separate chapter (Chapter 12) in the United States. See 11 U.S.C. §§ 1201-1231 (1994).

⁷⁶ Many Finnish liquidating bankruptcy filers had no or very few assets. Bankruptcy liquidation proceedings terminate if assets are insufficient to pay administrative expenses. In 1993, these cases comprised 43.2% of cases and, in 1994, 41.3% of the cases. A firm probably will not try to reorganize with very few assets. If these cases are excluded, reorganization filings represent only about 14% and 13% of the 1993 and 1994 insolvency filings, respectively. U.S. figures also include zero asset cases.

⁷⁷ See EISENBERG, *supra* note 2, at 10-11.

⁷⁸ See *id.* at 10. The 45% figure includes filings under Chapters 12 and 13 as well as Chapter 11. If one excludes Chapter 12 farm filings, the reorganization filing rate was 29.7% of business filings. If one counts only Chapter 7 and Chapter 11 filings, Chapter 11 accounted for about one-third of the business insolvency filings. These figures are based on the Administrative Office of the U.S. Courts's data, available on computer disks. For

1980s, Chapter 11 filings consistently exceeded 30% of business failures, as reported by Dun & Bradstreet.⁷⁹ During the 1990s, reorganization filings regularly exceeded 24% of all business insolvency filings.⁸⁰ The Eastern District of Wisconsin and the Western District of Missouri, discussed here, also show Chapter 11 rates exceeding Finnish reorganization rates.⁸¹ U.S. firms' high Chapter 11 rate is consistent with Chapter 11's reputation as pro-debtor.

As noted above, high U.S. reorganization rates generate mixed influences on the financial profiles of reorganizing firms. Chapter 11's attractiveness to debtors should encourage a high fraction of firms to file and their filings should occur at an earlier stage. The early-filing effect should increase the U.S. firms' solvency relative to Finnish firms, but the high-rate effect should decrease solvency. Thus, equally situated firms should file earlier in the United States, but the group of filing firms may have different financial characteristics.

To analyze firms' financial health at filing, we compared U.S. and Finnish firms' solvency at the time of filing. By some measures, the firms are not noticeably different in their solvencies. The average reorganizing firm in each country has a negative net worth. The median solvency ratio (the ratio of shareholders' equity to total assets) is -.29 for the Finnish firms and -.25 for the U.S. firms. A somewhat higher percentage of Finnish firms have a negative net worth, 78.4% compared to 62.9% of the U.S. firms.

Closer inspection of the solvency distributions shows that Finnish firms' solvency is more concentrated just below and around zero. U.S.

concerns about the reliability of the Administrative Office's bankruptcy data, see Fenning & Hart, *supra* note 11, at 120-22.

⁷⁹ See Eisenberg, *supra* note 49, at 660 fig.2.

⁸⁰ See 1994 ANN. REP. DIR. ADMIN. OFF. U.S. CTS., AI-186 tbl.F-2 [hereinafter 1994 AO REPORT] (Chapter 11 comprised 13,379 of 54,425 (24.6%) business bankruptcy filings); 1993 ANN. REP. DIR. ADMIN. OFF. U.S. CTS., AI-190 tbl.F-2 [hereinafter 1993 AO REPORT] (Chapter 11 comprised 17,068 of 64,857 (26.3%) business bankruptcy filings); 1992 ANN. REP. DIR. ADMIN. OFF. U.S. CTS., 316 tbl.F-2 [hereinafter 1992 AO REPORT] (Chapter 11 comprised 20,070 of 71,725 (28.0%) business bankruptcy filings).

⁸¹ For fiscal 1992, 1993, and 1994, for example, Chapter 11 filings in the Eastern District of Wisconsin were, respectively, 15.2%, 21.1%, and 11.5% of the business filings under Chapters 7, 11, and 13. See 1992 AO REPORT, *supra* note 80, at 317 tbl.F-2; 1993 AO REPORT, *supra* note 80, at AI-191 tbl.F-2; 1994 AO REPORT, *supra* note 80, at AI-187 tbl.F-2. The percentages for the same three years for the Western District of Missouri were 16.3%, 20.4%, and 21.6%. See 1992 AO REPORT, *supra* note 80, at 318 tbl.F-2; 1993 AO REPORT, *supra* note 80, at AI-191 tbl.F-2; 1994 AO REPORT, *supra* note 80, at AI-187 tbl.F-2. For fiscal year 1982, the year with published data most closely corresponding to the Kerkman sample, 85 of 476 (17.9%) of business bankruptcy filings in the Eastern District of Wisconsin were Chapter 11 filings. See 1982 ANN. REP. DIR. ADMIN. OFF. U.S. CTS. 401 tbl.F3A. For the nine-month period ending June 30, 1980, the period with published data most closely corresponding to the LoPucki sample, 36 of 407 (8.8%) of business bankruptcy filings in the Western District of Missouri were Chapter 11 filings. See 1980 ANN. REP. DIR. ADMIN. OFF. U.S. CTS. 562 tbl.F-3BC.

firms tend to have both higher and lower solvency ratios. One-fourth of the Finnish firms have ratios less than $-.91$ and one-fourth have ratios higher than $-.03$. The corresponding quartiles for the U.S. firms are -1.63 and $.54$. Figure 1 shows the distribution of solvency ratios for the Finnish and U.S. firms, with solvency ratios transformed to a logarithmic scale.⁸² Descriptive statistics for this "adjusted solvency" measure are reported in Table 3 above.

Figure 1 suggests that, despite small differences in mean and median solvency, the distributions are different, a result that is statistically significant.⁸³ The U.S. solvency ratios' distribution is consistent with the predictions that the U.S. Code attracts more firms and causes them to file at an earlier phase. The early-filing firms are likely to be more solvent, and may account for the greater concentration of U.S. firms at the right tail of the solvency distribution. The greater rate at which U.S. firms seek to reorganize suggests that U.S. filings should include a concentration of more marginal firms with low solvency ratios. This concentration of relatively low solvency firms could explain the greater concentration of U.S. firms in the left tail of the solvency distribution. Finland's reorganization law attracts firms with solvency ratios away from the high and low solvency extremes.

Which effect dominates? Since firm solvency may depend on firm characteristics such as size and industry, it is important to control for these factors when comparing intercountry solvency patterns. In a regression that assesses solvency, while controlling for size and industry, the country dummy variable (equal to one for U.S. cases and zero for Finnish cases) has a positive sign, implying that U.S. firms tend to be more solvent, although only marginally significantly so (p -value = $.074$).⁸⁴

⁸² The logarithm of the absolute value of the solvency ratio (as a percent) was taken, and then the initial sign restored. Figure 1 shows the kernel density estimates for this solvency measure. The more traditional way of portraying univariate statistical distributions, the histogram, can be thought of as a kind of kernel density estimator. Kernel density estimates have the advantage of being smooth and independent of bin location, a choice that can profoundly shape the appearance of a histogram. For a brief discussion of, and references about, kernel density estimation, see 2 STATA CORP., STATA REFERENCE MANUAL: RELEASE 5.0, 288-95 (1997).

⁸³ A Kolmogorov-Smirnov test of the equality of distributions, using a logarithmic transformation of solvency, yields $p = .004$. The corresponding p -value for the unadjusted solvency measure is $.005$.

⁸⁴ We present regression results using robust standard errors since heteroskedasticity can be a problem when two subsamples are compared in a regression. See Halbert White, *A Heteroskedasticity-Consistent Covariance Matrix Estimator and a Direct Test for Heteroskedasticity*, 48 *ECONOMETRICA* 817 (1980).

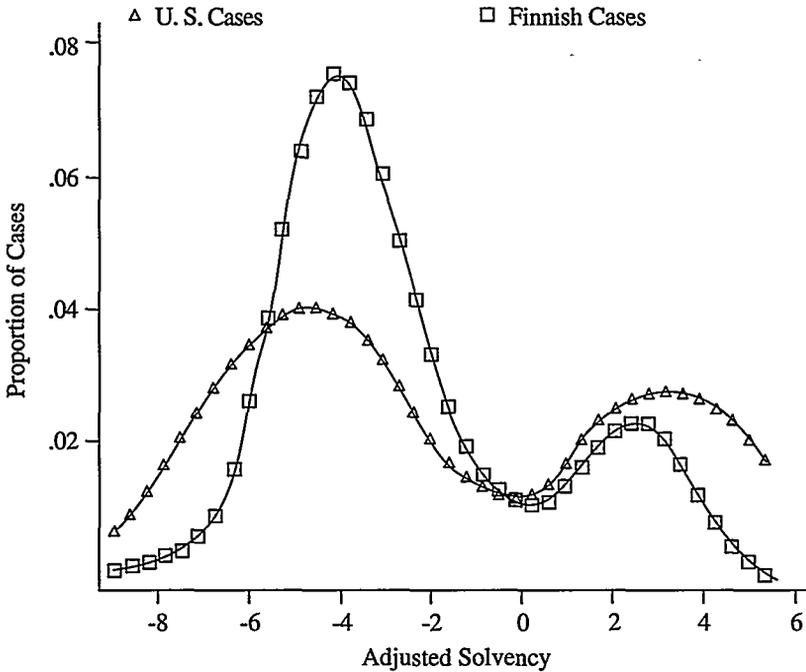


FIGURE 1. KERNEL DENSITY ESTIMATES OF SOLVENCY DISTRIBUTIONS

These results suggest that Chapter 11’s inducements to file early overpower its attractiveness to financially weak firms, the type that presumably file for liquidation in Finland. Although Chapter 11 also attracts this group of weaker firms, U.S. firms on the whole are no less solvent than Finnish firms seeking to reorganize. A complementary explanation of U.S. firms’ greater solvency relates to macroeconomic conditions. Both countries suffered from recessions during the years studied. Finland’s recession, however, was deeper.⁸⁵ Poor macroeconomic conditions may imply that firms have weaker financial characteristics when they file a petition.

But it is not clear that macroeconomic conditions account for the differing shapes of the solvency distributions. Poorer macroeconomic

⁸⁵ The trend in the industrial production index shows that both countries suffered from recessions during the years of the filings, but that the recession was deeper in Finland. In Finland, industrial production fell sharply a couple of years prior to the year of the study, 9% (from 132 to 120) between 1990 and 1991. After that, industrial production increased 2% from 1991 to 1992, and 6% from 1992 to 1993. LoPucki’s sample originates from 1979 to 1980, and Kerkman’s sample from 1982. The corresponding U.S. index shows growth of 6% from 1977 to 1978, growth of 4% from 1978 to 1979, a decline of 3% from 1979 to 1980, growth of 2% from 1980 to 1981, and a sharp decline of 8% from 1981 to 1982. Indices are taken from U.N. DEP’T OF INT’L ECON. & SOC. AFFAIRS, MONTHLY BULLETIN OF STATISTICS, July 1983, at 24, 30, U.N. Doc. ST/ESA/STAT/SER.Q/127 and U.N. DEP’T FOR ECON. & SOC. INFO. & POLICY ANALYSIS STATISTICAL DIV., MONTHLY BULLETIN OF STATISTICS, Sept. 1995, at 26, 32, U.N. Doc. ST/ESA/STAT/SER.Q/273.

conditions may imply that the whole Finnish solvency distribution should, compared to the U.S. distribution, be shifted to the left in Figure 1. Different macroeconomic conditions do not necessarily forecast such different shapes in the distributions.

B. Probability of Adopting a Reorganization Plan

Differences between the countries' reorganization laws offered no firm prediction about comparative plan confirmation rates. The data reveal no substantial differences.

Table 3 shows that 28.2% (102 of 362) of the Finnish firms emerged from reorganization proceedings with a confirmed plan. Only two of the plans were liquidation plans. Thus, 100 firms (27.6%) emerged with plans allowing the firm to stay in business. Excluding liquidation plans, the rate of confirmed plans in the LoPucki/Kerkman sample is 31.8%, or 36.5% if cases pending when the study was conducted were assumed to be eventually confirmed.⁸⁶ The higher U.S. rate casts some doubt on the stereotypical view of Chapter 11 as having unusually low confirmation rates.

One possibility is that differences in solvency, firm size, and industry distribution explain the confirmation rates. Perhaps, holding these other factors constant, the U.S. confirmation rate is, in fact, lower. We have explored regression models testing whether U.S. firms' higher rate of emerging from reorganization proceedings with an operating plan correlates with solvency, firm size, or industry distribution. Based on these regressions, we cannot reject the hypothesis that, controlling for solvency, size, and industry, U.S. and Finnish firms achieve confirmation at the same rate.

One concern is that the two U.S. districts studied may not be representative. Perhaps these two districts confirm plans at higher rates than other districts. The best available data covering a broad geographic base come from Flynn's report on Chapter 11 confirmation patterns.⁸⁷ Flynn's reported confirmation rates do not appear to account for consolidation of cases, which Flynn reports as substantial and varying depending on firm size.⁸⁸ Because confirmation rates LoPucki and Kerkman report do account for consolidations,⁸⁹ some adjustment is needed to achieve comparable confirmation rates.⁹⁰

⁸⁶ Four cases from Kerkman's study were omitted since different tables gave conflicting information regarding their outcomes. Note also that the confirmation rates differ somewhat from those reported in the published studies because farm debtors were omitted from the sample.

⁸⁷ Flynn, *supra* note 11.

⁸⁸ *Id.* at 13-16.

⁸⁹ LoPucki, *supra* note 66, at 101 n.7; Kerkman, *supra* note 67, at 163 n.33.

⁹⁰ Using all filings, rather than consolidated filings, to measure confirmation rates will understate confirmation rates because consolidated confirmed cases will be reported

Flynn reports consolidation rates and confirmation rates by case size.⁹¹ This allows us to compute national confirmation rates for different firm sizes, adjusted to reflect consolidation rates. Row (2) in Table 4 provides consolidation-adjusted confirmation rates that can be applied to firms in the four asset ranges the Table's columns specify.⁹²

TABLE 4. FIRM SIZE AND CONFIRMATION RATES

	<i>Firm Size by Assets (in thousands)</i>			
	<i>less than \$100</i>	<i>\$100-500</i>	<i>\$500-1,000</i>	<i>over \$1,000</i>
(1) Percent of Flynn's cases in asset range	29.4	38.5	14.3	17.8
(2) Confirmation rate (adjusted to reflect consolidations)	8.07	15.87	26.42	50.62
(3) Percent of LoPucki/Kerkman cases in asset range (N=88)	14.7	35.2	14.7	35.2
Expected confirmation rate for LoPucki/Kerkman sample using (2) and (3)	28.5			

Row (3) shows that the LoPucki/Kerkman sample differs from Flynn's national sample in its lower representation of small, low confirmation rate cases (assets less than \$100,000), and in its higher representation of large, high confirmation rate cases (assets greater than \$1 million). In the national sample, according to row (1), 29.4% of the firms had assets of less than \$100,000. In the LoPucki/Kerkman sample, only 14.7% of the firms had assets of less than \$100,000. In the national sample, 17.8% had assets of more than \$1 million. In the LoPucki/Kerkman sample, 35.2% of the firms had assets of more than \$1 million. Both these differences should lead the LoPucki/Kerkman cases to have higher confirmation rates than Flynn's national sample. Using the number of LoPucki/Kerkman cases in each asset range, and applying the adjusted confirmation rates in row (2), leads to an overall expected confirmation rate of 28.5% for cases with the asset distribution of the LoPucki/Kerkman sample of cases.⁹³

as a single confirmation of many filings. To illustrate: ten Chapter 11 filings by ten related corporations cause the statistical opening of ten cases. If those cases are consolidated and have a plan confirmed, they should be counted either as ten confirmations for ten filings or as one confirmation for one filing, with the latter seeming to us to be the better practice. If one simply counts the number of confirmations and divides by the number of cases, one understates the confirmation rate to be 10% rather than 100%.

⁹¹ Flynn, *supra* note 11, at 16-22.

⁹² The adjusted confirmation rates in row (2) of Table 4 were obtained by multiplying Flynn's confirmation rates for each asset range, *id.* at 34 tbl.31, by the consolidation rates for each asset range reported in *id.* at 15 tbl.11A.

⁹³ Note that this percentage does not take into account that some plans may have prescribed liquidations rather than continued operations of the firms.

This 28.5% expected confirmation rate does not account for possible differences in the industry distribution of Flynn's national sample and the LoPucki/Kerkman sample. For instance, the LoPucki/Kerkman data contain few real estate cases,⁹⁴ which have low confirmation rates due to the likely power of a mortgage holder to block confirmation of a plan. Many debtors file Chapter 11 real estate cases merely to delay foreclosure proceedings.⁹⁵ Furthermore, Flynn's figures include farm filings, but the Finnish sample and the LoPucki/Kerkman sample omit them. Flynn estimated that the confirmation rate should be in the 30 to 35% range after 1986, when Chapter 12, the family farm chapter, had been adopted.⁹⁶ An industry-adjusted confirmation rate, based on the national data, may well exceed 30% for firms with the size and industry characteristics of the LoPucki/Kerkman sample.

We thus find no evidence that U.S. confirmation rates are lower than Finnish confirmation rates. This does not necessarily mean that confirmation rates in either country are optimal. The U.S. system may provide creditors with too little influence over the confirmation process. U.S. debtors shape and communicate information about the plan and may be expected to present the data in a light most favorable to plan approval. Thus, the U.S. system may be confirming plans that should be rejected.⁹⁷

In Finland, the administrator shapes the plan, disseminates information about it, and can take a more neutral stance. As a result, perhaps too few firms achieve plan confirmation under the Finnish Code. Finland's more stringent initial screening may deny access to firms that could have had plans confirmed. Only "major" creditors may challenge the eligibility of cases. The major creditors often are banks who, in many cases, have a part of their claims secured by collateral. Thus, because of the standard conflict of interest between lower priority and higher priority claims, the banks may argue that a firm should be liquidated, even where its value would be higher if reorganized.⁹⁸

But other factors suggest that the Finnish system is not too strict. First, a Finnish court need not defer to the wishes of major creditors.

⁹⁴ Compare Kerkman, *supra* note 67, at 165 tbl.1 (where real-estate cases represented no more than 11% of total cases), with Fenning & Hart, *supra* note 11, at 143 tbl.7 (where real-estate cases represented 40% of the total cases studied).

⁹⁵ See Fenning & Hart, *supra* note 11, at 142.

⁹⁶ Flynn, *supra* note 11, at 11-12.

⁹⁷ See Jensen-Conklin, *supra* note 11, at 321-31 (noting a high default rate for confirmed plans).

⁹⁸ See Michael C. Jensen & William H. Meckling, *Theory of the Firm: Managerial Behavior, Agency Costs, and Ownership Structure*, 3 J. FIN. ECON. 305 (1976) (describing agency problems between lower priority claimholders (shareholders in their framework) and higher priority claimholders (creditors in their framework)).

It is entitled to take into account all available information.⁹⁹ This reduces the ability of major secured creditors to terminate reorganizations inappropriately. Second, the fact that many firms reorganized under the Finnish Code file for bankruptcy within a short time after plan confirmation indicates that the Finnish screening system is not extremely strict. Of the 100 firms that emerged with a plan allowing them to continue to operate, sixteen had failed to comply with the plan in a follow-up study.¹⁰⁰

Thus, in the LoPucki/Kerkman sample, confirmation rates are higher than Finnish confirmation rates but the difference is neither large nor statistically significant. Flynn's national sample yields no solid evidence of lower U.S. confirmation rates for similarly situated firms. Although more firms file for Chapter 11, firms achieve confirmation rates comparable to their Finnish counterparts.

C. Time in Reorganization Proceedings

Debtor control of Chapter 11, together with the benefits to debtors from delaying the proceedings, should lead Chapter 11 proceedings to progress more slowly than Finnish proceedings. Table 3 above shows the time elapsed in reorganization for Finnish and U.S. cases. It is helpful to distinguish between cases in which courts confirm plans and cases in which they do not.

1. Cases with Confirmed Plans

For debtors that emerged with confirmed reorganization plans,¹⁰¹ the mean time between filing and confirmation is 10.9 months for Finnish firms, which is almost the same as the U.S. mean of 10.7 months. The median time for both countries is 10.0 months. Regression analyses that control for firm solvency and firm size confirm the similarity of time periods.¹⁰²

⁹⁹ See KOSKELO, *supra* note 28, at 81-83, 95-108, for additional details on the initial screening of cases.

¹⁰⁰ See Stefan Sundgren, Does a Reorganization Law Improve the Efficiency of the Insolvency Law? The Finnish Experience 13 (Dec. 1996) (unpublished manuscript, on file with authors). The average time between the day of plan confirmation and the follow-up study was 525 days. See *id.*

¹⁰¹ These figures include liquidated cases.

¹⁰² Indeed, the U.S. figures are biased downward because four cases were still pending when the LoPucki and Kerkman studies were conducted. If some of the pending cases eventually were confirmed, the mean and median times would increase. All filings in the Finnish sample were closed when the study was conducted. We also ran regressions with the time elapsed as a dependent variable, and (i) a country dummy variable; (ii) solvency; and (iii) the size of the case as dependent variables both for the entire sample and only for the limited liability companies. The coefficients of the country dummy variables were small and insignificant, as were the other explanatory variables.

Other studies, however, suggest that U.S. cases take about twice as long as Finnish cases. Flynn reports mean and median confirmation times of 24.6 and 21.1 months, respectively.¹⁰³ Jensen-Conklin, whose study covers one office in the Southern District of New York, reports a median time of 22 months.¹⁰⁴ LoPucki, reporting on cases successfully reorganized in the Western District of Wisconsin in 1987 and 1988, finds mean and median confirmation times of 19.4 and 17.5 months, respectively.¹⁰⁵ Fenning and Hart, studying one district, find that the median time between filing and confirmation is 13.1 months.¹⁰⁶ Efforts to impose a "fast track" system of case processing reduced U.S. processing times; in one district, processing time was even below the Finnish level.¹⁰⁷

A possible explanation for the difference in time is the degree of debtor control. Finnish administrators, assumed to act in the interest of creditors, may propose more feasible and complete plans in the initial phase of the proceedings. U.S. debtors can, at least in principle, delay proceedings by submitting plans not complete enough to submit to creditors for their approval, but sufficiently complete to avoid dismissal or conversion.¹⁰⁸

The times to confirmation for the LoPucki/Kerkman sample, and the fast-track management system in North Carolina and Los Angeles, show that it is possible to achieve speeds close to those achieved under the Finnish system. But results from other districts show that

¹⁰³ Flynn, *supra* note 11, at 24.

¹⁰⁴ Jensen-Conklin, *supra* note 11, at 319.

¹⁰⁵ LoPucki, *supra* note 56, at 741-42.

¹⁰⁶ Fenning & Hart, *supra* note 11, at 152.

¹⁰⁷ Judge Small's fast-track procedure in the Eastern District of North Carolina requires early filing of plans, provides conditional approval of disclosure statements, and combines disclosure and confirmation hearings. See A. Thomas Small, *Small Business Bankruptcy Cases*, 1 AM. BANKR. INST. L. REV. 305, 307 (1993). He reports confirmation times for Chapter 11 plans of six to eight months. *Id.* at 315. Bufford's recent study reports mean and median times for 126 cases filed in the Central District of California, located at Los Angeles, from 1988 to 1993. Bufford, *supra* note 11, at 116 tbl.A-1. Judge Mund adopted a fast-track procedure that handled one hundred of the cases. The key feature of fast-track management was that Judge Mund ordered the filing of a plan and disclosure statement at a specified date approximately 120 days after the case was filed, and set a date for a hearing. See *id.* at 99. This practice corresponds with the Finnish rule that the court should specify a date when a plan should be filed, ordinarily no longer than 120 days. Fin. Reorg. L. § 40. For the fast-track cases, the median time between filing and confirmation was 12.7 months (381 days), and for the 26 firms that filed before adoption of the faster management, the median time was 16.7 months (502 days). See Bufford, *supra* note 11, at 116 tbl.A-1. Fast track management reduced the time elapsed by about 24%, but the median Finnish time was 21% faster than cases under the Central District's fast-track procedure.

¹⁰⁸ Apparently, debtors were given a second chance to come up with a plan in some cases under the fast-track management system. Cases were dismissed or converted after the initial hearing only if the disclosure statement and plan were *completely* insufficient. See Bufford, *supra* note 11, at 99-100.

such speeds are rarely achieved. On balance, it appears that the U.S. system takes longer to achieve plan confirmation.

2. *Cases in Which No Plan Is Confirmed*

Examining cases in which no plan is confirmed demonstrates the relative speed of the two countries' reorganization systems. Compared to U.S. firms, Finnish firms stay in reorganization proceedings for a much briefer period before they terminate. Table 3 above shows the mean time is 3.7 months, compared to 8.6 months for U.S. firms. The median times are 2.5 and 7.0 months, respectively. Regression results, reported elsewhere, confirm that this finding holds after controlling for the effects of industry, size, and firm solvency.¹⁰⁹ The coefficient for the country dummy variable, equal to one for U.S. firms, is positive and statistically significantly different from zero. Data from other studies show a similar tendency.¹¹⁰

Much of Finland's faster processing time is probably due to the difficulty of converting or dismissing U.S. cases early in the proceedings. In Finland, major creditors and others may challenge debtors' eligibility early in the proceedings. Only 24% (61 of 257) of the Finnish cases that eventually were terminated passed the initial screening process. Differences in elapsed time for cases terminating at different stages of the proceedings suggest how the initial screening accelerates terminations. The median time between filing and termination was 1.4 months for the 32 cases the debtor withdrew before the screening process had ended, 2.2 months for the 159 cases denied commencement after the screening process, and 8.3 months for the 60 cases permitted to commence that were later terminated.

D. Proposed Repayment Percentages

1. *United States and Finland*

The U.S. debtors' greater control of Chapter 11 proceedings suggests that U.S. reorganization plans should be more favorable to debtors than Finnish plans. LoPucki and Kerkman both find that the debtor is in nearly complete control of the reorganization process.¹¹¹

But our data differ from this prediction. With respect to payments to unsecured creditors, Table 3 shows that the mean proposed

¹⁰⁹ Eisenberg & Sundgren, *supra* note 13, at 36.

¹¹⁰ Fenning & Hart report the median time between filing and dismissal to be 6.7 months, and between filing and conversion to be 9.4 months. Fenning & Hart, *supra* note 11, at 152. Under Judge Mund's fast-track procedure, the median times between filing and conversion, and filing and dismissal, are 5.0 months and 5.3 months, respectively. See Buford, *supra* note 11, at 105-08. This is more than twice the time elapsed under the Finnish Code.

¹¹¹ LoPucki, *supra* note 66, at 272; Kerkman, *supra* note 67, at 182.

payment percentage to unsecured creditors is 42.9% of unsecured liabilities for Finnish cases, and 64.0% for U.S. cases. The medians are 37% and 80%, respectively. The difference in means is statistically significant.¹¹² This effect cannot be explained away on the ground that Finnish firms propose faster repayment periods, thereby leading to payments with more equal present values across the two countries. Table 3 shows that Finnish firms propose substantially longer, not shorter, payout periods than U.S. firms. Finnish firms thus propose lower payments over a longer period of time. The present value of the promised stream of payments is therefore much higher in the United States. Post-confirmation performance rates do not seem to be noticeably different.¹¹³

Regression results in Table 5 below show that U.S. creditors being promised higher repayment amounts survives after controlling for industry, solvency, size, and length of repayment period. The coefficient for the country dummy variable, equal to one for U.S. firms, is positive and statistically significant.¹¹⁴

Table 5 below also shows that solvency is significantly and positively correlated with the proposed repayment percentage. Firm size is significantly negatively related to repayment percentage: larger firms promise lower percentage repayments to their creditors. A possible reason is that larger firms have more bargaining power with their creditors.¹¹⁵ Moreover, problems with underpricing assets, if the firm were to be sold in a liquidating bankruptcy, increase with firm size.¹¹⁶ Finally, Table 5 below shows that the repayment period variable is positively related to the promised repayment percentage. Thus, there is a trade-off between promising higher repayment percentages over longer periods and lower percentages over shorter periods. This is not surprising since, given a proposed repayment percentage, the payments' value decreases with the period's length.

¹¹² T-test (p -value = .0007). Similar results emerge from other U.S. studies. See *infra* Table 6.

¹¹³ Compare Sundgren, *supra* note 100, at 14 (projecting a 50% failure rate after six years), with LoPucki, *supra* note 66, at 107 (reporting 11 surviving firms after 2.5 to 3.5 years), 122-23 (showing 21 confirmed or pending plans in the third numerical column of Chart III).

¹¹⁴ The results in Table 5 do not change materially if one uses a square root, logarithmic, or logit transformation of the dependent variable. For the logit model, we reset 100 percent prepayment plans to 99 percent.

¹¹⁵ Weiss, *supra* note 47, at 297-98, presents empirical evidence supporting the thesis that debtors' bargaining power increases with firm size. He finds that deviations from the APR are more likely to occur in large Chapter 11 cases filed in the Southern District of New York than in the normally smaller cases filed in other districts. *Id.* at 297-99.

¹¹⁶ See Andrei Schleifer & Robert W. Vishny, *Liquidation Values and Debt Capacity: A Market Equilibrium Approach*, 47 J. FIN. 1343 (1992).

TABLE 5. DETERMINANTS OF PROPOSED REPAYMENT PERCENTAGES TO UNSECURED CREDITORS. REGRESSION RESULTS

Dependent Variable = Proposed Repayment Percentage

<i>Independent Variables</i>	<i>Coefficient</i>	<i>Significance</i>
U.S. filing	20.197	.010
Adjusted solvency	2.643	.016
Assets (log)	-4.772	.008
Repayment period	.135	.056
Industry dummy variables	not reported	
Constant	67.227	.000
Number of cases	110	
Adjusted r-squared	.154	

Several factors could explain the pattern of higher proposed repayment percentages in the United States. First, it may be that in Finland, on average, a larger portion of claims are secured. This would leave proportionately less assets to satisfy unsecured creditor claims. Finnish creditors can obtain a floating charge on inventories and other assets. On average, 35.7% of the Finnish liabilities could be classified as secured.¹¹⁷ But U.S. creditors can also obtain security interests in debtors' inventory, receivables, and other assets. A Department of Justice study of Chapter 11 cases filed in fiscal 1981 randomly sampled 500 cases from 18 districts. It found, on average, secured liabilities to be 43.1% of total liabilities.¹¹⁸ The firms in the sample, however, were much smaller than the firms in the LoPucki/Kerkman data, so it is unclear whether the Department of Justice data suggest that the LoPucki/Kerkman firms would have similar proportions of secured debt.¹¹⁹ Other U.S. studies find both greater and lesser percentages of secured debt in wider loan portfolios.¹²⁰

¹¹⁷ See Sundgren, *supra* note 100, at 12 tbl.4.

¹¹⁸ See Michelle J. White, *Bankruptcy Liquidation and Reorganization*, in HANDBOOK OF MODERN FINANCE 35-1, 35-30 tbl.35.3, col.6 (Dennis E. Logue ed., 1984). White reports a similar percentage for 45 firms that filed to reorganize in the Southern District of New York in 1980-81. *Id.* col.4.

¹¹⁹ See *id.* col.6 (showing mean assets of \$257,000 compared to over \$2 million for the LoPucki/Kerkman sample). Even adjusting the Department of Justice data for inflation would not suggest that the firms in the samples were of comparable size. Liabilities entitled to priority do not appear to be large enough to substantially influence the analysis. See *id.* (showing priority liabilities comprising less than 5% of total liabilities).

¹²⁰ See Allen N. Berger & Gregory F. Udell, *Collateral, Loan Quality, and Bank Risk*, 25 J. MONETARY ECON. 21, 31 (1990) (in sample of bank loans from 1977 to 1988, 27% of dollar volume of loans were secured); James R. Booth, *Contract Costs, Bank Loans, and the Cross-Monitoring Hypothesis*, 31 J. FIN. ECON. 25, 31-32 (1992); John D. Leeth & Jonathan A. Scott, *The Incidence of Secured Debt: Evidence from the Small Business Community*, 24 J. FIN. & QUANTITATIVE ANALYSIS 379, 379 (1989) (reporting studies finding that almost 80% of dollar volume of large- and small-business loans were secured).

Second, differences in the classes of preferred unsecured creditors could also affect the proposed payoff rate to general unsecured creditors. However, Finnish priority rules for unsecured claims do not self-evidently lead to a smaller pool for unsecured creditors than U.S. rules. As part of the legislation that reduced the priority of the floating charge, Finnish law eliminated the priority of pension payments, taxes, and wages. Finnish law treats unpaid wages, pension payments, and taxes as general unsecured claims.¹²¹ (But note that wages enjoyed a high priority during a period of transition that includes the period studied here.) In the United States, these and other unsecured claims enjoy some priority over general unsecured claims.¹²² Administrative expenses include attorney fees and enjoy priority over unsecured claims. They are, therefore, not likely to be substantially lower in the United States than in other countries.¹²³ Thus, treatment of preferred unsecured creditors does not unambiguously point towards higher U.S. payments to general unsecured creditors.

Third, U.S. unsecured creditors could be paid more at the expense of the payoff to secured creditors. Results for public firms show that Chapter 11 plans overpay debtors at the expense of secured creditors, but that this overpayment rate is small.¹²⁴

Fourth, different cultural norms might exert pressure on U.S. debtors to repay a higher fraction of their unsecured debts. Our instinct, however, is that the United States is not especially known for aversion to debt avoidance and that Finland is not especially known for a fondness for debt avoidance. We suspect that other, more tangible, factors are at work.

Fifth, different macroeconomic conditions might have prevailed at the times of the studies. If Finnish economic prospects were weaker, debtors may have proposed, and creditors may have accepted, lower proposed plan payments. But economic prospects in the United States were not particularly bright at the time of the LoPucki/

¹²¹ The priority rules are contained in "L om ordning i vilken borgenärer skall få betalning" [Priority Law] 30.12.1992/1578. Although wages are not priority claims, the government guarantees unpaid pre-filing wages. The European Community requires that member states take measures necessary to insure that institutions guarantee payment of employees' outstanding wages and employment claims arising before insolvency. Council Directive 80/987 of 20 Oct. 1980 Protection of Employees in the Event of the Insolvency of Their Employer, 1980 O.J. (L 283) 23.

¹²² See 11 U.S.C. § 507(a)(3),(8) (1994).

¹²³ See, e.g., Eisenberg & Tagashira, *supra* note 4, at 146 n.82 (reporting low administrative costs for Japanese compositions).

¹²⁴ See Julian R. Franks & Walter N. Torous, *A Comparison of Financial Restructuring in Distressed Exchanges and Chapter 11 Reorganizations*, 35 J. FIN. ECON. 349, 363 (1994) (reporting negative deviations of -1.67% for secured creditors in a study of 37 reorganizations); *id.* at tbl.6; LoPucki & Whitford, *supra* note 47, at 142 tbl.III.

Kerkman cases. Bankruptcy filings were fairly high.¹²⁵ In addition, the Finnish data cover a period that followed a severe recession, but the firms studied did not file for reorganization in the midst of the recession.¹²⁶

The simplest explanation for the different proposed repayment percentages is varying cramdown standards. Chapter 11's standard for confirming a plan over the objection of an unsecured creditor class requires either that all senior classes be paid in full or that no junior interest receive any value under the reorganization plan.¹²⁷ Because ownership interests are junior to creditor interests, the firm's owners, in general, cannot retain any interest in the reorganized firm unless they propose a plan that will pay all creditors in full. Finnish owners are not constrained by an APR. To confirm a plan over an objecting creditor class, they merely need approval of one-fifth of all creditors.

The data suggest the importance of the APR. Looking deeper into the difference between the U.S. and Finnish mean and median proposed repayment percentages is revealing. The difference in proposed, unsecured liability repayment percentages stems from the dominance of U.S. plans in which debtors propose to repay 100% of unsecured liabilities. In the LoPucki/Kerkman sample, complete repayment plans constituted 45.5% (15 of 33) of the plans for which repayment terms are known. In Finnish cases, only 10.6% (9 of 85) of the plans proposed 100% repayment.¹²⁸ Many U.S. firms probably opt for 100% repayment plans because the owners shaping those plans want to retain ownership of the reorganized firms. Plan completion rates do not appear to differ substantially.¹²⁹

Thus, the results undermine the belief that U.S. creditors' weaker negotiating position leads to their receiving repayments that are too small under debtor-dominated plans. A U.S. legal rule—absolute priority—protects creditors to the point of rendering them better off than Finnish creditors. Perhaps Finnish creditors should be more concerned about the absence of an APR than U.S. creditors should be about Chapter 11's prodebtor features. Under Chapter 11, U.S. creditors receive more of a firm's going concern surplus than Finnish creditors do under their country's system.¹³⁰

¹²⁵ See White, *supra* note 118, at 35-26 tbl.35.1.

¹²⁶ See *supra* note 85 for data on macroeconomic conditions in the countries at the times of the reorganization filings.

¹²⁷ 11 U.S.C. § 1129(b)(2)(B)(ii), (b)(2)(C)(ii) (1994).

¹²⁸ The difference in the rate of 100% repayment plans is highly statistically significant ($p < 0.0001$).

¹²⁹ See *supra* note 112 and accompanying text.

¹³⁰ The going concern surplus depends on the percentage of debt to be repaid and on the discount rate used to calculate the present value of payments. Using a 21% discount

2. *Other Countries*

The higher U.S. proposed repayment rates are sufficiently startling to merit further exploration. In addition to the United States and Finland, we consider data on reorganization payments to unsecured creditors in Australia, Canada, and Japan. These countries' reorganization laws resemble Chapter 11, though important differences exist. Discussions of these countries' reorganization laws are available elsewhere¹³¹ so we summarize briefly only central features here.

Although their reorganization laws resemble Chapter 11, these countries all grant the debtor less control of the reorganization process than Chapter 11 grants. In all three countries, a neutral or creditor-oriented official plays a greater role than in the United States. The United States is the only country in which, in a typical case, the debtor commences the case, the debtor's management retains control of the firm during the reorganization, the norm is limited, serious early screening of the likelihood of a successful reorganization, the debtor proposes the reorganization plan, and the debtor prepares and disseminates information about the reorganization plan.

These Chapter 11 features support the common belief that U.S. reorganization laws are more lenient towards debtors than other countries' reorganization laws. Given this pro-debtor orientation, one might expect, as a first approximation, other countries' laws to lead to more favorable treatment of unsecured creditors than Chapter 11.

To assess this prediction, Table 6 below summarizes twelve empirical studies¹³² of the five countries' reorganization laws. It presents subject firms' assets, the monetary units in which those assets are expressed, the unsecured creditors' proposed repayment percentages, and each study's rank based on the proposed repayment percentage.

rate and estimates of firm liquidation value (available only for Finnish firms), the average surplus for the Finnish firms in the sample is 13%. See Sundgren, *supra* note 100, at 2. See *id.* at 14 for the justification for the particular discount rate used.

¹³¹ See CORPORATE INSOLVENCY LAW (J.P.G. Lessing & J.F. Corkery eds., 1995) (Austrian law); Eisenberg & Tagashira, *supra* note 4; Lynn M. LoPucki & George M. Triantis, *A Systems Approach to Comparing U.S. and Canadian Reorganization of Financially Distressed Companies*, 35 HARV. INT'L L.J. 267 (1994).

¹³² The studies are, in the order listed in the Table: Simon Coad, *The Australian Society of CPAs Survey of the First Year of Voluntary Administrations*, in CORPORATE INSOLVENCY LAW, *supra* note 131, at 49; FISHER & MARTEL, *supra* note 62; Timothy C.G. Fisher & Jocelyn Martel, *Will the Bankruptcy Reforms Work? An Empirical Analysis of Financial Reorganization in Canada*, 20 CAN. PUB. POL'Y—ANALYSE DE POLITIQUES, 265, 267 (1994); L. Kryzanowsky & J. Holland, *Bankruptcies and Commercial Arrangements in Canada*, INSOLVENCY BULL., Sept. 1984, at 3; this study (for Finland and the United States); Eisenberg & Tagashira, *supra* note 4, at 139; Eberhart et al., *supra* note 47, at 1461-63; LoPucki & Whitford, *supra* note 47, at 142; Flynn, *supra* note 11, at 17, 31; Weiss, *supra* note 47, at 295, app. at 300-12 tbl.4; and White, *supra* note 118, at 35-30 to -35.

TABLE 6. REORGANIZATIONS IN FIVE COUNTRIES: PROPOSED UNSECURED REPAYMENT PERCENTAGES

Country	Study; (N) in parentheses	Mean Assets (monetary units)	Unsecured Payment %	Rank
Australia	Coad (1995) (423)	unavailable	21.5	12
Canada	Fisher & Martel (1996) (393)	2,453 (000 1993 \$C)	38.0	9
Canada	Fisher & Martel (1994) (338)	2,372 (000 1993 \$C)	43.6	7
Canada	Kryzanowsky & Holland (1984) (41)	248 (000 nominal \$C)	36.9	10
Finland	this study (85)	2,100 (000 1992 \$)	42.9	8
Japan	Eisenberg & Tagashira (1994) (352)	499 (mill. 1987 ¥)	46.9	6
U.S.	Eberhart, Moore, & Roenfeldt (1990) (30)	public	69.0	1
U.S.	this study (33)	2,257 (000 1992 \$)	64.0	2
U.S.	LoPucki & Whitford (1990) (41)	public	49.0	5
U.S.	Flynn (1989) (2,395)	4,800 (000 nominal \$)	56.4*	3
U.S.	Weiss (1990) (37)	public	53.0	4
U.S.	White (1984) (64)	1,643 (000 1984 \$)	34.0	11

* This figure is the middle of the median repayment percents of 15 districts studied. The 15 medians ranged from 45.2% to 75.9%.

The data confirm the results of the U.S.-Finnish comparison. Table 6's nearly uniform pattern is that proposed repayments to unsecured creditors are higher in the United States than in any other country. As measured by mean unsecured creditor proposed repayment percentages, the five top-ranking studies are *all* of United States firms in Chapter 11.

Other factors could explain the observed pattern while preserving the pro-debtor view of Chapter 11. Some of the high U.S. proposed repayment percentages could be attributed to samples consisting of large public firms, which may be healthier than typical Chapter 11 firms. This could explain the Eberhart et al., LoPucki and Whitford, and Weiss studies. However, the higher proposed repayment percentages also emerge in studies of smaller firms, such as those studied here and in Flynn's study. Only White's 1984 study of 64 firms in one federal district departs from this pattern, and even this study contains only modest evidence that Chapter 11 unsecured creditors fare noticeably worse than unsecured creditors in other countries.

Other possible explanations, such as those explored above, could exist for each of these countries. But the multicountry comparison is consistent with our more detailed U.S.-Finnish comparison. Perhaps the pro-debtor view of Chapter 11 should be toned down or partially suspended.

3. *Implications of Findings for Priority Proposals*

Despite the Finnish rule limiting secured creditor priority, the United States has higher proposed payments to unsecured creditors. The principle underlying the 1993 introduction of partial secured priority into Finnish law was to promote equal treatment of creditors.¹³³ Lawmakers also believed that more equal treatment of creditors would reduce obstacles to reorganization.¹³⁴ Large differences between the competing interests of groups of creditors could cause conflicts between high and low priority claimholders. Because Finnish reorganization law does not predate 1993, one cannot compare payment rates to unsecured creditors before and after the introduction of partial secured creditor priority.

We can merely observe that Finland's partial secured creditor priority does not lead to greater proposed payouts to unsecured creditors in reorganizations than in the United States. It is also clear that several other factors, some of which we address in our empirical analysis, can influence unsecured payment rates. If we are correct, the high U.S. unsecured payment rate is a consequence of the APR. There is no theoretical reason why reduced secured creditor priority should not further enhance the unsecured creditors' position. Nevertheless, our data suggest, admittedly tentatively, that one should not expect dramatically increased reorganization payments to unsecured creditors to result from adjusting secured creditor priority. The pro-creditor Finnish system, with its reduced secured creditor priority, does not produce unsecured repayment percentages near the U.S. level. How much room is there for increase in the United States?

CONCLUSION

Given an insolvency filing, U.S. firms are more likely to choose reorganization over liquidation. Although firms file for reorganization at a higher rate in the United States, we find no significant differences in plan confirmation rates. U.S. filings are more likely to lead to plan confirmation, although not significantly so.

Finland's stricter initial screening leads to faster case processing. The time between filing and termination of unsuccessful reorganizations is almost three times longer for U.S. firms. The pro-debtor U.S. system also has longer successful proceedings. Compared with some studies, the time elapsed is more than twice as long as in Finland. But some districts achieve speeds close to those in Finland. On balance, the Finnish experience suggests that early, serious filtering of reorgan-

¹³³ See Draft bill 1992rd-RP 181, at 19 (proposal for revised priority rules).

¹³⁴ See *id.* at 17.

ization candidates could reduce the time dedicated to firms with weak reorganization prospects.

One expects the more pro-debtor Chapter 11 to yield plans promising less to creditors and leaving the owners with a larger share of the reorganization surplus. Yet, the data do not support this prediction. Unsecured creditors receive significantly more under the U.S. Code. The most likely explanation is Chapter 11's requirement of payment in full to senior classes before junior classes receive consideration.

Unsecured creditors' beneficial treatment bears on the impact of reduced secured creditor priority. Will reduced priority lead to observable differences in payments? Our results suggest that secured creditor priority is part of a complex system in which the effect of a change in priority will filter through *ex ante* lending practices, the decision to file for bankruptcy or reorganization, the financial status of the firms, preferred creditor priorities, and confirmation standards.¹³⁵ The marginal effect of reduced secured creditor priority on U.S. unsecured Chapter 11 creditors, who already fare relatively well, may be modest. Different results may obtain under Chapter 7.

¹³⁵ Our data may contain the first evidence, albeit indirect, that Chapter 11 provides creditors with more than they would receive in liquidation. For the Finnish firms we study, reorganization law has provided a gain to creditors over what they would have received in liquidation. See Sundgren, *supra* note 100, at 18-19. We show that Chapter 11 results in at least as high payments to creditors as does Finnish law. Therefore, unless U.S. and Finnish liquidation values differ substantially, for firms comparable to those in the LoPucki/Kerkman sample, Chapter 11 also results in creditors receiving more than they would in liquidation.