Seton Hall University

School of Law

Accidental Convergence: Corporate Reorganization in Two Federal Systems

Stephen J. Lubben

<u>First Draft</u>

(please do not circulate or quote without my consent)

ACCIDENTAL CONVERGENCE: CORPORATE REORGANIZATION IN TWO FEDERAL SYSTEMS

Stephen J. Lubben[*]

The clumsily titled Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 is known primarily for its supposed reforms of consumer bankruptcy in the United States, but it also contained a host of revisions to chapter 11, the business reorganization provision of the Bankruptcy Code.[1] Taken together, the 2005 amendments to chapter 11 can be seen as Congress' forceful response to the troubles seen in the Eastern Airlines chapter 11 case.

Of course, Eastern Airlines stopped flying in early 1991, and chapter 11 had become a much different creature by the time Congress' "fixes" became effective in October 2005.[2] Congress apparently did not notice or care.[3]

---

[*] Daniel J. Moore Professor of Law, Seton Hall University School of Law.

[1] Pub. L. No. 109-8, 119 Stat. 23 (2005).

[2] *See, e.g.*, Douglas G. Baird & Robert K. Rasmussen, *The End of Bankruptcy,* 55 Stan. L. Rev. 751 (2002); Douglas G. Baird & Robert K. Rasmussen, *Chapter 11 at Twilight,* 56 STAN. L. REV. 673 (2003); Douglas G. Baird & Robert K. Rasmussen, *Private Debt and the Missing Lever of Corporate Governance,* 154 U. PA. L. REV. 1209 (2006); Jay Lawrence Westbrook, *The Control of Wealth in Bankruptcy,* 82 TEX. L. REV. 795 (2005); Stephen J. Lubben, *The "New and Improved" Chapter 11,* 93 KY. L.J. 839 (2005). It is not clear that this information was considered or would have mattered, given Congress' general hostility to the bankruptcy community during the enactment of the 2005 amendments.

[3] As two leading practitioners have noted, "The bill's business

The 2005 changes represent the first significant step away from a long-term inclination toward corporate rescue, or, perhaps more precisely, aiding corporate reorganization. In doing so, Congress, however unwittingly, partially reunited American corporate bankruptcy practice with its long forgotten, much smaller twin, Switzerland.

Like the United States, Switzerland is a federal state with a well-developed commercial economy and a long-standing democratic tradition. And like the United States, Switzerland modernized its bankruptcy laws in the late nineteenth century.[4] For most of the early twentieth century, bankruptcy practice in the two nations would look remarkably similar – in particular, corporate bankruptcy largely meant corporate liquidation. But in the United States a process of corporate reorganization began to develop outside of formal bankruptcy, and, following the Great Depression, this approach increasingly became

---

bankruptcy provisions, many of which are poorly drafted, make substantial changes to Chapter 11 reorganization law, changes that, for the most part, will adversely affect the ability of businesses to reorganize." Richard Levin & Alesia Ranney Marinelli, *The Creeping Repeal of Chapter 11: The Significant Buisness Provision of the Bankruptcy Abuse Protection and Consumer Protection Act of 2005*, 79 Am. Bankr. LJ. 603, 603 (2005). To be sure, the 2005 Amendments were nine years old by the time they were finally enacted, but apparently Congress did not bother to consider if anything had changed in the interim. Harvey R. Miller & Shai Y. Waisman, *Is Chapter 11 Bankrupt?*, 47 B.C. L. REV. 129, 161-62 (2005) ("the [2005] modifications to the Bankruptcy Code appear to be a continuation of the creditors' clawback of creditor prerogatives and the special-interest legislation that followed the 1978 Act.").

[4] Switzerland in a statute enacted in 1889, which became effective in 1892, the United States with the enactment of the 1898 Bankruptcy Act. *See*, *infra*.

part of the bankruptcy statute, culminating in the enactment of chapter 11 in 1978.[5]

Switzerland followed a more typically European course and eschewed reorganization in favor of creditor protection. Only recently have they amended their statue to facilitate a rather limited chance for corporate reorganization.[6] But now, with Congress' recent amendments, the two systems have become closer than ever in the past eighty years. In particular, by limiting the length of debtor control over the chapter 11 process, Congress has opened the possibility that American practice will increasingly see either short reorganization cases or failed reorganization cases that result in liquidations. Further burdens on small business debtors will make this likely trend even more pronounced for the smallest firms that find themselves in chapter 11.[7]

Ironically, this limited form of reorganization has been criticized by Swiss commentators as inadequate.[8] Indeed, the Swiss argue that

---

[5] Stephen J. Lubben, *Railroad Receiverships and Modern Bankruptcy Theory*, 89 CORNELL L. REV. 1420 (2004).

[6] The revised version of the Swiss Federal Statute on Debt Enforcement and Bankruptcy (SchKG) came into force in January 1997.

[7] *See* Robert M. Lawless & Elizabeth Warren, *The Myth of the Disappearing Business Bankruptcy*, 93 Cal. L. Rev. 743, 787-88 (2005).

[8] *See, e.g.,* Dimitra Kessenides, *Bankruptcy Breaks through Cultural Barriers,* American Lawyer/Focus Europe (Winter 2004) (quoting Swiss attorney, who observed that as a result of the Swiss Air bankruptcy, "[w]e realized that despite the most recent revisions in 1997, the Swiss bankruptcy law might not be good enough, especially in complex cases of large companies.") (available at http://www.americanlawyer.com/focuseurope/markets/switzerland010

their current, limited reorganization system too often leads to late filings and company liquidation. Why would Congress want to move the American system in this direction?

To address this key question, I offer a comparison of corporate reorganization systems in these two leading commercial, federal systems. In particular, I examine the Swiss system for rescuing failed companies and compare it with the post-BACPA version of chapter 11. While the American system clearly remains more "debtor friendly," the space between the two systems has significantly narrowed. More generally, through this short paper I demonstrate how Congress' ill-conceived amendments to chapter 11 may have damaged a corporate reorganization system that is increasingly the subject of imitation worldwide.[9] As the Swiss experience demonstrates, a truncated reorganization process offers little hope for real reorganization in all but the simplest cases. And the obvious alternative – out of court reorganization – is rarely a realistic substitute for that significant, albeit residual group of cases that require a formal aggregation process to avoid liquidation.

4.html); Bettina Kopta-Stutz, *The Swiss Reorganization Law In A Crisis*, Zürich University Legal Sciences Institute Working Paper (February 19, 2005) (on file with author) ("The sobering conclusion [is] that Swiss reorganization proceedings do not meet companies' requirements on reorganization law.").

[9] Jay Lawrence Westbrook, *A Global Solution to Multinational Default*, 98 Mich. L. Rev. 2276, 2278-79 (2000). *See also* Stephen J. Lubben, *Financial Distress in Emerging Markets*, in EMERGING MARKETS: PERFORMANCE, ANALYSIS AND INNOVATION (Greg N. Gregoriou ed. 2009).

I. Post-2005 American Business Bankruptcy Law

In the United States, business debtors have their choice of two chapters: chapter 7, which is primarily the liquidation chapter, and chapter 11, which is primarily the reorganization chapter. Of course the liquidation/reorganization line between the two chapters is not as strict as often suggested, inasmuch as the chapter 7 trustee can seek authorization to operate a debtor's business until sale, and chapter 11 expressly contemplates the existence of a liquidating plan (sometimes oddly referred to as a "liquidating plan of reorganization").[10]

Chapter 7 provides the kind of liquidation bankruptcy proceeding that can be found in any developed economy: a trustee takes charge of the debtor's assets, sells them, and pays out the proceeds to creditors according to a set statutory scheme.[11] Chapter 11, on the other hand, is a distinctly American contribution to bankruptcy. The debtor controls its case, remaining "in possession" of the estate without a trustee, and exercises the initial right to propose the terms of reorganization.[12] Under both chapters debtors enjoy the protection of an "automatic" stay, which prohibits most collection efforts upon filing the petition.[13]

While chapter 11 was often criticized for its perceived "debtor bias," by the turn of this century it was generally agreed that the pendulum had swung in the direction of creditors.[14] Indeed, while

---

[10] Stephen J. Lubben, *Business Liquidation*, 81 Am. Bankr. L.J. 65 (2007).

[11] 11 U.S.C. §726.

[12] *See* 11 U.S.C.§§1101(1), 1107(a).

[13] 11 U.S.C. §362.

[14] *See, e.g.*, Douglas G. Baird & Robert K. Rasmussen, *The End of Bankruptcy*, 55 Stan. L. Rev. 751 (2002).

some argued that creditors, particularly secured creditors, might now have too much control over the reorganization process, the concerns of the 1980s, particularly involving the length of cases, seemed to have largely vanished.[15]

Notwithstanding this change, as part of the 2005 amendments to the Bankruptcy Code, Congress decided to enact several provisions designed to speed up chapter 11.[16] And several provisions were also added that granted certain business creditors special treatment in chapter 11. For small businesses[17] the news was even worse, as Congress also enacted a further set of provisions seemingly designed to limit, and perhaps even end, small businesses' use of chapter 11.[18]

Small businesses are now required to file a slew of documents at the start of the case, and comply with various reporting requirements, beyond typical requirements, throughout the case.[19] The U.S. Trustee – a unit of the Justice Department – is given stronger powers to monitor and oversee small business bankruptcy cases. Small business debtors who return to bankruptcy within two years do not get the

---

[15] Stephen J. Lubben, *The "New and Improved" Chapter 11*, 93 Ky. L.J. 839 (2005).

[16] Pub. L. No. 109-8, 119 Stat. 23 (2005).

[17] *See* 11 U.S.C. §101(51D).

[18] Robert M. Lawless, *Small Business and the 2005 Bankruptcy Law: Should Mom and Apple Pie Be Worried?*, 31 S. ILL. U. L.J. 585 (2007).

[19] 11 U.S.C. §§ 308, 1116. *See also* Thomas E. Carlson & Jennifer Frasier Hayes, *The Small Business Provisions of the 2005 Bankruptcy Amendments*, 79 AM. Bankr. L.J. 645 (2005); James B. Haines, Jr. & Philip J. Hendel, *No Easy Answers: Small Business Bankruptcies After BAPCPA*, 47 B.C. L. Rev. 71 (2005).

benefit of the automatic stay.[20] And a small business debtor faces a hard 300-day limit on the duration of its case.[21]

In the general chapter 11 case, the 2005 amendments now provide that the debtor's exclusive right to propose a plan is limited to 18 months.[22] Thus, even a creditor who is unable to convince the court to lift the automatic stay can achieve the same results, after a year and a half, under a plan.

Perhaps more importantly, in 2005 landlords obtained strict time limits on a debtor's ability to assume or reject a commercial lease under section 365.[23] In a large retail case where the debtor has myriad leases – Kmart had about 2,000 when it filed for chapter 11 – the new time limit places an unrealistic outside date on the debtor's reorganization efforts.[24] DIP lenders are aware of this reality, and the have begun setting loan terms that call for the termination of credit if a retail debtor does not adopt a plan within the time frame for assumption or rejection of leases.[25] In this way, the limitations in

[20] 11 U.S.C. §362(n).

[21] 11 U.S.C. §1121(e)(2).

[22] 11 U.S.C. §1121. *See also* Neill D. Fuquay, Note, *Be Careful What You Wish For, You Just Might Get It: The Effect on Chapter 11 Case Length of the New Cap on a Debtor's Exclusive Period to File a Plan*, 85 Tex. L. Rev. 431 (2006).

[23] 11 U.S.C. §365(d)(4).

[24] Debtors now have up to 210 days from the start of the bankruptcy case to assume or reject their nonresidential real property leases. If the debtor does not act within the time allotted by the statute, the lease is automatically rejected. In re Tubular Techs., LLC, 362 B.R. 243 (Bankr. D.S.C. 2006).

[25] *Debtors' Motion for Interim and Final Orders Pursuant to 11 U.S.C. §§ 105, 361, 362, 363 and 364 and Federal Rules of Bankruptcy Procedure 2002 and 4001 (I) Authorizing Debtors (A) to*

newly amended section 365(d)(4) have become hard and fast time limitations on a retail chapter 11 case.

Other exemptions not only favor specific creditors, but also create liquidity issues for the debtor, further imperiling the chances for reorganization.[26] Utilities now have the ability to demand affirmative deposits upon bankruptcy; administrative priority no longer being sufficient under the Code.[27] Like derivatives traders, utility companies also obtained the right to setoff against a deposit without notice to the bankruptcy court,[28] unlike most other creditors.[29]

General trade creditors also benefit from a host of exceptions from the normal rules. The revised "ordinary course of business" exception to the Code's preference rules protect a much broader range of transactions from being questioned and perhaps unwound post-bankruptcy[30] – allowing trade creditors substantially increased leverage against distressed companies.[31] Newly added sections of the

---

Obtain Postpetition Financing and (B) to Utilize Cash Collateral; (II) Granting Adequate Protection; and (III) Scheduling Interim and Final Hearings, In re Circuit City Stores, Inc., Case No. 08-35653 (KRH) (Bankr. E.D. Va. Nov. 10, 2008).

[26] Levin and Ranney-Marinelli, *supra* note 3, at 605.

[27] 11 U.S.C. §366; Bertrand Pan & Jennifer Taylor, *Sustaining Power: Applying In Chapter 11 Post-BAPCPA*, 22 BANK. DEV. J. 371 (2006).

[28] 11 U.S.C. §366(c)(4).

[29] 11 U.S.C. §362(a)(7).

[30] Charles Jordan Tabb, *The Brave New World of Bankruptcy Preferences*, 13 AM. BANKR. INST. L. REV. 425, 440-45 (2005).

[31] 11 U.S.C. §547(c)(2). *Cf.* Vern Countryman, *The Concept of a Voidable Preference in Bankruptcy*, 38 VAND. L. REV. 713, 775-76 (1985).

Code give large swaths of trade creditors administrative status[32] and enhanced reclamation rights – beyond what is provided under the state law and the UCC.[33]

In sum, post-2005 chapter 11 has become a more technical, time constrained, and liquidity-draining proposition.

---

[32] 11 U.S.C. §503(b)(9). Alan N. Resnick, *The Future of the Doctrine of Necessity and Critical-Vendor Payment in Chapter 11 Cases*, 47 B.C.L. REV. 183, 203-05 (2005).

[33] 11 U.S.C. §546(c); *compare* U.C.C. §2-702.

II. Swiss Business Bankruptcy Law

Following the Napoleonic wars, Switzerland emerged as a confederation of cantons that were only loosely affiliated, somewhat like the American colonies during the Articles of Confederation period.[34] Following a brief civil war in the late 1840s, these cantons were more closely bound together with the adoption of a new constitution that transformed Switzerland into a true federal state, modeled in part on the United States' Constitution of 1789.[35]

Like its American counterpart, one key goal of the new constitution was to promote the economic integration of the Swiss cantons.[36] The 1848 constitution primarily achieved this by abolishing tariffs among the cantons,[37] but the 1874 constitution expressly gave the federal government the power to pass

---

[34] Thomas Maissen, *The 1848 Conflicts and their Significance in Swiss Historiography*, in THE MAKING OF MODERN SWITZERLAND, 1848-1998 at 3, 5, 10 (Michael Butler et al, eds 2000).

[35] *Id*. at 14-15. The Swiss constitution has been amended on several occasions, including complete redraftings in 1874 and 1999. The frequent amendments are apparently the result of a lack of a broad, Hamiltonian/*Marbury* conception of implicit federal powers. *See Thomas Cottier, Reforming the Swiss Federal Constitution: an International Lawyer's Perspective*, in THE MAKING OF MODERN SWITZERLAND, supra note 34, 75, 76-78.

[36] E. BONJOUR ET AL., A SHORT HISTORY OF SWITZERLAND 270-71 (1952). Under the present constitution, Article 95 provides that the federal government "shall strive to create a unified Swiss economic area." The current Swiss constitution is available in English at: http://www.admin.ch/org/polit/00083/index.html?lang=en.

[37] FEDERAL CONSTITUTION OF THE SWISS CONFEDERATION 12 (2d ed. 1867) (English translation of 1848 constitution, Article XXIX).

bankruptcy legislation.[38] Like the United States, this federal bankruptcy power was not immediately exercised, leaving the cantons (or the states) to fill the void.[39] Finally, in 1889 a new federal bankruptcy statute was enacted by popular referendum.[40] This new law, which did not become effective until 1892, not only nationalized debt enforcement but also placed ultimate judicial authority over bankruptcy with the Swiss Federal Court, the highest court in the nation.[41] This statute remains the foundation of the current Swiss Bankruptcy law.

Unlike the United States,[42] however, bankruptcy in Switzerland is part of a general federal law of debt enforcement.[43] Indeed, debt

---

[38] THE CONFEDERATE CONSTITUTION OF THE SWISS REPUBLIC 15 (1875) ((English translation of 1874 constitution, Article 64).

[39] *See* S. WHITNEY DUNSCOMB, JR., BANKRUPTCY: A STUDY IN COMPARATIVE LEGISLATION 124-26 (1893) (discussing Geneva's insolvency law "which will shortly be replaced by a Federal bankruptcy law for all Switzerland"). While the United States had a handful of temporary federal bankruptcy acts throughout the nineteenth century, the first permanent law was the 1989 Bankruptcy Act. Ch. 541, 30 Stat. 544, *amended by* Act of June 22, 1938, (the "Chandler Act"), ch. 575, 52 Stat. 840, *repealed by* Bankruptcy Reform Act of 1978 (the "Bankruptcy Code"), Pub. L. No. 95-598, 92 Stat. 2549. *See* Lubben, *supra* note 5, at 1440-41 (discussing the history of American bankruptcy laws). During periods of federal inactivity, the various states filled the void with statutes whose effects were limited by the Contract Clause. UNITED STATES CONSTITUTION, Article I, section 10, clause 1.

[40] The vote, held on November 17, 1889, was relatively close: 244,317 in favor, 217,921 opposed. ROBERT CLARKSON BROOKS, GOVERNMENT AND POLITICS OF SWITZERLAND 155 (1921).

[41] *Id. at 165-66.*

[42] *But cf.* Hanover National Bank v. Moyses, 186 U.S. 181, 189-90 (1902) ("One of the effects of a bankrupt law is that of a general

> enforcement is divided between specific enforcement, which corresponds to American state debtor-creditor law, and general enforcement, or bankruptcy.[44]

---

execution issued in favor of all of the creditors of the bankrupt, reaching all his property subject to levy and applying it to the payment of all his debts according to their respective priorities."). It is unclear if Congress could federalize all collection law under its Constitutional bankruptcy power. *See* Jonathan C. Lipson, *Debt and Democracy: Towards a Constitutional Theory of Bankruptcy*, 83 NOTRE DAME L. REV. 605, 620 (2008).

[43] *See generally* BERNHARD MEYER-HAUSER, ENFORCEMENT OF A MONEY CLAIM IN SWITZERLAND (1997). The original 1889 bankruptcy statute was enacted under Article 64 of the 1876 Constitution, which roughly corresponds with Article 122, paragraph 1 of the current Constitution. This provision provides that legislation "in the field of civil law and civil procedure is a federal matter." Interestingly, non-monetary debt enforcement is governed by cantonal laws. Konstantinos D. Kermeus, *Enforcement Proceedings*, in INTERNATIONAL ENCYCLOPEDIA OF COMPARATIVE LAW, Installment 16, Chapter 10, at 7 (1982).

[44] *Schuldbetreibungs und Konkursgesetz* (SchKG -- Debt and Bankruptcy Law) Art. 38 [hereinafter, "SchKG"]. Throughout this paper, citations are to the English translation of the statute, STEPHEN V. BERTI, SWISS DEBT ENFORCEMENT AND BANKRUPTCY LAW - ENGLISH TRANSLATION OF THE AMENDED FEDERAL STATUTE ON DEBT (1997). The official text of the statute, in German, can be found at: http://www.admin.ch/ch/d/sr/c281_1.html. The reader should be aware that the SchKG has been amended on several occasions since the 1997 publication date of the foregoing English translation. These amendments do not, however, involve the provisions discussed in this paper. A complete accounting of these amendments (again, in German) can be found at http://www.admin.ch/ch/d/sr/2/a281_1.html. Those interested in the historical evolution of the Swiss bankruptcy statute can find a translation of the law as it stood in the early 1930s (essentially as it was enacted in the nineteenth century, as the law was not first amended until the 1950s), in *Switzerland*, 5 J. NAT'L ASS'N REF. BANKR. 94 (1931).

Business bankruptcy in Switzerland involves a choice between bankruptcy liquidation,[45] the rough equivalent of chapter 7 of the U.S. Bankruptcy Code, and composition, which is the focus of this paper.[46]

While the Swiss bankruptcy law appears to allow debtor firms in any state of financial distress to seek a composition,[47] commentary suggests that section 725 of the Swiss Code of Obligations,[48] which provides that a corporate board has a duty to notify the bankruptcy court upon balance sheet insolvency, provides that actual trigger point for most bankruptcy cases.[49] Filing a notice of insolvency constitutes a petition for bankruptcy liquidation, unless the debtor moves to institute a composition proceeding.[50] Because Swiss bankruptcy law does not contemplate any role for shareholders, it is argued that directors are hesitant to

---

[45] SchKG Arts. 197-207.

[46] SchKG Art 293.

[47] SchKG Art. 293 ¶ 1.

[48] SWISS CODE OF OBLIGATIONS: VOLUME II, at 71 (2005) (English translation of Article 725).

[49] Hans Caspar von der Crone et al., Some Theses Concerning Modern Swiss Reorganization Law, in THE CHALLENGES OF INSOLVENCY LAW REFORM IN THE 21ST CENTURY 517, 520-23 (Henry Peter, Nicolas Jeandin, & Jason Kilborn ed. 2006) (criticizing current Swiss law for not allowing an earlier filing); Katherine Ashton et al., *When a Multinational Group of Companies is in Financial Difficulty*, 30 INT'L BUS. LAW. 350, 352-53 (2002).

[50] SchKG Art. 191. In exceptional cases the judge may postpone bankruptcy if she is presented with a restructuring proposal that she believes likely to succeed. SWISS CODE OF OBLIGATIONS, *supra* note 48, at 71-72 (English translation of Article 725a).

file, and disenfranchise shareholders, before they are legally bound to do so.[51]

On the other hand, creditors may institute bankruptcy proceedings, and thus composition proceedings,[52] in instances where the debtor has failed to pay a claim.[53] Thus, while a debtor's petition is subject to a balance sheet insolvency test, a creditor's petition is subject to a kind of cash flow insolvency test.[54]

Upon receipt of a composition petition, the court will order a preliminary stay of collection efforts.[55] Unlike its American counterpart, this stay is not automatic,[56] and some commentators have asserted that the "going concern" value of many Swiss businesses can be destroyed during the gap between filing and imposition of the stay.[57] If the court finds that the debtor is likely to successfully complete its reorganization, an enduring stay is implemented.[58] Typically this stay will last from four to six

---

[51] *See* von der Crone et al., *supra* note 49, at 520 n.17. For a good overview of Swiss corporate law, see Gundrun Bürgi-Schneider, *Corporate Law*, in SWITZERLAND BUSINESS & INVESTMENT HANDBOOK 117, 126-26 (Christian H. Kälin ed. 2006).

[52] SchKG Art. 293 ¶ 2.

[53] SchKG Art. 190 ¶ 2.

[54] Henry Peter, *Bankruptcy Reorganization Trigger Criteria: From a Retrospective (Balance Sheet) to a Prospective (Cash Flow) Test*, in THE CHALLENGES OF INSOLVENCY LAW REFORM, *supra* note 49, at 33, 34-35.

[55] SchKG Art. 293 ¶ 3.

[56] *Cf.* 11 U.S.C. § 362(a) ("a petition filed under . . . this title, or an application filed under section 5(a)(3) of the Securities Investor Protection Act of 1970, operates as a stay, applicable to all entities").

[57] von der Crone et al., *supra* note 49, at 523-24.

[58] SchKG Art. 295 ¶ 1.

months, although the statute authorizes up to 24 months of protection in particularly complex cases.[59]

Upon commencement of a proceeding, the debtor is authorized to continue normal business operations, subject to the supervision of a commissioner.[60] As in the United States,[61] extraordinary business transactions must be approved by the court.[62]

The commissioner has no direct counterpart in American law, being somewhat less invasive than the rarely appointed chapter 11 trustee,[63] but certainly more paternalistic than the typical chapter 11 "debtor in possession," charged with a fiduciary duty to its creditors.[64] A closer analogy might be to the monitors appointed in Canadian *Companies' Creditors Arrangement Act* proceedings.[65]

The commissioner is typically a law or accounting firm, nominated by the petitioning party.[66] In addition to supervising the operation of the debtor's business, the commissioner is obligated to

---

[59] SchKG Art. 295 ¶ 4. *See also* SChKG Art. 297 (outlining the effects of the stay on creditors).

[60] SchKG Art. 298 ¶ 1. *Cf*. 11 U.S.C. § 1108.

[61] 11 U.S.C. § 363(b); *see also* 11 U.S.C. § 363(c).

[62] SchKG Art. 298 ¶ 2.

[63] 11 U.S.C. §§ 1104, 1106.

[64] 11 U.S.C. § 1107.

[65] Under the CCAA, a monitor is an independent third party who is appointed by the court to monitor the company's ongoing operations and assist with the filing and voting on the plan of arrangement. *See* Jacob Ziegel, *The BIA and CCAA Interface*, in CANADIAN BANKRUPTCY & INSOLVENCY LAW 307, 326-27 (Stephanie Ben-Ishai & Anthony Dugan eds., 2007).

[66] Hartmann Müller Partners & PricewaterhouseCoopers, *Restructuring and insolvency in Switzerland* 3 (2006) (available at http://www.europeanrestructuring.com/).

prepare a report on the debtor's financial situation. The commissioner is also charged with conducting the various creditor meetings contemplated under the composition provisions.

During the period of stay, the commissioner negotiates a composition agreement between the debtor and the creditors.[67] As soon as a draft agreement is produced, the commissioner convenes a creditors' meeting by public notice. Composition agreements cover all claims incurred before the filing, but only those creditors who have filed claims are allowed to vote at the meeting.

The Swiss bankruptcy statute contemplates two types of composition agreements: so called "ordinary" agreements, and agreements involving an assignment of assets.[68] The latter resemble many liquidating chapter 11 plans in the United States: the debtor's assets are transferred to a liquidator, who pays claims under the agreement from the proceeds of one or more asset

---

[67] The agreements are extremely concise by American standards: the draft agreement in the Swiss Air bankruptcy, one of Switzerland's largest corporate insolvency cases ever, was a mere four pages. A copy can be found at http://www.liquidator-swissair.ch/uploads/media/agreement.pdf. As of early 2008, it was expected that the general unsecured creditors in this case would recover between 7.7% and 14.3% of their claims. *Circular no. 14 from the liquidator to creditors of SAirGroup in debt restructuring liquidation* (April 2008) (available at http://www.liquidator-swissair.ch/uploads/media/SG_Zirkular_Nr14_e.pdf). This is somewhat lower than the average recovery in American chapter 11 liquidations, but somewhat higher than is typical in chapter 7, inasmuch as unsecured creditors typically receive no recovery at all. Stephen J. Lubben, *Business Liquidation*, 81 AM. BANKR. L.J. 65 (2007).

[68] SchKG Arts. 314, 317.

sales.[69] The liquidator is supervised by a creditors' committee during the process.[70]

All types of composition agreements must be approved by either a majority of creditors representing two-thirds of the total debt or one-fourth of the creditors representing three fourths of the total debt.[71] That is, like chapter 11, approval is subject to a two-part voting rule, that looks to both the number of creditors approving the plan and the size of their claims.[72] If the agreement contemplates the use of a liquidator, that party is elected as part of the voting process.[73]

The agreement is then subject to review by the court.[74] Among other things, the court must find that any liquidation under the agreement will provide at least as much return to creditors as an ordinary bankruptcy proceeding, and the agreement must provide adequate security for all priority claims as well as claims incurred during the course of the proceedings.[75] The latter requirement has been criticized inasmuch as it restricts the debtor's available cash, further diminishing the possibility of a successful reorganization.[76]

---

[69] SchKG Art. 317 ¶ 1.
[70] SchKG Art. 320 ¶ 1.
[71] SchKG Art. 305.
[72] *See* 11 U.S.C. 1126.
[73] SchKG Art. 317 ¶ 2.
[74] SchKG Art. 306.
[75] SchKG Art. 306 ¶ 2; *cf*. 11 U.S.C. § 1129(a)(7) (providing that all chapter 11 plans must provide at least as much recovery as creditors would realize in chapter 7).
[76] von der Crone et al., *supra* note 49, at __.

Indeed, corporate restructuring in Switzerland, like many European jurisdictions, revolves around the sale of troubled companies.[77] Even though the ordinary composition agreement provisions of the statute would seem to contemplate a reorganization plan as understood in the United States, commentators report that "almost all composition proceedings under [the Swiss bankruptcy law] end in liquidation."[78] Smaller businesses are often sold to a new entity organized by the previous owners,[79] a process that mirrors that used to reorganize American railroads in the late nineteenth and early twentieth centuries.[80]

Upon the approval of an agreement, the Swiss law provides for dismissal of all pending debt enforcement actions against the debtor – in essence, the debtor is discharged.[81] But the agreement does not affect a creditor's right to proceed against collateral, which further limits the ability to achieve reorganization as understood by American bankruptcy lawyers.[82]

The restructuring judge does have a limited ability to prevent foreclosure on real estate for up to a year.[83] To achieve such a stay, the debtor must show that it is not more than one year behind

---

[77] Oscar Couwenberg, *Survival Rates in Bankruptcy Systems: Overlooking the Evidence*, 12 Euro J. L. & Econ. __ (2001).

[78] von der Crone et al., *supra* note 49, at 520 n.18.

[79] Isaak Meier, *"Prepackaged Chapter 11 Plan" – Chances and Limits of a Prenegotiated Reorganization in the Existing and Future Swiss Insolvency Law*, in THE CHALLENGES OF INSOLVENCY LAW REFORM, *supra* note 49, at 407, 412.

[80] *See* Lubben, *supra* note 5, at ___.

[81] SchKG Art. 311.

[82] *Id.*

[83] SchKG Art. 306a.

on interest payments to the creditor and that the real estate is vital to the debtor's business operations.[84] While this stay may allow the debtor to maintain its location, other important aspects of its business may be lost absent consent from the secured creditors.

In this regard, reorganization under the Swiss procedures is somewhat like the composition proceedings that existed under section 12 of the 1898 Bankruptcy Act – the only federal reorganization statute in the United States until the enactment of sections 77 and 77B in the early 1930s.[85] But as discussed in the next section, there are also some real similarities between post-2005 chapter 11 practice and the Swiss procedure, especially with regard to small business bankruptcy cases.

---

[84] *Id.*

[85] John E. Mulder & Charles M. Solomon, *Effect of the Chandler Act Upon General Assignments and Compositions,* 87 U. Pa. L. Rev. 763, 787-88 (1939). *See also* Bankruptcy Act of 1898, § 12, 30 Stat. 541 (1898). Most similarly, proceedings under section 12 did not discharge secured claims. *See* In re Dorb The Chemist, Inc., 3 F. Supp. 457, 459 (S.D.N.Y. 1933)

III. Convergence, Partially

Following the 2005 amendments to the U.S. Bankruptcy Code, small business chapter 11 cases clearly have taken on something of a European hue. The bankruptcy system has been directed by the legislature to become somewhat skeptical of debtors, and debtors are given a relatively short time to reorganize. Particularly for the smaller debtor, the system has clearly become more creditor-oriented.

In this sense the U.S. and Swiss systems have become similar. Both provide a limited opportunity to save a failing business, with a high degree of oversight by outside officials. And, as in Switzerland, smaller debtors in the United States are apt to find it increasingly difficult to navigate the chapter 11 process. More failed reorganizations, and liquidations, will be the inevitable result.[86]

For debtors generally, the 2005 amendments also bring the two jurisdictions together, albeit not quite as closely as in the specific case of small business debtors. Even large business debtors in the U.S. now face limits on their ability to control the chapter 11 process, although a loss of plan exclusivity is unlike the loss of the stay in the Swiss proceedings in fundamental respects – although possibly with similar functional outcomes. Once a creditor can propose a plan in the United States, the terms of that plan may call for a quick liquidation of the debtor, but at least the bankruptcy process itself does not come to an end.

[86] Elizabeth Warren & Jay Lawrence Westbrook, *The Success Of Chapter 11: A Challenge To The Critics*, 107 Mich. L. Rev. 603 (2009).

Perhaps more importantly, in the United States the cash requirements that a debtor faces post-filing have increased tremendously since the 2005 amendments, which created several new classes of favored creditors. This in turn creates the same liquidity problems in the United States that have been identified in Switzerland.

Of course, the degree of convergence is easy to overstate. Even a small business debtor in the U.S. still has a more powerful tool at its disposal than its Swiss counterpart. American debtors of all sizes can adjust their secured debts – reducing the secured claim to the value of the collateral and rescheduling payments on the remainder – where as Swiss proceedings have no effect on attempts to collect from the collateral, once the stay has been terminated.[87] American business debtors also benefit from a stay that goes into place upon filing the petition, and more direct control over the formulation of a reorganization plan.

At least in the small business area, it does seem like the two jurisdictions are headed to the same point. Indeed, immediately after 2005 it seemed as though the two jurisdictions might pass each other – with the Swiss system offering a better chance at reorganization -- a

[87] The Swiss deference to secured claims is not unusual, see Klaus Kamlah, *The New German Insolvency Act: Insolvenzordnung*, 70 Am. Bankr. L.J. 417, 428-29 (1996), and historically was the case in the United States. *See*, *supra* note 85. *See also* Wataru Tanaka, *Extinguishing Security Interests: Secured Claims In Japanese Business Reorganization Law And Some Policy Implications For U.S. Law*, 22 Bank. Dev. J. 427 (2006). On the other hand, the high degree of secured debt seen in the U.S. would probably mean that such a system would be ineffectual. Elizabeth Warren & Jay Lawrence Westbrook, *Contracting Out of Bankruptcy: An Empirical Intervention*, 118 Harv. L. Rev. 1197, 1222 (2005).

phenomenon also noted with regard to U.S. personal bankruptcy. [88] But in the past year, particularly following the inability of Circuit City to reorganize, Congress and others have begun to question the wisdom of the 2005 business bankruptcy amendments.[89] In short, it is not entirely clear which way American business bankruptcy is moving.

That being said, before making the U.S. system any "weaker" or "stronger," it bears learning from other developed economies, particularly ones like Canada and Switzerland that have dual legal systems like the United States. And the Swiss experience does suggest that a shortened procedure is not clearly an overall good – a point many of the 2005 Amendments seem to have missed.[90]

---

[88] Jason Kilborn, *Out with the New, In with the Old: As Sweden Aggressively Streamlines Its Consumer Bankruptcy System, Have U.S. Reformers Fallen Off the Learning Curve?*, 80 Am. Bankr. L.J. 435 (2007).

[89] *E.g.,* Anousha Sakoui, *Call for reform of bankruptcy code: Specialists seek US Chapter 11 rethink,* Fin. Times, July 22, 2009, at 3.

[90] *Cf*. Warren & Westbrook, *supra* note 86, at 626 (noting how stories of the delay associated with chapter 11 have influenced reform efforts in other jurisdictions).

IV. Conclusion

This article has provided a brief overview of the Swiss business bankruptcy procedure, contextualized by reference to recent developments in the United States. The basic story told is one that, on a general level, could be told with many European jurisdictions – while these jurisdictions have been moving toward more of a flexible, reorganization based system, the United States amended chapter 11 to reduce its utility.[91] The Swiss example, however, is especially interesting given Switzerland's federal structure, as well as its unique role, especially among Continental jurisdictions, as a financial center. Both make Switzerland and the United States particularly relevant to each other when it comes to business bankruptcy.

---

[91] Lubben, Stephen J., *Systematic Risk & Chapter 11*(May 4, 2009). Temple Law Review, 2009; Seton Hall Public Law Research Paper No. 1399015. Available at SSRN: http://ssrn.com/abstract=1399015.