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เล่ม ๖ ปีที่ ๔๓ เมษายน–มีนาคม ๒๕๔๗

OVERVIEW OF THE UNITED STATES
BANKRUPTCY LAWS
BURTON R. LIFLAND
UNITED STATES REORGANIZATION LAW
SAMUEL L. BUFFORD

บทคัดย่อ : กฎหมายที่นิยมใช้ในการขอทรัพย์ที่เป็นภัย
การพิจารณาล้มละลาย
ความผิดเรื่องพระราชบัญญัติหลักทรัพย์และตลาดหลักทรัพย์ พ.ศ. ๒๕๓๕
(ตอนที่ ๔)

สุรพล การประชุมศาลขั้นต้นของประเทศไทยต่างๆ ในกฎหมายธุรกิจ
ณ ประเทศไทย กรุงเทพฯ ระหว่างวันที่ ๒๙–๓๑ กรกฎาคม ๒๕๔๕

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สุรนิล สนธิวงศ์

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วัฒนธรรม

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นายทอง

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ขวบ

"นายบ่อย"

กิตติศักดิ์ ปาริณ

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ชุติ นิติศาสตร์
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บทคัดย่อ: กฎหมายพัฒนาภูมิการของสถาบันธุรกิจ
โดย อุปีรศิลป์ พุทธศุษิตตา

การพัฒนาภูมิการในคดีมั่นคง
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ความรู้เรื่องพระราชบัญญัติหลักทรัพย์และตลาดหลักทรัพย์ พ.ศ. ๒๕๓๕ (คอมมิชชั่น ๕)
โดย สัทธิ นงหิริภัษ

สรุปผลการประชุมพิจารณาข้ามแดนของประเทศต่างๆ ในญี่ปุ่นเกี่ยวกับการพิจารณา ณ ประเทศสหรัฐอเมริกา ระหว่างวันที่ ๑๕-๒๖ กรกฎาคม ๒๕๔๒
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สารบัญ

ปัญหาการร่าง
โดย ชวลิต ยัปยะศรี .......................................................... 165

สิ่งที่มีเรื่อง ฟ้องพระ (ตอนที่ ๒)
โดย ประทีป อ้วนวิจิตรกุล .................................................... 137

คำสั่งคุ้มครองศาลฎีกา
โดย ชวลิต จันทร์ครับ เอกคติ์ อันครภรณ์ .................................. 153

คุณภาพ พระราชทานคำสั่ง ออกปี ๒๑ เลม จัดทำโดยสำนักงาน
ส่งเสริมงานคุ้มครอง เพื่อเผยแพร่ความรู้ด้านกฎหมายและวิชาการต่าง ๆ ที่
เป็นประโยชน์แก่พื้นที่กฎหมายและข้าราชการกระทรวงยุติธรรม
สอบถาม ส่งข้อความ ข่าวสารได้ที่ ๗ ๙๔๑๒๒๒, ๙๔๑๒๔๔
Fax ๙๔๑๒๐๐๘, ๙๔๑๒๐๔
UNITED STATES REORGANIZATION LAW

Samuel L. Bufford*

UNITED STATES REORGANIZATION LAW
I. INTRODUCTION

Thailand is in the process of revising its bankruptcy law to permit businesses to reorganize their financial affairs. This will give businesses an alternative to liquidation. The purpose of bankruptcy reorganization is principally to preserve the value of a business as a whole, which is lost if its pieces are sold separately.¹

It takes time and it costs money to assemble the components of a business. These components include establishing a business location adapted to the functions of the business, purchasing business equipment and setting it up, locating suppliers and establishing business relationships with them, finding markets and establishing relationships with purchasers of finished goods or services, hiring and training a labor force, and educating management and supervisors in effectively conducting the business. The salvage value of deployed assets is always less than the value of undeployed assets, because of the salvage costs. So long as there is a market for the goods or services provided by the business, an established business enjoys a very substantial advantage over a new business because of these factors.

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UNITED STATES REORGANIZATION LAW

This difference is recognized in the market place: we call it the “going concern value” of a business. One of the principal purposes of business reorganization is to preserve this going concern value, and to divide it between creditors and the debtor’s owners.²

II. UNITED STATES BUSINESS REORGANIZATION LAW

A. Background

The laws of many countries provide the traditional bankruptcy solution to an insolvent business enterprise: appoint an official to close the business, sell the assets, and distribute the funds to the creditors (generally on a pro rata basis).³ Essentially all bankruptcies in the United States took this form before 1933.⁴

In 1933, at the height of what we call our “Great Depression”, the failure of businesses became so common place that the entire economy was in danger of collapse.⁵ The stock market had lost more than 80% of its value, and the unemployment rate exceeded 25%.⁶ The United States amended its bankruptcy law at that time in an attempt to keep businesses going and to preserve jobs.⁷ After

⁵ See Collier, supra note 4, § 1100A.05.
several subsequent revisions, the principal reorganization provisions were
codified in chapter 11 of our bankruptcy code.8 This article describes the main
features of the chapter 11 process in the United States.

B. Other Types of Reorganization

Three other chapters of the United States Bankruptcy Code provide for
the reorganization of non-business entities. Chapter 13 provides a simplified form
of reorganization for consumer debtors.9 Chapter 12 provides a similar simple
reorganization structure for family farms.10 Chapter 9 provides for the reorganiza-
tion of governmental entities (such as Orange County, California, which has
recently been prominent in the news).11

One other type of reorganization is common. Frequently a debtor and its
creditors negotiate a plan to restructure the debtor’s financial affairs without a
bankruptcy case. Because the rights of the debtor and the creditors under chapter
11 are generally well known, a reorganization plan outside of bankruptcy can
frequently be negotiated, and the bankruptcy costs and delays can be avoided.
These negotiations take place “in the shadow of bankruptcy,” because the parties
expect a chapter 11 bankruptcy case to result if the negotiations fail. The result
is usually similar to a chapter 11 plan. In the United States we call this a non-
bankruptcy “workout,” because the parties work out the financial problems
without filing a bankruptcy case.12

1995.
12. See In re Pengo Indus., 962 F.2d 543, 547 (5th Cir. 1992), cert. denied, 113 S. Ct. 602 (1992); In re Chateaugay Corp.,
961 F.2d 378, 381 (2d Cir. 1992); See also generally A Practical Guide To Out-Of-Court Restructurings (Nicholas
C. Concepts Common to Liquidations and Reorganizations

1. Secured Creditors

United States law divides creditors into two basic categories: secured creditors and unsecured creditors. A secured creditor is a creditor who has a right to cause the sale of specified property ("collateral") for the payment of the debt if the debtor does not voluntarily pay. The property that provides security for the debt is normally voluntarily mortgaged by the debtor as an inducement to obtain credit. However, taxing agencies and unsecured creditors with court judgments can also obtain liens against specific property to satisfy debts owing to them.

Unsecured creditors, in contrast, have no right to require the sale of specific property if the debtor fails to pay. Thus unsecured creditors enjoy a less favored status under United States law, including United States bankruptcy law.

The rights that secured creditors have in the collateral securing their debts are recognized as property rights under United States law. These property rights enjoy constitutional protection, and limit what a debtor may do (absent creditor consent) during a bankruptcy case. Generally, a debtor must provide "adequate protection" for a secured creditor security interest as a condition of the nonconsensual use of the property at issue during a bankruptcy case. In contrast, consent of unsecured creditors (or a court order) is required only for use of property.

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18. See American Mariner, 734 F.2d at 435.
outside of the ordinary course of business during a bankruptcy case.\textsuperscript{20}

2. Involuntary Cases

More then 99\% of all United States bankruptcy cases are voluntarily filed by debtors.\textsuperscript{21} More then 800,000 bankruptcy cases are filed each year, and 15,000 to 20,000 are filed under chapter 11.\textsuperscript{22}

United States bankruptcy law permits creditors to file an involuntary bankruptcy case against the debtor.\textsuperscript{23} Involuntary cases are rarely filed under chapter 11, principally because the chapter 11 filing fee is $800, while the filing fee under other chapters is $160 to $200.\textsuperscript{24} However, an operating business is frequently permitted to convert an involuntary liquidation case to a chapter 11 case.\textsuperscript{25}

3. Automatic Stay

The filing of a bankruptcy case immediately invokes an automatic stay against all creditor collection actions against the debtor or the debtor's property.\textsuperscript{26} In effect this is a broad and temporary injunction, the broadest available under United States law.\textsuperscript{27} Unlike other injunctions, it is imposed automatically when a bankruptcy case is filed: the debtor has no need to show the need for an injunction, creditors have no opportunity to object, and it is effective even against creditors who have no notice that a bankruptcy case has been filed.\textsuperscript{28} Creditor

\textsuperscript{21} 1.4\% of chapter 11 cases are filed by creditors. See Admin. Office of the U.S. Courts, Tables of Bankruptcy Statistics for the Twelve Month Period Ended June 30, 1988 (260 of 18,629 chapter 11 cases were involuntary filings).
collection actions in violation of the automatic stay are void, but a creditor who takes action without notice of the automatic stay is excused from paying punitive damages.\textsuperscript{29}

The policy behind the automatic stay is to protect the estate from depletion by creditors’ lawsuits and seizures of property before the debtor has had a chance to marshal the assets.\textsuperscript{30} The automatic stay is also intended to give debtors breathing room by stopping all collection efforts, all harassment, and all foreclosure actions.\textsuperscript{31} Additionally, the automatic stay prevents piecemeal dismemberment and allows the debtor time to reorganize.\textsuperscript{32}

In many countries, such as Canada, Great Britain, and Australia, the automatic stay does not apply against a secured creditor.\textsuperscript{33} However, in the United States secured creditors are subject to the automatic stay.\textsuperscript{34} Unlike unsecured creditors, however, secured creditors frequently qualify for relief from the automatic stay. To qualify for such relief, they must show that the debtor has no equity in the property and that it is not necessary for an effective reorganization, or show some other cause such as the lack of adequate protection.\textsuperscript{35}

D. The Chapter 11 Process

Like any other bankruptcy case in the United States, a chapter 11 bank-

\footnotesize{\begin{itemize}
\item[31.] 11 U.S.C. § 362 (1995), Historical and Revision Notes.
\item[32.] See In re Computer Communications, Inc., 824 F.2d 725, 731 (9th Cir. 1987); see also United States v. Nicolet, Inc., 857 F.2d 202, 206 (3d Cir. 1988).
\end{itemize}}
ruptcy case begins with the filing of a two-page bankruptcy petition.\textsuperscript{36} It also requires the payment of an $800 filing fee.\textsuperscript{37}

The filing of the bankruptcy case creates a bankruptcy estate, which consists in all of the debtor’s property at the time of filing.\textsuperscript{38} The estate is considered a separate legal entity for many purposes, which is distinct from the prepetition debtor.\textsuperscript{39}

Within 15 days after filing the petition, the debtor is required to file a list of secured and unsecured creditors.\textsuperscript{40} It is also required to file a detailed disclosure of its present financial status and its important transactions within the prior year.\textsuperscript{41}

1. Early Procedures in the Case

Shortly after the filing of a chapter 11 case, the United States trustee (a regional official in the United States Department of Justice) appoints a committee of creditors to oversee the reorganization process.\textsuperscript{42} There are generally seven members of the committee, who are chosen from the ten largest unsecured creditors. The committee hires its own legal counsel and sometimes other professionals at the expense of the estate.\textsuperscript{43} The committee members are entitled to compensation from the estate for attending meetings, but are not paid any other compensation.\textsuperscript{44}

Immediately after the filing of a reorganization case, the debtor’s counsel

\textsuperscript{36} Fed. R. Bankr. P. 1002(a); Official Bankr. Forms, 1 & 5.
\textsuperscript{39} See Havelock v. Tasei (In re Pace), 67 F.3d 187, 192(9th Cir. 1995).
\textsuperscript{40} 11 U.S.C. § 521(1); Fed. R. Bankr. P. 1007(a), (c), (d).
applies for court approval for his or her employment.45 While the debtor's choice of counsel is rarely disapproved by the court, it examines the terms and conditions of employment, and makes a determination that counsel has no conflict of interest.46

Legal counsel for the debtor and for the creditor's committee, as well as other professionals that may be retained on either side, are entitled to compensation from the bankruptcy estate.47 They may each apply for interim compensation no more frequently than every four months during the case.48 After confirmation of the plan, the court holds a final fee hearing, and makes final fee awards.49

The court must also set a deadline for filing claims against the bankruptcy estate.50 Notice of the deadline must be given to creditors.51 However, a creditor is not required to file a claim if the debtor's statement of financial affairs clearly admits that the debt is unpaid and owing.52

2. Objection to Claims

As in a liquidation case, in a chapter 11 case it is necessary to examine claims and to litigate those that are objectionable. While any party in interest has a right to object to a claim,53 the claims analyses and objections are usually handled by the debtor's attorney. Sometimes the attorney for the creditor's committee files claims objections.

3. Avoidance Actions

A chapter 11 debtor, like a chapter 7 trustee, also has the power to avoid certain prepetition transactions. A creditor who has received a payment that is avoided must return the funds to the estate. In certain circumstances the payment of antecedent debts within 90 days of filing the bankruptcy case can be avoided, and payment of debts to insiders can be avoided up to a year before the filing.

There is no principle that dictates these time limitations: before 1979 United States law provided for recovery of payments made up to 120 days before the bankruptcy petition was filed. Eastern european countries have adopted varying “rollback” periods for the avoidance of preferential payments.

Certain payments made to preferred creditors within the 90 days are not avoidable. Such payments include contemporaneous exchanges, payments made in the ordinary course of business and according to ordinary business terms, and payments after which the creditor has extended new credit. In addition, payments to fully secured creditors are not recoverable.

In addition, a fraudulent transfer for less than equivalent value may be

55. 11 U.S.C. § 547(b) (1995); Ehriing v. Western Community (In re Ehriing), 900 F.2d 184, 186 (9th Cir. 1990).
57. See, e.g., Great Britain’s Insolvency Act 1986 (c 45), 341 Relevant Time under §§ 339, 340; West Germany’s Konkursordnungen §§ 36, 37(1).
58. For example, Romania’s time limitation is set at 120 days. Romania, Law Governing the Procedure of Reorganization and Liquidation, Art. 40(1)(d)-(f) (1995); Bulgaria’s time limitation is set at three months. Bulgaria, Commercial Code Act, Ch. 37, Art. 64 (1994). Croatia’s time limitation is set at thirty days. Republic of Croatia, Draft Law on Bankruptcy, Pt. 3, Art. 9 (Proposed Official Draft 1995).
61. See Sloan v. Zions First National Bank (In re Castletons, Inc.), 990 F.2d 551, 554 (10th Cir. 1993) (citing COLLIER, supra note 4, § 547.08).
avoided and the funds must be returned to the estate. This generally includes gifts and transfers of property by the debtor at substantially discounted prices. Transactions that are vulnerable to fraudulent transfer recovery may have occurred several years before the bankruptcy filing. In addition to transfers intended to defraud, delay or hinder creditors, United States law permits the avoidance of transfers for less than reasonably equivalent value if (1) the debtor was insolvent or rendered insolvent by the transaction, (2) the transaction left the debtor undercapitalized, or (3) the debtor intended to engage in a business or transaction for which it had insufficient remaining assets after the transfer at issue.

4. Who May Propose a Plan

Chapter 11 gives a debtor the exclusive right to file a plan of reorganization during the first 120 days of the case. If a debtor files a plan during this period of time, the time is extended for an additional 60 days for the debtor to attempt to confirm the plan. After the exclusivity period expires, any creditor also has the right to propose a plan. While the bankruptcy court is authorized to extend these periods of time for “cause”, in most of the United States it is uncommon to extend the exclusivity period except in large cases. In a typical chapter 11 case, it takes more than two years after the bankruptcy filing before a plan is confirmed. Thus creditors typically have a substantial period of time in which to propose a plan. While creditor plans are quite uncommon, the right to propose a plan has a substantial impact on the bargaining power of a creditor in negotiating a consensual plan with a debtor.

63. See, e.g., Joe T. Dehner Distas. v. Murry Owen Temple, 826 F.2d 1463, 1466 (5th Cir. 1987); In re Treadwell, 699 F. 2d 1050, 1050 (11th Cir. 1983).
5. Chapter 11 Plans

In due course a chapter 11 debtor (or creditor) proposes a plan of reorganization. If such a plan is not proposed in due course, the case is dismissed or converted to a liquidation case.

Before the plan is distributed to creditors, the plan proponent must also prepare a disclosure statement, and the court must find that it contains adequate information for creditors to make a decision on whether to vote for or against the plan. In addition to a plain English description of the main features of the plan, the disclosure statement must also contain historical financial information for the debtor, and projections as to its future profitability. The disclosure statement also explains why the debtor is in bankruptcy, and why it is now able to function without bankruptcy court protection.

The plan typically provides for payment in full of secured creditors, and a pro rata partial payment of unsecured creditors. It must provide for the payment in full of tax liens, typically over a period of six years. The reorganization plan frequently proposes to exchange equity in the business for creditor’s claims. The plan must divide creditors into classes according to their interests. Secured creditors must be classified separately from unsecured creditors, and unsecured creditors may be divided into several classes.

73. See Hall, 887 F.2d at 1043; Metrocraft, 39 B.R. at 568.
74. 11 U.S.C. § 1122 (1995); see, e.g., In re McClurkin, 31 F.3d 401, 405 (6th Cir. 1994); In re Rash, 31 F.3d 325, 327 (5th Cir. 1994).
77. 11 U.S.C. § 1122(a) (1995); COLLIER, supra note 4, 1122.03(4).
UNITED STATES REORGANIZATION LAW

Reorganization plans typically also provide for existing owners of the debtor to retain some or all of their equity interest in the business. So long as the plan is approved by the appropriate number of creditors, this does not raise a problem.

6. Confirmation Criteria

a. Consensual Plans

To qualify for confirmation as a consensual reorganization plan, the plan must be approved by a sufficient number of creditors holding a sufficient quantity of claims. More than half of the creditors in each voting class must vote in favor of the plan, and these creditors must hold two-thirds of the value of the claims in each class.\(^ {78} \) Non-voting creditors are ignored in determining whether the plan has received sufficient votes.\(^ {79} \) Even though a plan receives sufficient votes in each class for confirmation, each creditor who votes against the plan must receive at least as much as the creditor would receive in a liquidation.\(^ {80} \)

In addition, a class is presumed to accept the plan (and does not vote), if the class is unimpaired.\(^ {81} \) A class is unimpaired if the plan does not alter the legal, equitable and contractual interest of any of the class members.\(^ {82} \)

In addition to receiving sufficient votes, a plan must satisfy a number of other requirements to qualify for confirmation.\(^ {83} \) The most important is that the court must find that confirmation is not likely to be followed by the need for further bankruptcy relief.\(^ {84} \) This is determined by examining the debtor's finan-

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79. 11 U.S.C. § 1129(a)(8), (b) (1995); see In re Kuhl-Sweetwater, Inc., 856 F.2d 1263, 1266 (10th Cir. 1988).
cial history and financial projections, and considering any other relevant evidence.85

b. Non-Consensual Plans

If a reorganization plan does not receive sufficient votes for consensual confirmation, confirmation is still possible if at least one impaired class has voted in favor of the plan.86 To qualify for such confirmation, the plan must meet the “absolute priority” rule, which requires that each class be paid 100% of its claims before a lower ranking class receives any payment.87 The principal impact of this rule is to require that all creditors be paid in full under the plan if existing owners are to retain any interest in the debtor.

There is an exception to the absolute priority rule for owners who are contributing “new value” to a business.88 If the new value is sufficient in amount to constitute a new capitalization of the business, the prior owners may retain an ownership interest on account of the new capitalization.89 The new value must be contributed in money or property readily convertible to money (it may not be future services by the owners), it must be retained in the business as new capital (and thus may not be used to pay unsecured claims under the plan), and it must be sufficient in amount to constitute a new capitalization.90 The new capitalization may need to reach 20% of the value of the assets of the business (determined without regard to the outstanding debt) for a new value plan to qualify for confirmation.

c. Plan Litigation

Two features of a reorganization plan frequently require litigation at the

86. In re Briscoe Enter., 594 F.2d 1160, 1166 (5th Cir. 1979).
87. 11 U.S.C. § 1129(b)(2)(c) (1995); see In re Woodbrook Assoc., 19 F.3d 312, 319-21 (7th Cir. 1994).
88. See Woodbrook Assoc., 19 F.2d at 319 (7th Cir. 1994) (citing Case v. Los Angeles Lumber Prods. Co., 308 U.S. 106, 121-22 (1939)).
89. Id.
90. Id.
time of confirmation. First, it is frequently necessary to determine the value of the business to see whether dissenting creditors are receiving as much as they would in a liquidation case. The valuation frequently results in testimony by competing experts on how much the business is worth.

Second, a secured creditor is entitled to a market rate of interest on any secured loan that is not to be paid off immediately upon confirmation. A reorganization plan frequently rewrites a secured loan, to extend its duration and to change its interest rate. This frequently produces litigation to determine the market rate of interest for the revised loan. This is particularly difficult to determine, because the revised loan frequently is for 100% of the value of the collateral, and there is no market for such loans. Courts have generally solved this problem by dividing loans into three parts. The first part includes 75% to 80% of the value of the collateral, for which there is a recognized market in which an interest rate is ascertainable. The second part, which covers the remainder up to 90% of the collateral, can also be priced in a recognized market at a somewhat higher interest. For the final 10%, the court adds an interest rate premium to compensate for the additional risk. The weighted average for the three parts is then calculated to determine the overall interest rate.

d. Effects of Confirmation

Once a plan of reorganization is confirmed, it goes into effect generally

91. See Tranel, 940 F.2d at 1172.
92. Id.
95. Id.
96. Id.
97. Id.
98. Id.
within a month of confirmation. The plan is binding on the creditors as well as
the debtor, and replaces the rights that the creditors held prior to the filing of the
bankruptcy case.\textsuperscript{99}

After the court has made final fee awards and the debtor has begun per-
formance under the plan of reorganization, generally the case is completed, and
the court can close the bankruptcy file.

7. Success Rate for Chapter 11 Cases

A plan of reorganization is confirmed in 17\% of chapter 11 cases in the
United States.\textsuperscript{100} Approximately 20\% to 30\% of the confirmed plans provide for
the liquidation of the debtor’s business.\textsuperscript{101} Thus 12\% to 14\% of the plans provide
for the continued existence of the debtor after plan confirmation.\textsuperscript{102} While many
think that 12\% to 14\% is not a high success rate for chapter 11 cases, going concern
value would be preserved in none of the cases if chapter 11 were not available
to businesses. Under chapter 11 the going concern value is preserved in at least
12\% of the cases through the confirmation of a plan of reorganization. In addi-
tion, the confirmation rate is much higher for large businesses, so that the economic
impact of successful chapter 11 reorganizations is much higher than the numbers
suggest.\textsuperscript{103}

Furthermore, the going concern value of a chapter 11 debtor is frequently
preserved without the confirmation of a plan of reorganization. Frequently the

\textsuperscript{100} Hard Times for Lenders Is Running Theme Through ABA Convention in the Big Easy, BNA BANKR. L. DAILY, Aug. 17, 1994.
\textsuperscript{101} See Ed Flynn, Statistical Analysis of Chapter 11, p. 12 (Oct. 1989) (unpublished manuscript, on file with Judge
Samuel Bufford). The Flynn study was based on statistics gathered by Ernst & Young in a study of 2395 chapter 11
cases in fifteen districts that had resulted in confirmed plans. Id. at 9. It also drew on data received from the bankruptcy
courts by the Statistical Analysis and Reports Division (SARD) of the Administrative Office of United States Courts.
Id., Introduction.
\textsuperscript{102} Id.
\textsuperscript{103} Flynn, supra note 101, at 11-12.
business is sold to a third party without the confirmation of a plan, and going concern value is preserved. In addition, some 30% to 40% of chapter 11 cases involve what we call “single asset real estate” cases: cases where the debtor owns a single commercial property or a multiple family dwelling, with a number of rent-paying tenants. Even if a secured creditor forecloses on the property, its going concern value is largely preserved in the foreclosure process.

When all of these factors are combined, chapter 11 preserves the going concern value of businesses in perhaps 40% of chapter 11 cases. Adequate statistics are not presently available, but a major study funded by the Endowment for Education of the National Conference of Bankruptcy Judges (the professional association of United States bankruptcy judges) is in the process of collecting and analyzing data that will provide much better information on this subject.

III. CONCLUSION

The United States has the most extensive experience of any country in the world on the reorganization of financially troubled businesses under bankruptcy law. The foregoing description of the legal structure and how it operates may be helpful to Thailand in determining what type of reorganization structure it wants.