

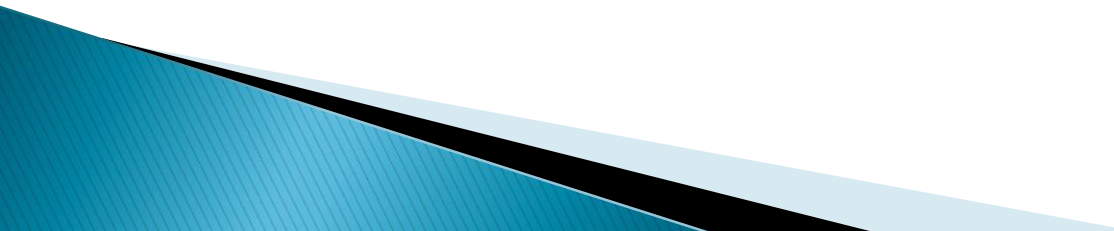
Polish Commercial Law

2. Insolvency law – basics

Dr Marek Porzycki



Standard debtor–creditor relation

- ▶ claim and liability
 - ▶ relevant only for the parties – usually no effect for third persons
 - ▶ the creditor can take recourse to compulsory enforcement → „grab law” – „first come – first served”
- 

Insolvency

- ▶ insufficiency of assets for total satisfaction of all debts
- ▶ relevant for other creditors
- ▶ Any payment to one creditor means less assets for covering the debtor's liabilities towards other creditors

→ CONFLICT BETWEEN CREDITORS

- ▶ Compulsory enforcement of a debt by one creditor harms all the other creditors
- ▶ on the margin: insolvency law or bankruptcy law? cf. Latin *concursum creditorum* / Italian *banca rotta*

Two forms of insolvency

- ▶ cash flow insolvency – the debtor has stopped to pay his debts as they fall due
Attention – insolvency vs. illiquidity
- ▶ balance-sheet insolvency – the debtor's total assets are worth less than his total liabilities

Traditional function of insolvency law

- ▶ **collective debt enforcement:**
 - including all assets of the debtor (→ **insolvency estate**)
 - in the interest of all creditors
 - within organized and orderly proceedings provided for by the law, aimed at achieving a just distribution among creditors

Two purposes: creditor satisfaction and maintaining social peace (avoiding chaotic and/or violent acts by creditors)

- ▶ ban on individual debt enforcement
- ▶ impact on almost all legal relations of the debtor → interactions with several branches of law

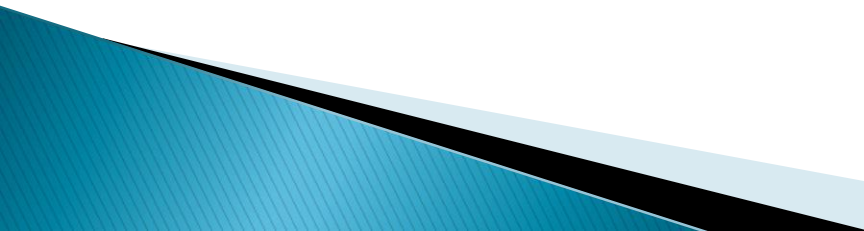
Stages of traditional insolvency proceedings

- ▶ taking over and assessment of the debtor's assets by an **external administrator/liquidator**
- ▶ verification of the debtor's liabilities/admission of claims
- ▶ possibility of invalidation of the debtor's previous acts detrimental to the creditors
- ▶ **winding-up** (liquidation) of the debtor's estate (mostly by sale)
- ▶ **distribution** of proceeds among creditors, depending on priority rules and/or collateral
- ▶ effect: winding-up of the debtor's enterprise. If the debtor is a legal person, in most cases it is dissolved.

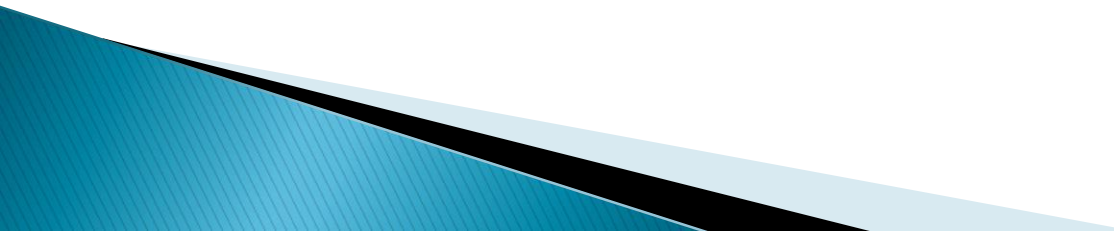
Restructuring – „modern” function of insolvency law

- restructuring distressed but viable enterprises → corporate rescue, „second chance”
- avoiding unnecessary liquidation → preserving jobs, avoiding further insolvencies („domino effect”)
- reducing losses of creditors and business partners → interest of a wider range of stakeholders involved
- preventing a further build-up of non-performing loans → improving financial market stability
- focus on preventive restructuring → early measures to prevent insolvency → applicable also in case of likelihood/threat of insolvency

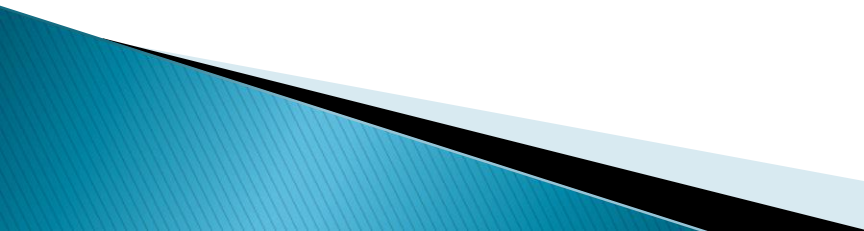
How can restructuring be achieved?

- ▶ sale of the entire enterprise to a new investor
 - ▶ negotiating an arrangement between the debtor and his creditors enabling a continued functioning of the debtor's enterprise. Varying complexity of solutions adopted.
 - ▶ typical feature of the arrangement: the majority of creditors overrule the minority → the arrangement is binding also on the minority voting against it („hold-outs“)
 - ▶ varying extent of the debtor's divestment – from 'debtor in possession' to administration by an external administrator/liquidator
- 

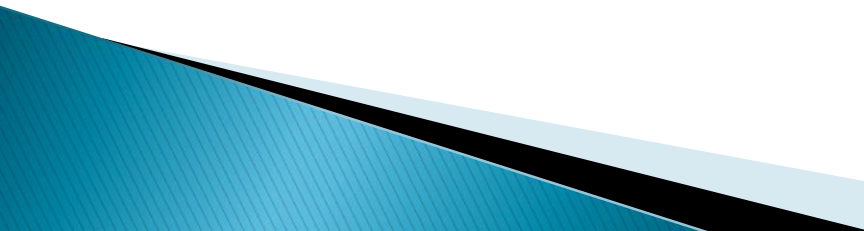
Potential drawbacks of restructuring?

- moral hazard?
 - keeping in existence unviable enterprises / outdated business models on „life support“ → preventing or delaying reallocation of resources to more productive uses
 - „creative destruction“ as a fundamental mechanism of the market economy
- 

Insolvency of individuals

- insolvency of individuals vs. corporate insolvency
 - „**fresh start**” – discharge of overindebted natural persons in order to reintegrate them into the economy and society
 - justification: social and economic reasons
 - potential drawbacks: moral hazard; a breach of the basic rule „*pacta sunt servanda*”
 - applicable to: consumers and/or entrepreneurs
 - one-off decision or (more often) after a specified „good behaviour” period or after partial payment of debts
- 

Bottom line: usual functions of (substantive) insolvency law

- creditor satisfaction - collective debt enforcement
 - restructuring
 - „fresh start“/discharge (in case of individuals)
- 

Further reading

- ▶ Th. Jackson, *The Logic and Limits of Bankruptcy Law* (any edition):
 - Introduction: The Two Roles of Bankruptcy Law
 - Chapter 1: The Role of Bankruptcy Law and Collective Action in Debt Collection[available on Google Books]
- 