

Creditor's (conflict of) interest during the bankruptcy proceeding

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Nowadays we are living in the golden age of involuntary dissolutions of companies . Starting from the liquidations' statistics, the role of the reorganization keeps growing. Its important to say, that the crisis management processes mostly cannot be solved indoors, the active assistance of the creditors is necessary. The regulated crisis management supported by law, which is to the debtor company's advantage doesn't operate satisfactory because of the special environment of the creditors, and because of their usually subjective, multi-coloured and controversial type of behavior.

1 The creditors' role during the reorganization process

The essential part of the reorganization process are the creditors. Considering that the further operating of the debtor corporation is the main condition of the reorganization, it is needed that its work by means of the creditors' patience and concession is guaranteed. The escape from the crisis is namely unimaginable without participating further sources. Among the creditors' authorizations the reorganization is threatened by the fact that according to the operating legislation, if the debtor don't fulfil or dispute his acknowledged or non-disputed contractual liability in 15 days after the contract expires and nor he fulfil it after the creditor written request for payment, the creditor is entitled to file a petition to the competent court to initiate the liquidation process. The final order for starting the process blocks the crisis management. At the same time we must mention that the creditors are not interested in the liquidation from the point of the refund of demand. Every year thousands of companies get under liquidation process, most of them entirely propertyless. [1]

Because of the debtor enterprises' financial condition the 90 % of the liquidation processes are simplified processes, on the other hand the creditors' claims are rarely settled, only the 2,8 % 1 of the claims are refunded (based on other sources

1 Based on my own research in Győr-Moson-Sopron county

this percent can be lower). It involves if the firm is recoverable, the creditors – theoretically – should prefer the reorganization to the liquidation. While the crisis management can mean the survival for the debtors, for the creditors their claims’return. Their goals are theoretically the same: to save the debtor company, which is in an economical crisis. But the creditors’ decisions are far not so definite.

2 Working out a theoretical model

Within the scope of bankruptcy proceeding conducted reorganization can be considered as a special situation, as the creditors not the management of the firm have the right to decide on the debtor company’s fate about their own opinions, decisions and informations. [2] If we want to study the deforming effect of the subjective factors within the creditors’ decisions we will need an objective, theoretical model. At a company the reorganization process can be considered in two steps along two questions.

1. **Was the company salvable?**
2. **Was the reorganization successful?**

The first question is a sort of situation report: it examines the depth of the crisis and considers from economical point of view if it was worth to do anything and were the negative processes reversible. The second question is about the quality of the crisis management. While the first question is a decidable question, the second is accessible from many ways. To simplify, I consider that procedure successful, which finishes with the long-lasting recovery of the firm.

The first illustration examines the company’s future as a function of the answers. Logically a crisis management cannot be successful if the firm is terminated. There can be only three results of the crisis management procedure:

		was the company salvable?	
		<i>yes</i>	<i>no</i>
Was the company reorganizable?	<i>yes</i>	continue working	-----
	<i>no</i>	terminate	terminate

1.illustration (own editing)

The theoretical model of the reorganizational decisions

The first illustration shows that the firms' survival can be guaranteed only if the crisis stays at a manageable level and the reorganization is successful. The model shows besides that logically there cannot be a situation when the company cannot be saved but the reorganization is prosperous.

3. Creditors' decisions during the bankruptcy proceeding

The essential goal of the bankruptcy proceeding is to help the debtor to solve his payment difficulties through an agreement with the creditors. The greatest advantage of the bankruptcy proceeding in contradiction to the non-regulated reorganization, that from the beginning date of the procedure – namely from that date when the application for the procedure arrives at the court – until the bankruptcy proceeding finishes liquidation and consummation cannot be initiated and most of the running procedures are suspended. The commence of the legally regulated reorganization is important for the debtor for the following reason too, because if during the procedure the court adjudicate a respite of payment the legal consequences of non-payment or postpayment won't come into force. During the bankruptcy proceeding there is at least two negotiations with the creditors. On the first negotiation the creditors decide if they agree with giving the 90 days respite of payment according to the Bankruptcy Law. The moratorium is the essential part of the bankruptcy proceeding: the debtor don't have to pay² his payable debts for 90 days so he has time to work out a reorganization plan which helps to get straight. [3]

So according to the prevailing law the moratorium is not assured automatically, a definite part of the creditors must agree. The agreement is guaranteed only if at the beginning of the procedure the simply majority of the overdue claims' owner and the quarter of the unexpired claims' owner contribute the debtor to make use of the respite of payment, presuming that these creditors' entire demand reaches the 2/3 of the creditor's entire demands that appears in the debtor's books. [4]

During the moratorium the debtor tries to agree with the creditors based on the reorganization program, agreement recommendations and the related consummation plans. The goal of the debtor is to convince the creditors that as a result of a substantial detailed situation analysis he is able to save the company for a longer period.

² The moratorium doesn't affect all debts of the debtor. In the 12 §. of the Bankruptcy Law there is a list of claims that don't belong to the moratorium: for example the claims based on employment relation, contributions, allowances, canal tolls, water-rates.

The decision levels at the bankruptcy proceeding are formally in accordance with the questions which were asked in our theoretical model. In the first step the debtors decide if the reorganization is worth in their opinion, namely: is the debtor able to recover? In the second step they analyse the reorganization program and the agreement recommendation submitted by the debtor, they namely qualify the reorganization.

Though we must emphasize that the creditors don't have and cannot have the adequate answers because of their external role.

It excel that during the bankruptcy proceeding the creditors decide in accordance with the question of the theoretical model. If the creditor's legally regulated part decides that the company is salvable, namely the crisis is returnable, the debtor gets the respite of payment and if they find the reorganization plan worked out during the period of the respite of payment satisfactory the crisis management can be considered as a success.

After filing an instance for bankruptcy proceeding according to the prevailing law the process can have 3 consequences:

<i>CONSEQUENCE</i>	<i>THEORETICAL RESULT</i>
The process is ceased without respite of payment	Terminate
The process is ceased after getting respite of payment but without an agreement of the creditors	Terminate
The process ends with giving respite of payment and during that time the creditors conclude the agreement	Survival

1. graph (own editing)

The theoretical results of the bankruptcy proceeding

If the company concerned by bankruptcy procedure after any consequences of the process is ceased or it continues in business can be showed through the ruling of the liquidation (as a form of termination). The second gaph shows the proceedings among the yearly published bankruptcy proceeding which finished with liquidation breaking down by their results. (The numbers in the brackets show the total amount of the bankruptcy proceedings belonging to every single year and their consequences.)

	Bankruptcy proceeding finished with agreement		Terminated after getting respite of payment		Terminated without getting respite of payment	
2003	2	(7)	8	(8)	2	(5)
2004	1	(4)	8	(9)	7	(9)
2005	0	(3)	8	(10)	7	(10)
Relation of liquidation	17,6%		89%		67%	

2. graph (own editing)

The „real” results of the bankruptcy proceeding

From the datas of the graph appears that a part of the firms which has conducted a successful bankruptcy proceeding are terminated with liquidation too. But its true though that among the bankruptcy processes published in 2005 – which – were finished later with creditor’s agreement – not any has been liquidated, but that can be a result of the relatively short period that elapsed since this study had been finished³. Moreover the datas show that every business corporations which didn’t get respite of payment (and so the bankruptcy proceeding wasn’t successful) weren’t liquidated, only the 67 % of them. In the remaining 33% the companies survived.

So our gap can be completed with another column, we need to examine the theoretical and the real results of the procedures.

CONSEQUENCE	THEORETICAL RESULT	PRACTICAL RESULT
The process is ceased without respite of payment	Terminate	survival 33% terminate 67%
The process is ceased after getting respite of payment but without an agreement of the creditors	Terminate	survival 11% terminate 89%
The process ends with giving respite of payment and during that time the creditors conclude the agreement	Survival	survival 82,4 % terminate 17,6 %

3. graph (own editing)

The theoretical and practical results of the bankruptcy proceeding

³ The study has been finished in March 2005

The debtor enterprise therefore – in opposite to the theoretical results of the decisions – can survive even though that most of the creditors adjudge that the company is not salvable and can be ceased with liquidation even though the necessary part of the creditors considers the reorganization successful.

The difference between the theoretical and the practical consequences is due to partly the absence of information that characterize the decisional situation of a creditor and partly to the subjectivity that comes from a distrust which is an essential characteristic of the creditors.

If we study every factor of the creditors' decisions – based on empiric datas – we can explain our model results which were inconceivable theoretically. Namely: there can be cases when the legally necessary part of the decision-makers judge that a company cannot survive, and after all it can conduct a successful reorganization. [3]

It can happen obviously because of two things: 1. the crisis was not real at all (in my opinion this is very unusual) 2. an external condition solves the problem, the creditors are dealing with it. Because of that the bankruptcy proceedings are rarely successful.

Resume

In the disfunctional operating of the institution of the bankruptcy there is a important role of the creditors' decisions and their anomalies. While the main motivation of the creditors by the decisions connected with the reorganization proceedings is to collect on their debts, they decide against the reorganization and it is because they rely on the one hand on their incomplete informations in connection with the debtor company, on the other hand on their own feelings and impressions that if they decide against the reorganization there can be an external impact that solves the crisis or they trust that the demands of the „obstinate” minority may be refunded to save the bankruptcy procedure. The anticipations of the creditors for the further status of the debtor firm are different of necessity. Based on the strongly proportioned interests of the creditors the chance of a successfully conducted reorganization proceeding is very minimal in advance.

References

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[4] Hungarian Bankruptcy Act (1991/XLIX.)