

**Towards a New Bankruptcy Regime for Oman: Lessons Taken from the  
Experience of Both England and the US**

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## **Abstract**

The main aims of this thesis are to assess the efficiency of the current bankruptcy system in Oman and to offer specific proposals for bankruptcy reform to be adopted by the Omani legislator. Where appropriate, in proposing solutions for various issues lessons will be taken from the experience of both England and the US.

This thesis consists of six chapters. The first chapter is a general introduction to the thesis which outlines the structure and scope of the study. Chapter Two critically explores the main theories underpinning bankruptcy law across the world. The aim of this exploration is to provide a general understanding of the policies underpinning bankruptcy laws and to establish the view of this thesis. Chapter Three discusses the experience of England and the US by identifying the main differences and similarities between bankruptcy proceedings in these jurisdictions; such discussion is necessary as a basis for determining the possibility of taking lessons from these developed bankruptcy regimes. Chapter Four provides a critical analysis of the current bankruptcy regime in Oman and outlines the key features of this regime. This chapter also discusses in detail the main issues with the current bankruptcy regime. This discussion includes: (1) the definition of bankruptcy; (2) the qualification of persons administering bankruptcy processes (3) ranking of creditors; (4) position of employees; (5) available alternatives under the current regime; and (6) the effect of declaration of bankruptcy on existing contracts. Chapter Five outlines the possibility of legal transplants and why it is desirable for Oman to adopt some of the bankruptcy principles that are found in England and the US. However, to avoid the risk of rejection of such transplants, this thesis will highlight the necessity of assessing the functionality and workability of western bankruptcy principles before transplanting them. This chapter also offers a proposal for future bankruptcy reform in Oman. Such reforms include having a clear statutory mandate, making bankruptcy law certain and predictable, and establishing a bankruptcy regime that encourage the rehabilitation of viable

enterprises instead of liquidating them. Chapter Six is the overall conclusion of this thesis which explains the main ideas discussed and highlights the main contributions made by this study.

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## Journal Abbreviations

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A.B.I.L.R.	American Bankruptcy Institute Law Review
A.B.L.J.	American Bankruptcy Law Journal
A.E.L.	Atlantic Economic Journal
A.J.C.L.	American Journal of Comparative Law
A.J.C.L.	Australian Journal of Corporate Law
A.L.Q.	Arab Law Quarterly
B.B.L.J.	Berkeley Business Law Journal
B.C.I.C.L.R.	Boston College International and Comparative Law Review
B.D.J.	Bankruptcy Development Journal
B.J.I.B.F.L.	Butterworth's Journal of International Banking and Financial Law
B.Y.U.L.R.	Brigham Young University Law Review
C.I.L.J.	Cornell International Law Journal
C.J.I.C.L.	Cardozo Journal of International and Comparative Law
C.L.	Company Lawyer
C.L.J.	Cambridge Law Journal
C.L.N.	Company Law Newsletter
C.L.R.	Cardozo Law Review
C.L.W.R.	Common Law World Review
C.R.I.	Corporate Rescue and Insolvency
C.R.I.J.	Corporate Rescue & Insolvency Journal
D.L.J.	Dalhousie Law Journal
E.B.D.J.	Emory Bankruptcy Development Journal
E.B.O.L.R.	European Business Organization Law Review
E.E.R.	European Economic Review
E.J.C.L.	Electronic Journal of Comparative Law
E.J.I.L.	European Journal for International Law
E.J.I.S.	European Journal of Interdisciplinary Studies
E.J.L.E.	European Journal for Law and Economic
E.J.L.R.	European Journal of Law Reform
E.J.P.S.	Egyptian Journal of Political Science
E.L.R.	Environmental Law Review
F.M.J.	Financial Management Journal
G.E.R.	Gas and Energy Resources
G.J.L.P.P.	Georgetown Journal of Law & Public Policy
H.I.L.J.	Harvard International Law Journal
H.L.R.	Harvard Law Review
I.B.L.J.	International Business Law Journal

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I.C.C.L.R.	International Company and Commercial Law Review
I.C.L.Q.	International and Comparative Law Quarterly
I.C.L.R.	International and Comparative Law Review
I.C.R.	International Corporate Rescue
I.I.	Insolvency Intelligence
I.J.I.O.	International Journal of Industrial Organization
I.J.L.C.	International Journal of Law in Context
I.J.L.I.	International Journal of Legal Information
I.J.L.M.	International Journal Law & Management
I.L.J.	International Law Journal
I.L.	Insolvency Lawyer
I.L.P.	Insolvency Law and Practice
Indian L.J.	Indian Law Journal
J.B.L.	Journal of Business Law
J.B.R.	Journal of Banking Regulation
J.C.L.S.	Journal of Corporate Law Studies
J.F.E.	Journal of Financial Economics
J.I.B.L.	Journal of International Banking Law
J.P.	Journal of Philosophy
J.P.E.	Journal of Political Economy
J.V.I.	The Journal of Value Inquiry
J.L.S.	Journal of Legal Studies
J.L.E.O.	The Journal of Law, Economics and Organization
J.S.L.	Journal of Shari'a and Law
L.C.P.	Law and Contemporary Problems
L.Q.R.	Law Quarterly Review
L.M.C.L.Q.	Lloyd's Maritime and Commercial Law Quarterly
L.U.L.R.	Lowa University Law Review
M.L.R.	Minnesota Law Review
M.L.R.	Michigan Law Review
M.L.R.	Modern Law Review
N.I.L.Q.	Netherland Ireland Legal Quarterly
N.L.J.	Nottingham Law Journal
N.U.L.R.	Northwestern University Law Review
O.J.L.S.	Oxford Journal of Legal Studies
O.U.L.R.	Osaka University Law Review
O.R.E.P.	Oxford Review of Economic Policy
P.T.L.	Practical Tax Lawyer

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Q.J.INSOL.I.	Quarterly Journal of INSOL International
R.C.L.	Review of Columbian Law
S.J.L.S.	Singapore Journal of Legal Studies
S.L.R.	Stanford Law Review
T.L.R.	Texas Law Review
U.B.C.L.R.	University of British Columbia Law Review
UCL J.R.	UCL Jurisprudence Review
U.C.L.R.	University of California Law Review
U.C.L.R.	The University of Chicago Law Review
U.P.J.I.E.L.	University of Pennsylvania Journal of International Economic Law
U.P.L.R.	University of Pennsylvania Law Review
V.L.R.	Vanderbilt Law Review
V.L.R.	Virginia Law Review
W.L.L.R.	Washington and Lee Law Review
W.U.L.Q.	Washington University Law Quarterly
W.Y.A.J.	Windsor Yearbook of Access to Justice
Y.L.J.	Yale Law Journal

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## Chapter One: Introduction

### 1.1 Background

Bankruptcy law is a vital and an essential law because it is a central part of the economy.<sup>1</sup> This is in part due to the fact that the flows of Foreign Direct Investment (FDI) might be determined by the efficiency and ‘the quality’<sup>2</sup> of the legal system<sup>3</sup> in the host country.<sup>4</sup> It is stated<sup>5</sup> that, before choosing their preferred markets, investors normally look at the effectiveness of bankruptcy laws in the targeted markets.<sup>6</sup>

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<sup>1</sup> Perry A., ‘Effective Legal System and Foreign Direct Investment: In Search of the Evidence’, (2000) 49 (4) I.C.L.Q 779, p. 779; Moskvan D. & Vrbova V., ‘Connecting the Dots: Attracting Foreign Direct Investment Through Harmonisation of European Insolvency Law’, in Belohlavek A. & Rozehnalove N., *Regulatory Measures and Foreign Trade 2013*, (Czech Yearbook of International Law, 2013), p. 50; Hornberger K., Battat J., & Kusek P., ‘Attracting FDI: How Does Investment Climate Matter’, view point, World Bank, available at:

<http://siteresources.worldbank.org/FINANCIALSECTOR/Resources/327-Attracting-FDI.pdf>. accessed on 31/12/2012.

<sup>2</sup> Hornberger K., Battat J., & Kusek P., *ibid.*

<sup>3</sup> Perry A., above 1, p. 779; ‘World Bank Doing Business Report: 2013’, p. 47, available at: <http://www.doingbusiness.org/~media/GIAWB/Doing%20Business/Documents/Annual-Reports/English/DB13-full-report.pdf>. accessed on 31/01/2012.

<sup>4</sup> For the importance of reforming and transplanting bankruptcy law: see below sections 5.3.1 & 5.3.2.

<sup>5</sup> Moskvan D. & Vrbova V., above 1, p. 50; Kastrinou A., ‘Forum Shopping under the EC Regulation on Insolvency Proceedings’, (2013) 24 (1) I.C.C.L.R. 20, p. 22; Belohlavek A., ‘Center of Main Interest (COMI) and Jurisdiction of National Courts in Insolvency Matters (Insolvency Status)’, (2008) 50 (2) I.J.L. & M. 53.

<sup>6</sup> Nonetheless, it is worth noting that the efficiency of bankruptcy law might be one of the determinants of FDI. There is much literature on behavioural economics that has analysed the determinants of FDI decisions: see Bockem S. & Tuschke A., ‘A Tale of Two Theories: Foreign Direct Investment Decisions from the Perspectives of Economic and Institutional Theory’, (July 2010) SBR 62, pp. 260-290, available at:

Further, it is believed<sup>7</sup> that building a viable bankruptcy system will help fuel a market economy.<sup>8</sup> Thus, it is not enough for countries to have in place laws that regulate the starting up of a business. Rather, it is crucial to have bankruptcy laws that regulate exit from the market. In this regard, it is argued that<sup>9</sup> having such laws may help in accelerating the rate of economic growth and may have an impact on saving and creating jobs.<sup>10</sup> In acknowledgment of its importance, many countries<sup>11</sup> have promulgated laws that are designed to deal with bankruptcy cases.<sup>12</sup>

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[http://www.sbr-online.de/pdfarchive/einzelne\\_pdf/sbr\\_2010\\_july\\_260-290.pdf](http://www.sbr-online.de/pdfarchive/einzelne_pdf/sbr_2010_july_260-290.pdf). accessed on 02/01/2014 (They analysed FDI from the perspective of economic and institutional theory. Their result showed that a firm's decision to engage in a foreign market is influenced by the attractiveness of the target market and by prior FDI decision of large and successful peers); see also Bolnigen B., 'A Review of the Empirical Literature on FDI Determinants', (2005) 33 A.E.J. 383 (This paper surveyed the literature on the determinants of Multinational Enterprises decisions and FDI location across the world. However, this study concluded by asserting that "the empirical literature on determinants of FDI is still young enough that most hypotheses are still up for grabs"): see pp. 397-398.

<sup>7</sup> Martin N., 'The Role of History and Culture in Developing Bankruptcy and Insolvency Systems: The Perils of Legal Transplantation', (2005) 28 B.C.I.C.L.R. 1, p. 4.

<sup>8</sup> In this regard, China, Indonesia, Hong Kong and Malaysia have attempted to establish a reorganisation regime for failing traders like Chapter 11 of the US Bankruptcy Code: see Tomasic R., Little P., Francis A., Kamarul K. & Wang K., 'Insolvency Law Administration and Culture in Six Asian Legal Systems', (1996) 6 A.J.C.L. 248, p. 248; Martin N., above 7, p. 4.

<sup>9</sup> Helmy O., 'The Efficiency of the Bankruptcy System in Egypt', (2005) Working Paper No. 100, E.C.E.S. 1-27, p. 1; for further discussion: see below pp. 305-306.

<sup>10</sup> Ibid.

<sup>11</sup> The UK Enterprise Act 2002, French Business Safeguard Act of 2006 and German Company Restructuring Facilitation Act of 2012; also China, Indonesia, Hong Kong and Malaysia have already reformed their bankruptcy laws: see Tomasic R., Little P., Francis A., Kamarul K. & Wang K., above 8, p. 248.

<sup>12</sup> In this regard, it is worth noting that while some countries have a separate bankruptcy/ insolvency law to regulate the insolvency and liquidation of traders, others do not have a separate bankruptcy law. Examples of countries that have separate bankruptcy laws are: the US Bankruptcy Act of 1978, the UK Insolvency Act 1986 & the UK Enterprise Act of 2002, French Business Safeguard Act of 2006, German Company Restructuring Facilitation Act of 2012 and Enterprise Insolvency Law of

However, national bankruptcy laws differ from one jurisdiction to another from a number of perspectives.<sup>13</sup> For instance, while some bankruptcy laws, like the US, regulate limited types of bankruptcy regimes,<sup>14</sup> others, like England, regulate various types of bankruptcy regimes.<sup>15</sup> In this regard, in the US there are two bankruptcy regimes: Chapter 11 bankruptcy procedures and Chapter 7 liquidation proceedings. However, in England there are five bankruptcy regimes: administration, administrative receivership, creditors' voluntary arrangement, scheme of arrangement and liquidation. However, as will be discussed in Chapter Three,<sup>16</sup> each one of these regimes has its own features. For example, while in the US Chapter 11 and England's creditors' voluntary arrangement the management retain their position during bankruptcy processes, they are displaced by bankruptcy practitioners under the administration regime in England.<sup>17</sup>

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the People's Republic of China of 2007. However, countries such as Oman, UAE, Egypt and Jordan, their Commercial Codes and Commercial Companies Laws provide a framework for the bankruptcy of traders and liquidation of companies: see below pp. 182-184.

<sup>13</sup> See Azar Z., 'Bankruptcy Policy: A Review and Critique of Bankruptcy Statutes and Practices in Fifty Countries Worldwide', (2008) 16 C.J.I.C.L. 279, pp. 282-283; McCormack G., 'Control and Corporate Rescue: An Anglo- American Evaluation', (2007) 56 (3) I.C.L.Q. 505; Tomasic R., Little P., Francis A., Kamarul K. & Wang K., above 8.

<sup>14</sup> Dahl H., 'USA: Bankruptcy under Chapter 11', (1992) 5 I.B.L.J. 555, p. 555; McCormack G., 'Apples and Oranges? Corporate Rescue and Functional Convergence in the US and UK', (2009) 18 INSOL International Insolvency Review 109, pp. 111-116.

<sup>15</sup> Armour J. & Mokal R., 'Reforming the Governance of Corporate Rescue: The Enterprise Act 2002', (2005) 1 L.M.C.L.Q. 28-64; Fletcher F., 'UK Corporate Rescue: Recent Development- Changes to Administrative Receivership, Administration, and Company Voluntary Arrangements- the Insolvency Act 2000, the White Paper 2001, and the Enterprise Act 2002', (2004) 5 (1) E.B.O.L.R. 120, p. 151; Goode R., *Principles of Corporate Insolvency Law*, (4<sup>th</sup> edition, Sweet & Maxwell, 2011), pp. 29-45.

<sup>16</sup> See below sections 3.2 & 3.3.

<sup>17</sup> See below section 3.4.1.

Whether the aim of bankruptcy laws should be to maximise merely the interests of creditors or whether there are other interests that deserve such protection is subject to debate.<sup>18</sup> Perhaps the main issue debated is whether bankruptcy law is only about creditors' rights or whether other interests, including the interests of employees and public interest, should be taken into account.<sup>19</sup> As will be shown in the Second Chapter, the creditors' bargain theory<sup>20</sup> argues that bankruptcy laws should be designed to maximise the interests of creditors, and as a result, promoting the concept of a rescue culture should not be within the objectives of the bankruptcy law unless it leads to the wealth of creditors.<sup>21</sup> However, it is argued<sup>22</sup> that there are a number of values that need to be protected which go beyond the

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<sup>18</sup> As will be discussed in Chapter Two, some scholars argue that the sole objective of bankruptcy laws should be to maximise the interest of creditors, for this view see: Jackson T., *The Logic and Limits of Bankruptcy Law* (hereinafter '*Logic and Limits*'), (Harvard University Press, 1986); Jackson T. and Scott R., 'On the Nature of Bankruptcy: An Essay on Bankruptcy Sharing and the Creditors', (1989) 75 V.L.R. 155; Baird D. & Jackson T., 'Bargaining After the Fall and the Contours of the Absolute Priority Rule', (1988) 55 U.C.L.R. 738; However, some scholars argue that the protection of bankruptcy law should be extended to other interests beyond the interests of creditors: for this view see: Korobkin D., 'Contractarianism and the Normative Foundations of Bankruptcy Law', (1993) 71 T.L.R. 541; Mokal R., 'The Authentic Consent Model: Contractarianism, Creditors Bargain and Corporate Liquidation', (2001) 21 J.L.S. 400; Gross K., 'Taking Community Interests into Account in Bankruptcy', (1994) 72 W.U.L.Q. 1031; Keay A., 'Insolvency Law: A Matter of Public Interest', (2000) 51 N.I.L.Q. 509; Gross K., *Failure and Forgiveness: Rebalancing the Bankruptcy System*, (Yale University Press, 1999), p. 205; Warren E., 'Bankruptcy Policy', (1987) 54 (3) U.C.L.R. 755; Korobkin D., 'Rehabilitating Values: A Jurisprudence of Bankruptcy', (1991) 91 R.C.L. 717; see below Chapter Two.

<sup>19</sup> Keay A. & Walton P., *Insolvency Law: Corporate and Personal*, (Longman, 2003), p. 25.

<sup>20</sup> See below section 2.2.1.

<sup>21</sup> Jackson T., *Logic and Limits*, above 18, p. 2.

<sup>22</sup> Warren E., above 18, p. 796; Korobkin D., above 18, p. 787; Gross K., above 18, p. 1031.

interests of existing creditors.<sup>23</sup> It will be argued later that<sup>24</sup> besides creditors' interests, bankruptcy laws should take into account other interests that might be affected by the debtor's bankruptcy.<sup>25</sup> As will be shown below,<sup>26</sup> there are, also, other means of maximising the return of the creditors, some of which will also benefit other interests.<sup>27</sup> For instance, rehabilitating the firm may benefit all creditors, whether secured or unsecured, in the long term.<sup>28</sup>

## 1.2 Issues with the Current Bankruptcy Regime in Oman

Although there is no separate bankruptcy law in Oman,<sup>29</sup> both Oman's Commercial Code of 1990 and the Commercial Companies Law of 1974 provide a framework for the bankruptcy of traders and liquidation of insolvent companies.<sup>30</sup> In

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<sup>23</sup> Example of these values are: the interests of shareholders in the preservation of their future expectations, as well as the interests of the community at large in the continuation of the business: see below Chapter Two; see below section 2.4.1.

<sup>24</sup> For a further treatment of this point: see below pp. 107-110.

<sup>25</sup> As will be shown below, this should be done by providing for the possibility of rehabilitation of distressed debtors as an alternative to liquidation: see *ibid.*

<sup>26</sup> *Ibid.*

<sup>27</sup> Goode R., above 15, p. 73.

<sup>28</sup> In this regard, an empirical study has revealed that post-Enterprise administrations deliver more returns to secured creditors than pre-Enterprise Act administrations: see Frisby S., 'Interim Report to the Insolvency Service on Returns to Creditors from Pre-and-Post Enterprise Act Insolvency Procedures', p. 14, Baker & McKenzie Lecturers in Company and Commercial Law, 24 July 2007, available at:

<http://webarchive.nationalarchives.gov.uk/+/http://www.insolvency.gov.uk/insolvencyprofessionandlegislation/research/returntocreditors.pdf>. accessed on 25/01/2014.

<sup>29</sup> In this regard, it is worth noting that the issue is not with the absence of a *separate* bankruptcy law. Rather, the main issue debated in this thesis is that bankruptcy proceedings should be designed in a way that facilitates the rescue of viable enterprises and liquidate promptly the unviable ones: see below p. 181.

<sup>30</sup> In this regard, it is worthy to briefly introduce how Omani law is structured. Currently, there is what is called Majlis Oman (Parliament of Oman) which consists of Majlis AL Dawla and Majlis AL

this regard, the Commercial Companies Law sets out procedures to be followed in the dissolution of a company and its extinction.<sup>31</sup> In addition, the Commercial Code contains rules and procedures governing the bankruptcy of individual traders and companies.<sup>32</sup> Generally speaking, the articles of this Code cover the adjudication of bankruptcy,<sup>33</sup> bankruptcy officials,<sup>34</sup> the legal effects of bankruptcy,<sup>35</sup> management of bankruptcy,<sup>36</sup> the termination of bankruptcy (including the composition with creditors scheme),<sup>37</sup> bankruptcy of companies,<sup>38</sup> discharge of bankrupts and bankruptcy-related offences.<sup>39</sup> The provisions of this Code relate to all ‘traders’, which covers companies and persons that carry out commercial activities.<sup>40</sup> In this regard, Article 16 of the Commercial Code defines a trader as “any person who has the legal capacity to engage in commercial activities as his or her profession in his

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Shura: see Article 58 of Basic Statute of the State of 1996 (BSS). According to Article 58 (bis 35) of the BSS, draft laws prepared by the Government (Council of Ministers) shall be referred to Majlis Oman for approval or amendment and then they shall be directly submitted to His Majesty the Sultan to be promulgated. In case of any amendments by Majlis Oman on the draft law, His Majesty the Sultan may refer it back to the Majlis for reconsideration of the amendments and then resubmission to His Majesty the Sultan. However, Majlis Oman may propose draft laws and refer them to the Government for review, and then the Government shall return the same to the Majlis: Article 58 (bis 36) of the BSS. According to Article 58 (bis 39) of the BSS, His Majesty the Sultan may promulgate Royal Decree that have the force of law between the sessions of Majlis Oman and while Majlis Al Shura is dissolved and the sessions of Majlis AL Dawla are suspended. The BSS can be downloaded from <http://mola.gov.om/eng/basicstatute.aspx>.

<sup>31</sup> Articles 14-45 of the Commercial Companies Law 1974.

<sup>32</sup> Book Five of the Commercial Code (CC) 1990, Articles 579 to 786.

<sup>33</sup> Ibid, Articles 579-596.

<sup>34</sup> Ibid, Articles 645-654.

<sup>35</sup> Ibid, Articles 602-614 & 630-633.

<sup>36</sup> Ibid, Articles 645-678.

<sup>37</sup> Ibid, Articles 696—740 & 753-786.

<sup>38</sup> Ibid, Articles 681-695.

<sup>39</sup> Ibid, Articles 741-752.

<sup>40</sup> Ibid, Articles 16.

or her name” and “any company undertaking any commercial activities or taking one of the forms stipulated in the Commercial Companies Law”. This includes foreign traders who have offices, local branches, or any other establishments in the country irrespective of whether they are also declared bankrupt abroad.<sup>41</sup>

Although these laws set out the procedures to be followed in the event of a trader’s bankruptcy, a number of issues need to be discussed.<sup>42</sup> First, as will be shown,<sup>43</sup> under the current Commercial Code a distressed debtor is allowed to seek composition with its creditors.<sup>44</sup> However, as will be shown,<sup>45</sup> the provisions relating to such a scheme do not have enough detail.<sup>46</sup> Moreover, as will be shown in Chapter Four,<sup>47</sup> the main purpose of the preventive composition scheme with creditors is not to rescue the company.<sup>48</sup> Rather, the aim of this scheme is to allow the trader to escape the consequences of a bankruptcy declaration.<sup>49</sup> Therefore, this scheme is not intended to promote the rescue of the distressed traders, but it is an alternative designed to protect the traders from falling into bankruptcy.

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<sup>41</sup> Ibid, Articles 19.

<sup>42</sup> It is worth noting that this section will highlight only some of the issues that this study will address.

<sup>43</sup> See below section 4.6.2.

<sup>44</sup> Ibid, Articles 753-786 set out the procedures of the preventive composition scheme with creditors.

<sup>45</sup> See below sections 4.6.2 & 4.8.3.

<sup>46</sup> For a detailed discussion: see below section 4.4.2.2.

<sup>47</sup> See below section 4.6.2.

<sup>48</sup> Article 753 of the CC.

<sup>49</sup> Article 753 of the CC; also as will be shown below (section 4.6.2), the title of Part Four of the Five book of the Commercial Code is “Preventive Composition from Bankruptcy”. This title indicates that the aim of preventive composition is merely to prevent the trader from bankruptcy. Thus, preventive composition is an alternative available for a distressed trader to avoid bankruptcy declaration and to continue the operation of the business if a composition with creditors is reached.

Further, even though the Commercial Code of 1990 makes reference to a bankruptcy supervisor/manager or even a liquidator,<sup>50</sup> in reality, unlike the case in England<sup>51</sup> or the US,<sup>52</sup> there is no formal body that regulates bankruptcy practitioners in Oman.<sup>53</sup> In England, for example, insolvency practitioners are required to obtain a professional qualification from a recognised professional body, the Secretary of State or a competent authority designated by the Secretary of State.<sup>54</sup> In Oman, the liquidator, the bankruptcy trustee or the supervisor is neither required to have any qualification nor to obtain specific training.<sup>55</sup> Therefore, this is one of the issues with the current bankruptcy regime in Oman that this thesis is going to address.<sup>56</sup> As will be argued later,<sup>57</sup> it is the role of bankruptcy practitioners to administer the bankruptcy process from the day of filing until

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<sup>50</sup> Articles 645-654 of the CC.

<sup>51</sup> Finch V., 'Insolvency Practitioners: Regulation and Reform', (1998) J.B.L. 334, p. 339; for further detail about Insolvency practitioners in the UK see <http://www.insolvency-practitioners.org.uk/>. This site provides information about the Insolvency Practitioners Association (IPA) which is a membership body recognised for the purposes of authorising and licensing insolvency practitioners under the Insolvency Act 1986.

<sup>52</sup> For further detail see [www.justice.gov/ust](http://www.justice.gov/ust). This site contains information about the United States Trustee Program and the federal bankruptcy system. The Program was established by the Bankruptcy Reform Act of 1978. The Program monitors the conduct of bankruptcy parties and private estate trustees, oversees related administrative functions, and acts to ensure compliance with applicable laws and procedures. It also identifies and helps investigate bankruptcy fraud and abuse in coordination with United States Attorney, the Federal Bureau of Investigation, and other law enforcement agencies.

<sup>53</sup> Oman's Commercial Code and Commercial Companies Law do not set any requirements or conditions for persons who want to act as bankruptcy trustees or liquidators.

<sup>54</sup> See above footnote 51.

<sup>55</sup> See below section 4.4 (E); for the suggestions of this thesis: see below section 5.5.4.6.

<sup>56</sup> For criticism of the position under the current bankruptcy regime in Oman: see below section 4.4 (E); for the view of this thesis: see below section 5.5.4.6.

<sup>57</sup> See below pp. 195-197.

bringing the process to its conclusion. These practitioners should be equipped with the necessary skills in order for them to control the process successfully.<sup>58</sup>

In addition, under the current system there are three bankruptcy options available: bankruptcy proceedings,<sup>59</sup> the preventive composition scheme<sup>60</sup> and liquidation procedures.<sup>61</sup> These proceedings apply to all companies whatever their size.<sup>62</sup> However, in this thesis it is argued that due to the significance of small and medium enterprises in Oman,<sup>63</sup> there is a need for special bankruptcy proceedings for these types of enterprises. At present, all companies have to follow the same procedures and have to bear the same costs.<sup>64</sup> This is unlike the case in England and the US. As will be shown in Chapter Three,<sup>65</sup> in England there is a company voluntary proceeding with moratorium that is solely designed for small companies.<sup>66</sup> Also, in the US there are special procedures designed for small businesses.<sup>67</sup>

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<sup>58</sup> See below section 5.5.4.6.

<sup>59</sup> Articles 579-752 of the CC.

<sup>60</sup> Articles 753-786 of the CC.

<sup>61</sup> Articles 14-27 of the Commercial Companies Law 1974.

<sup>62</sup> Article 14 of the Commercial Companies Law & Article 681 of the CC.

<sup>63</sup> For the important role that is played by SMEs in Oman: see below section 5.4 (B).

<sup>64</sup> Article 681 of the CC.

<sup>65</sup> See below section 3.2.3.

<sup>66</sup> Only smaller companies as defined in section 382 of the Companies Act 2006 may use the procedure. According to this section, a company is considered to be small if it meets two of the following three criteria: (1) its annual turnover is not greater than £5.6m; (2) its balance sheet total is not more than £2.8m and (3) its employees are not more than 50; As will be discussed below (section 5.4 (B)), at present there is no common definition of small and medium enterprises and such a definition varies from country to country: see Tambunan T., *Development of Small and Medium Enterprises in ASEAN Countries*, (Readworthy, 2009), p. 10.

<sup>67</sup> See below pp. 136-137.

Furthermore, it differs from the case in both England and the US where secured creditors are prevented from enforcing their claims during bankruptcy proceedings.<sup>68</sup> In Oman secured creditors' actions are not stayed during bankruptcy proceedings.<sup>69</sup> Thus, secured creditors are allowed to pursue their claims and, as a consequence, the notion of collectivity<sup>70</sup> is not adopted. This is one of the issues this thesis will address. As will be shown in Chapter Two<sup>71</sup> and Chapter Three,<sup>72</sup> not imposing a stay on creditors' claims could mean that the assets of the debtor would be dismantled<sup>73</sup> and the creditors would run to the court house to be first to enforce their securities.<sup>74</sup> Therefore, one of the main deficiencies of both bankruptcy and liquidation proceedings that this thesis will address is lack of imposing a stay on creditors' action during bankruptcy proceedings.<sup>75</sup>

Being a bankrupt is, also, regarded as some kind of reprehensible disgrace or reproach in Oman.<sup>76</sup> Bankruptcy is not viewed as a risk of doing business; but it is

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<sup>68</sup> This is the case, for example, during the US Chapter 11 proceedings and during administration procedures in England: see below section 3.4.2.

<sup>69</sup> See below section 4.4 (D).

<sup>70</sup> See below section 4.8.4.

<sup>71</sup> See below section 2.2.2 (A).

<sup>72</sup> See below section 3.4.2.

<sup>73</sup> Because creditors will have to spend time and money monitoring each of their debtors' assets and they will run to the court to take action to win the race to enforce their debt more quickly than other creditors: see Jackson T., *Logic and Limits*, above 18, p. 16; see below section 2.2.2.

<sup>74</sup> Jackson T., 'Bankruptcy, Non-Bankruptcy Entitlement, and the Creditors' Bargain', (1991) Y.L.J. 857, pp. 860-861.

<sup>75</sup> For addressing this issue under the current Oman's bankruptcy regime: see below sections 4.4 (D) & 4.6.2.4.

<sup>76</sup> Uttamchandani M., 'No Way Out: The Lack of Efficient Insolvency Regimes in the MENA Region', (March 2011), Policy Research Working Paper 5609, the World Bank, p. 1, available at:

always attributed to management failure.<sup>77</sup> Also, once a bankruptcy adjudication is declared by the court,<sup>78</sup> the owners of such a company might be deprived of a number of civil rights.<sup>79</sup> For instance, currently upon bankruptcy declaration, the bankrupt is prohibited from becoming a director or a member of the management board of any company and he/she is not allowed to apply for a public job or position.<sup>80</sup> This kind of attitude towards bankruptcy needs to be changed in order to promote a culture of rescue.<sup>81</sup> As mentioned above, the current bankruptcy regime in Oman focuses only on the complete dissolution of the distressed debtor. It will be argued later that there is an urgent need to have a modern bankruptcy law based on some of the international regimes to maintain a certain level of investment needed in the future.<sup>82</sup>

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<http://siteresources.worldbank.org/INTMNAREGTOPPOVRED/Resources/DECMENAFflagshipInsolvencyRegimes.pdf>. accessed on 05/01/2014.

<sup>77</sup> This is clear from displacing the management during bankruptcy proceedings (section 604 of the CC) and from holding them accountable and forcing them to pay all or some of the debts of the debtor: see below section 4.4.1.5; This is also the case in England where managers might be deemed responsible for the failure of the company and as a result they are displaced: see Goode R., above 15, p. 394; for discussing various arguments in favour of management displacement: see below section 3.4.1.1.

<sup>78</sup> As will be discussed below, the court makes an order declaring the debtor bankrupt if the conditions for adjudication exist. These conditions are: an application is submitted by the debtor itself, creditors or the court; the debtor ceases to pay a due commercial debt: see below sections 4.5.1, 4.5.2 & 4.5.3.

<sup>79</sup> Article 602 of the CC; see below section 4.4 (B).

<sup>80</sup> Ibid; see also below section 4.5.4 (A).

<sup>81</sup> See below section 5.5.4.2.

<sup>82</sup> See below section 5.4.

### 1.3 Terminology

It is necessary at the onset of a study of this kind to attain clarity in the terminology used. As legal terms, the meaning of 'bankruptcy' and 'insolvency' vary from one country to another.<sup>83</sup> For instance, in England the term 'insolvency' to companies and 'bankruptcy' applies to individuals.<sup>84</sup> In the United States, the term 'bankruptcy' applies for both individuals and corporations.<sup>85</sup> In Oman, the term 'bankruptcy' applies to traders<sup>86</sup> and the term 'insolvency' to individuals. In the interest of simplicity, however, this study will use both terms 'bankruptcy' and 'insolvency' as synonyms and both will be used interchangeably. Thus, both 'bankruptcy' and 'insolvency' extend to traders which covers companies and individuals that carry out commercial activities.<sup>87</sup>

Further, this thesis encourages the Omani legislator to promote a 'rescue culture'.<sup>88</sup> In this regard, Campbell stated that a company rescue "includes the available legal processes as well as possible management responses and is more appropriate to the legal response to company distress as it recognises the need for major intervention in the company's affairs, such intervention not necessarily

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<sup>83</sup> See Key A. & Walton P., above 19, p. 12; see Kipli J., *The Ethics of Bankruptcy*, (Reprinted edition, Routledge, 2002), p. 8.

<sup>84</sup> Key A. & Walton P., above 19, p. 12

<sup>85</sup> Ibid.

<sup>86</sup> Article 579 of the CC.

<sup>87</sup> For the purpose of this thesis, the terms bankruptcy and insolvency will not dictate any difference.

<sup>88</sup> See below section 5.5.4; Belcher defines the term 'rescue' "as a major intervention necessary to avert eventual failure of the company": Belcher A., 'The Economic Implication of Attempting to Rescue Companies', in Rajak H., *Insolvency Law: Theory and Practice*, (Sweet & Maxwell, 1993), p. 236.

attempting to restore the company to the pre-financial crisis position”.<sup>89</sup> “The purpose of the intervention is to avoid the failure of the company.”<sup>90</sup> Hence, for the purpose of this thesis, the term refers to a legal and institutional response to financial distress that is geared in the first instance to attempting to save troubled traders, rather than simply to close them down and distribute the proceeds to creditors as quickly as possible.<sup>91</sup> In this regard, some of the key features of a rescue procedure<sup>92</sup> are the easing of access to the rescue process, encouraging distressed traders to apply for the proceedings at an early stage, staying creditors’ claims, easing the access to new funding during the reorganisation process and cramming-down dissenting creditors. Also, in his article,<sup>93</sup> Hunter summarised the principles governing rescue culture.<sup>94</sup> These principles might include the capacity to exercise judicial pressure on petitioning creditors to accept a reasonable composition proposed by the debtor, an enforceable means of collectively binding creditors, the availability of a moratorium and the availability of qualified bankruptcy practitioners.<sup>95</sup>

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<sup>89</sup> Campbell A., ‘Company Rescue: The Legal Response to the Potential Rescue of Insolvent Companies’, (1994), 5 (1) I.C.C.L.R. 16, p. 16.

<sup>90</sup> Ibid.

<sup>91</sup> Armour J. & Mokal R., above 15, p. 32; Finch V., *Corporate Insolvency Law: Perspectives and Principles*, (2<sup>nd</sup> edition, Cambridge University Press, 2009), pp. 187-188.

<sup>92</sup> See Tolmie F., *Introduction to Corporate and Personal Insolvency Law*, (2<sup>nd</sup> edition, Cavendish Publishing Limited, 2003), p. 64.

<sup>93</sup> Hunter M., ‘The Nature and Function of A Rescue Culture’, (1999) J.B.L. 491, p. 500.

<sup>94</sup> Ibid.

<sup>95</sup> Ibid.

## 1.4 The Scope of the Thesis

The main purposes of this study are to assess the efficiency<sup>96</sup> of the current bankruptcy system in Oman and to offer specific proposals for bankruptcy reform to be adopted by the Omani legislator. However, this study will be restricted to some aspects of bankruptcy. Examples of such issues are as follows: whether Omani law strikes an appropriate balance between the interests of creditors and other stakeholders; whether a distressed trader is given an alternative to winding up; ranking of creditors; the liability of directors of bankrupt companies; whether employees of an insolvent company are protected under the current Omani regime; and the concept of moratorium and the notion of cram-down. The time and word limit are rationales for such restriction. Also, the selection of specific issues to be addressed in this thesis is not random but deliberate. Tolmie,<sup>97</sup> for example, mentioned a number of requirements for having a successful rescue regime.<sup>98</sup> Further, as will be stated below,<sup>99</sup> in the UNITRAL Legislative Guide it is affirmed that bankruptcy laws should be designed in a way that achieves a number of objectives. Examples of these objectives include offering distressed companies an alternative to liquidation, easing and facilitating the bankruptcy processes and establishing a clear priority rule.<sup>100</sup> Thus, the aim of this study is not to examine

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<sup>96</sup> This refers to its suitability to deal with various issues that occur during the bankruptcy of traders.

<sup>97</sup> Tolmie F., above 92, p. 64.

<sup>98</sup> See above p. 13; it is within the scope of this thesis to provide an overview of the current bankruptcy regime in Oman and to assess the availability of these requirements: see below section 4.6.2; However, it is worth noting that not all issues addressed by this thesis are related to rescue culture: see below, for instance, sections 4.8 (in particular section 4.8.4 & 4.8.1)

<sup>99</sup> See below pp. 28-29.

<sup>100</sup> See United Nations Commission on International Trade Law, 'UNCITRAL Legislative Guide on Insolvency Law', (2005), available at:

every single article in the law or to study in depth the procedures of various bankruptcy regimes under the current bankruptcy system in Oman<sup>101</sup>, but to look at some bankruptcy issues that are, as will be discussed in Chapter Four, insufficiently regulated or not regulated at all.<sup>102</sup>

It is necessary, first, to examine the current theoretical debates regarding the aims of bankruptcy/ insolvency law. Such debates focus on which policy objectives and policy mechanisms should be adopted in designing bankruptcy/ insolvency law.<sup>103</sup> Exploring these theoretical debates provides us with an understanding of the policy underpinning bankruptcy laws based on the perspectives of various scholars<sup>104</sup> and the view of this thesis.<sup>105</sup> This thesis argues that highlighting the principles and criticisms of various bankruptcy law theories allows us to envisage how policymakers can make the most of these theories in designing bankruptcy laws.

In addition, this study is going to draw lessons from two developed bankruptcy regimes:<sup>106</sup> England and the United States.<sup>107</sup> However, it is worth noting that it is not possible, even if this was desired, to transfer the whole experience of both

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[http://www.uncitral.org/pdf/english/texts/insolven/0580722\\_Ebook.pdf](http://www.uncitral.org/pdf/english/texts/insolven/0580722_Ebook.pdf), pp. 9-14, accessed on 10/01/2014.

<sup>101</sup> In this thesis, reference will be made to both the Omani Commercial Code of 1990 and Commercial Companies Law of 1974. It is not within the scope of this study to go into the procedures under both laws in depth. However, a focus will be given, as explained earlier, to a number of bankruptcy issues.

<sup>102</sup> For example, see below sections 4.4 & 4.8.

<sup>103</sup> Keay A. & Walton P., above 19, p. 25.

<sup>104</sup> See below Chapter Two.

<sup>105</sup> For the view of this thesis: see below section 2.8.

<sup>106</sup> See below Chapters Three, Four and Five.

<sup>107</sup> For the rationale behind this selection: see below section 1.7.

England and the US since each jurisdiction has its own characteristics.<sup>108</sup> Thus, the aim of this thesis is to opt for bankruptcy principles that are appropriate for Oman.<sup>109</sup> As will be discussed in Chapter Five,<sup>110</sup> the capacity of courts and the competence of persons administering the bankruptcy process in Oman<sup>111</sup> play an important role in determining what sort of bankruptcy regimes should be adopted<sup>112</sup> and what sort of rules should be transferred or are applicable to be transferred.

Having discussed all of the above issues, this study will proceed by proposing a map for future reform.<sup>113</sup> However, it is worth mentioning that it is not enough to have an effective bankruptcy regime; rather, there is a need to combine it with other reforms, for instance, training judges, enacting practitioners' regulations,<sup>114</sup> and changing people's mentality towards bankruptcy through advising them of the potential of a rescue culture. As a consequence, this study provides an analysis of the essential elements of an effective insolvency regime.<sup>115</sup>

At this stage, it is worth mentioning that the provisions of the Commercial Code do not apply to the bankruptcy of distressed banks. In this regard, Chapter Seven<sup>116</sup> of the Banking Law of 1974 regulates the bankruptcy of banks. However, the aim of this chapter is not to offer a reorganisation procedure, rather it merely

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<sup>108</sup> For detailed discussion of this point: see below pp. 278-279.

<sup>109</sup> See below section 5.5.4.

<sup>110</sup> See below section 5.5.

<sup>111</sup> This thesis outlines the necessity of having qualified bankruptcy practitioners: see below section 5.5.4.6.

<sup>112</sup> See below section 5.5.3.

<sup>113</sup> See below section 5.5.

<sup>114</sup> See below section 5.5.4.6.

<sup>115</sup> See below section 5.5

<sup>116</sup> Articles 82-89 of the Omani Banking Law 1974.

regulates the liquidation of distressed banks.<sup>117</sup> At present, there is no rescue proceeding available for distressed banks and other financial institutions in Oman. In addressing this issue, Tomasic argued that the Global Financial Crisis (GFC) has demonstrated the weakness of legal regimes and regulatory structures in dealing with troubled banks and financial institutions in many advanced markets.<sup>118</sup> It is worth noting that even though discussing the bankruptcy of banks and financial institutions is beyond the scope of this study, it is important to introduce a bankruptcy reform in which viable types of these institutions should be allowed to restructure their affairs instead of liquidating them.

To summarise, it is within the scope of this thesis to deal with a number of issues/ questions. These issues/questions include: Whether bankruptcy law should be directed at maximising returns for creditors? Or should it be directed at protecting the interests of creditors and non-creditors, such as employees and the community?; To what extent, if at all, British and American bankruptcy laws encourage the rehabilitation of distressed debtors?; Critically examine various bankruptcy procedures in Oman in order to identify whether, or not, Oman should adopt a rescue culture; Exploring how employees of the distressed traders are treated under the current Oman's bankruptcy regime; How are the claims of various creditors ranked under the current bankruptcy system in Oman?; Outlining

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<sup>117</sup> Ibid.

<sup>118</sup> Tomasic R., 'Establishing a UK Rescue Regime for Failed Investment Banks', (2010) 3 (2) C.R.I. 160, p. 160; Campbell also stated that it has become the international norm for countries to establish a separate legal system to deal with banking crises: Campbell A., 'Bank Insolvency and the Interests of Creditors', (2006), 7 J.B.R. 133, p. 134; also in their article, Peter Cartwright and Andrew Campbell highlighted the main objectives of bank insolvency laws by discussing the position in the United Kingdom: 'Bank Insolvency Issue', (2002), 6 I.L. 198.

the importance of designing a special bankruptcy regime for Small and Medium Enterprises (SMEs); what kind of bankruptcy regime should be adopted by Oman; and, finally, how can the legislator of Oman take lessons from the experience of England and the US?

### **1.5 The Importance of this Study**

This study is important from a number of angles. First, it will highlight the importance of bankruptcy law theories and how it is essential for policy makers to have recourse to these theories when considering further development of particular bankruptcy laws. As will be argued later, the above discussed theories highlight the different roles that might be played by bankruptcy law and in this regard each one has its own merits.<sup>119</sup> Secondly, this study is also significant as it observes the experience of England and the US in constructing their insolvency laws and explores to what extent, if at all, the Omani legislator can take lessons from their experience. It will be shown that many countries<sup>120</sup> have reformed their bankruptcy laws through transplanting, imitating and borrowing other countries' laws.<sup>121</sup> In this regard, these countries have attempted to establish a reorganisation regime for failing traders, like Chapter 11 of the US Bankruptcy Code.<sup>122</sup> Thirdly, the main importance of this study lies in critically examining the current bankruptcy regime in Oman and in proposing a map for future bankruptcy reform. In examining existing bankruptcy regimes in Oman, this thesis will explore various alternatives available

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<sup>119</sup> See below pp. 104-107.

<sup>120</sup> These include China, Indonesia, Hong Kong and Malaysia: see Tomasic R., Little P., Francis A., Kamarul K. & Wang K., above 8, p. 248; Martin N., above 7, p. 4.

<sup>121</sup> For a fuller treatment of this point: see below section 5.3.1.

<sup>122</sup> Martin N., above 7, p. 4.

for distressed enterprises there and discuss the general features of each alternative. Exploring these alternatives should help in identifying clearly the deficiencies of the current bankruptcy regime in order to propose a number of means to overcome them.<sup>123</sup> In addition, besides proposing a map for future bankruptcy reform in Oman, this study places emphasis on the importance of having an adequate judicial system and qualified bankruptcy practitioners.<sup>124</sup> This is due to the fact that the complexity of bankruptcy cases requires having in place persons who are able to deal with them in an orderly manner. Furthermore, the outcome of this study may also benefit some Arab countries since they still do not have a bankruptcy law that recognises the concept of a rescue culture.<sup>125</sup> In this regard, it is stated that<sup>126</sup> “insolvency systems in MENA<sup>127</sup> are generally inconsistent with international best practice”.<sup>128</sup> Finally, such an outcome that leads to bankruptcy reform in Oman may help in allowing the distressed enterprises to

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<sup>123</sup> For a detailed discussion of some deficiencies of the current bankruptcy regime in Oman: see below sections 4.4 & 4.8.

<sup>124</sup> For the current position in Oman: see below section 4.4 (E); for the suggestion made by this thesis to change the current position: see below section 5.5.4.6.

<sup>125</sup> See Uttamchandani M., above 75, pp. 1-3.

<sup>126</sup> Hawkamah/ World Bank/ OECD/ INSOL International, ‘Survey on Insolvency System in the Middle East and North Africa’ (2009), available at:

<http://www.oecd.org/daf/ca/corporategovernanceprinciples/44375185.pdf>. accessed on 12/01/2014.

<sup>127</sup> The MENA Region includes Algeria, Bahrain, Djibouti, Egypt, Iran, Iraq, Israel, Jordan, Kuwait, Lebanon, Libya, Malta, Morocco, Oman, Qatar, Saudi Arabia, Syria, Tunisia, United Arab Emirates, West Bank and Gaza and Yemen.

<sup>128</sup> Hawkamah/ World Bank/ OECD/ INSOL International, above 126, p. 4.

rehabilitate their business instead of liquidating their assets and dismissing their employees.<sup>129</sup>

## **1.6 Reasons for Selecting Oman as the Object of this Thesis**

This will be the first study to examine in depth the effectiveness of the Omani bankruptcy regime. At present, there are only two books and two master degree dissertations<sup>130</sup> that have been written in regard to bankruptcy law in Oman. The first book is A. AL-Muqdad, *Commercial Companies Law in Oman*.<sup>131</sup> This book considers the procedure for the formation and registration of various types of companies which may be formed in Oman. It also discusses the nature and constitution of companies and the establishment of limited liability and joint stock companies.<sup>132</sup> It further provides a concise coverage of the main principles of company law, including liabilities and responsibilities of a company as a legal person. However, in regard to bankruptcy law, this book provides only a brief introduction to the range of liquidation procedures available in Oman, various grounds upon which a company may be wound up by the court, powers of liquidators and distribution of assets. Thus, this book does not include a critical analysis of the current bankruptcy regime in Oman.

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<sup>129</sup> As will be shown in Chapter Five, this thesis proposes the establishment of a rescue regime: see below section 5.5.4.

<sup>130</sup> It is worth noting that these dissertations are not published. However, they are available at Sultan Qaboos University Library.

<sup>131</sup> (Sultan Qaboos University Press, 2006).

<sup>132</sup> Joint stock companies are defined as “commercial companies whose capital is divided into equal negotiable shares pursuant to the law. The liability of the shareholders shall be confined to the payment of the value of the shares he subscribes and he shall not be responsible for the debts of the company except within the limits of the nominal value of the shares he subscribes”: see Article 56 of the Commercial Companies Law of 1974.

The second book is S. Darmaki, *Bankruptcy Procedures under the Commercial Code in Oman*.<sup>133</sup> This is a small book (120 pages) that provides an overview of the available bankruptcy procedures under Oman's Commercial Code of 1990. It considers application procedures for both bankruptcy proceedings and preventive composition schemes. It also discusses the requirements upon which a trader may be declared bankrupt by a court and the possible consequences of declaring a trader bankrupt. Although this book provides a brief discussion of the available bankruptcy procedures in Oman, this thesis will go further<sup>134</sup>, which differentiates it from this book. Since the aim of this thesis is to assess the efficiency of Oman's current bankruptcy system, the discussion will not be focused merely on providing an overview of the current bankruptcy procedures in Oman. Rather, it is going to criticise the current bankruptcy system and propose a means to overcome the problems of the current bankruptcy regime in Oman based on the experience of England and the US.

The first dissertation is by S. Al-Hinai, 'Preventive Composition Scheme under Omani Commercial Code 1990'.<sup>135</sup> This dissertation provides a detailed discussion of preventive composition procedures in Oman. It starts by providing definitions of preventive composition scheme and its requirements. It then explores various issues, including the procedures to be followed in order to initiate preventive composition scheme, the consequences of initiating such a scheme on creditors'

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<sup>133</sup> (Sultan Qaboos University Press, 2013).

<sup>134</sup> As will be shown below, this thesis will critically examine the available bankruptcy procedures in Oman: see below sections 4.5, 4.6, 4.7 & 4.8.

<sup>135</sup> (Master Degree Dissertation, College of Law, Sultan Qaboos University, 2012); as noted above, this dissertation is not published. However, it is available at Sultan Qaboos University Library.

claims (i.e. stay on creditors' actions), and how such schemes are concluded. As will be shown in Chapter Four, this thesis will make reference to this dissertation, since for example this dissertation has already highlighted the necessity of stating clearly what is meant by 'inability to pay debts'.<sup>136</sup> However, this thesis differs in that it is going to criticise preventive composition schemes and show how different they are from being a rescue process. Thus, this thesis criticises this scheme from a number of perspectives.<sup>137</sup>

The Second dissertation is by B. AL-Mahruqi, 'Liquidation Procedures under Omani Commercial Companies Law'.<sup>138</sup> This dissertation explores liquidation procedures for distressed companies in Oman. It first provides an overview of the various types of companies that may be registered in Oman. It then discusses the grounds upon which a company may be wound up. It finally discusses various liquidation procedures in Oman, the powers, duties and obligations of the liquidator, and the distribution of assets. Although this dissertation explores various liquidation procedures in Oman, it does not criticise the current liquidation procedures there. In particular, it does not refer to the concept of collectivism and its importance in protecting the assets of the company from being wasted. Also, it does not stress the significance of having in place qualified bankruptcy practitioners to administer liquidation procedures. Therefore, this thesis gains its importance from approaching these issues and from offering suggestions to the Omani legislator.

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<sup>136</sup> See below sections 4.4 (A) & 5.5.2.1.

<sup>137</sup> See below sections 4.6.2 & 4.8.3.

<sup>138</sup> (Master Degree Dissertation, College of Law, Sultan Qaboos University, 2013).

In addition, this thesis selects Oman as an object of this study because there are approximately 250,000 registered businesses<sup>139</sup> in Oman, of which small and medium enterprises (SME) represent 90 per cent.<sup>140</sup> Family-owned companies and SMEs are the major contributors of Oman's GDP<sup>141</sup> as well as being the engine for job creation.<sup>142</sup> According to Sheikh Salah AL-Maawali, Director General for the Directorate General of SME Development at the Ministry of Commerce and Industry, almost 13.8 per cent of Oman's GDP is accounted for by small and medium enterprises.<sup>143</sup> Thus, it will be argued that<sup>144</sup> there is a need to protect these businesses in the event of financial difficulties by offering them a legal mechanism whereby it is possible to rehabilitate their businesses instead of liquidating them and causing job losses. Further, following an order made by Sultan Qaboos, the ruler of Oman, in January 2013 a three day 'Government Symposium for the Development of Small and Medium Enterprises in Oman' was held. One of the issues discussed in this symposium was bankruptcy of small and medium enterprises and how reform of bankruptcy law is needed. In this regard,

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<sup>139</sup> This includes individual traders, small, medium and large companies.

<sup>140</sup> AL-Shanfari D., AL-Said A., AL-Said F. & AL-Busaidi S., 'SME Development Symposium: Research Summary', Held in Seih AL-Shamikat in Oman, 21-23 January 2013, p. 1, available at: [http://thefirm.om/Projects\\_and\\_Publications\\_files/SME%20Development%20Symposium%20Brief%20v2.pdf](http://thefirm.om/Projects_and_Publications_files/SME%20Development%20Symposium%20Brief%20v2.pdf). accessed on 05/01/2014.

<sup>141</sup> Oman newspaper, 5<sup>th</sup> Dec. 2012, available at <http://www.omannews.gov.om/ona/english/newsDetails.jsp?newsID=155387>

<sup>142</sup> Ibid.

<sup>143</sup> See Muscat Daily of February 12, 2013, available at: <http://www.muscatdaily.com/Archive/Business/SMEs-contribute-14-to-country-s-GDP-says-official-21dd>.

<sup>144</sup> For the importance of SMEs for diversification and development of the economy in Oman: see below section 5.4 (B).

this study will explore the gap in this area and propose a regime to be considered by the Omani legislator.<sup>145</sup>

The more modern concept of corporate restructuring or reorganisation which appears, for example, in the bankruptcy/ insolvency laws of England and US is currently not an alternative under Omani Law.<sup>146</sup> At this time, Omani law allows for complete dissolution of the distressed trader rather than reorganisation.<sup>147</sup> Also, as we shall see, currently the bankruptcy procedures are costly, lengthy and inefficient, such that both debtors and creditors have very little incentives to use the bankruptcy system as a formal mechanism.<sup>148</sup> It will be argued that Oman should reform its laws since the development of a proper bankruptcy regime is one of the most important factors contributing to successful economic growth.<sup>149</sup> Hence, the need for a proper and effective bankruptcy regime in Oman is essential. In this regard, lessons should be learned from other jurisdictions for example, from England and from the US Bankruptcy Law. However, careful consideration should be taken when proposing a bankruptcy regime since there is no 'one size fits all'.

### **1.7 Why Observe the Experience of England and the US?**

This study observes the experience of both England and the US since both of them have bankruptcy regimes in which a rescue culture is recognised<sup>150</sup> and

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<sup>145</sup> See below sections 5.4 (B) & 5.5.3.

<sup>146</sup> For the current bankruptcy procedures in Oman: see below section 4.3.

<sup>147</sup> Ibid.

<sup>148</sup> See below section 4.8.1 (World Bank Doing Business Report: Oman 2014).

<sup>149</sup> Martin N., above 7, p. 4; Perry A., above 1, p. 779.

<sup>150</sup> See below sections 3.2.1 & 3.3.1.

many other countries<sup>151</sup> have learned from their experience. More specifically, England is selected for comparative purposes because of its creditor-friendly regime.<sup>152</sup> England has adopted a rescue model in which creditors' interests continue to affirm a prevailing influence.<sup>153</sup> As will be shown in Chapter Three,<sup>154</sup> even though England modernised the administration regime in 2002, Fletcher argued that under the current administration regime "the traditional disposition of English insolvency law to elevate the interests of creditors above the possible benefits of a corporate rescue" still prevails.<sup>155</sup> This is also affirmed by Finch, a UK scholar, who criticised the whole UK insolvency regime by maintaining that "present English rescue procedures might be portrayed as giving strong priority to the protection of creditors' interests and limited priority to rescue".<sup>156</sup> Further, in England there are various insolvency proceedings, namely administration, receivership, company voluntary arrangement and scheme of arrangement. Chapter Three will explore these proceedings and see how they differ from each other. Hence, one of the aims of this thesis is to observe the experience of England in this regard and then see how it diverges from that of the US.

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<sup>151</sup> These countries include China, Indonesia, Hong Kong and Malaysia. It is stated that "as globalization takes place...[M]any countries have attempted to create a reorganization scheme for failing enterprises like Chapter 11 of the US Bankruptcy Code": see Martin N., above 7, p. 4; see also Tomasic R., Little P., Francis A., Kamarul K. & Wang K., above 8, p. 248.

<sup>152</sup> For the meaning of a creditor-friendly regime and its main characteristics as well as the differences between this regime and a debtor-friendly regime: see below section 4.8.2.

<sup>153</sup> Fletcher F., above 15, p. 129; McCormack G., above 14, p. 115.

<sup>154</sup> See below section 3.2.1.

<sup>155</sup> Fletcher F., above 15, p. 137.

<sup>156</sup> Finch V., above 91, p. 278; for more discussion see below section 3.2.1.

The United States is selected for comparative purposes because it has an insolvency regime which is considered to be friendlier<sup>157</sup> to debtors rather than to creditors from a number of perspectives.<sup>158</sup> As will be discussed in Chapter Three, during US Chapter 11 proceedings, the management of the company will not be displaced and they will continue running the business of the company.<sup>159</sup> Also, the debtor is allowed to obtain new funding and existing creditors might be taken over by the new lender.<sup>160</sup>

Hence, it is within the aim of this study to observe the experience of both England and the US and explore to what extent the Omani legislator can benefit from their experience. The rationales behind the observation of England and the US bankruptcy regimes are to identify the principles underpinning each regime and to examine the possibility of adopting such principles. Examples of such principles include staying creditors' claims during the proceedings, cramming-down dissenting creditors and nominating professional persons to administer the processes.<sup>161</sup>

It is worth mentioning that choosing England and the US regimes in this study does not mean that the aim of this study is to import the whole experience of England or the US. Rather, the aim of examining these bankruptcy regimes is to see how these jurisdictions deal with debtors' financial difficulties and how the

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<sup>157</sup> See below section 4.8.2.

<sup>158</sup> Franken S., 'Creditor- and Debtor-Oriented Corporate Bankruptcy Regimes Revisited', (2004) 4 E.B.O.R. 645, p .650; McCormack G., above 14, p. 115.

<sup>159</sup> See below section 3.4.1.2.

<sup>160</sup> See below section 3.4.3.

<sup>161</sup> For a detailed discussion see below sections 3.2 & 3.3.

above mentioned principles<sup>162</sup> are deployed under both systems. Hence, this study will avoid the wholesale transplantation of these systems since this thesis believes that what might be applicable in the US and England might not be applicable in Oman.<sup>163</sup> This is due in part to the fact that, at present, Oman does not have an adequate institutional infrastructure and professional expertise<sup>164</sup> and, as a consequence, a number of considerations should be taken into account in proposing a new approach to be adopted by the Omani legislator.<sup>165</sup> As will be shown below,<sup>166</sup> due to cultural factors, it is not appropriate to allow the management to run the company during bankruptcy proceedings without any kind of supervision in Oman. In this regard, it will be argued later that although the concept of debtor-in-possession is a common feature of the US Chapter 11, it is not suitable to be wholly adopted by the Omani legislator.<sup>167</sup>

## **1.8 The Role of International Organisations in Proposing the Development of National Insolvency Laws**

A number of international organisations recognise the importance of having in place an effective insolvency law.<sup>168</sup> Both the World Bank and United Nations

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<sup>162</sup> Examples of these principles are the notion of debtor-in-possession, moratorium, new financing and the concept of cram-down dissenting creditors: see above p. 13: for a detailed discussion see below section 3.4.

<sup>163</sup> See below pp. 273-275 & 318-320; see also below section 5.5.4.

<sup>164</sup> See below section 4.4 (E).

<sup>165</sup> See below section 5.5.

<sup>166</sup> See below section 5.5.4.2.

<sup>167</sup> Ibid.

<sup>168</sup> These organisations include the World Bank (in issuing Principles and Guidelines for Effective Insolvency and Creditors Rights Systems, available at: [http://www.worldbank.org/ifa/ipg\\_eng.pdf](http://www.worldbank.org/ifa/ipg_eng.pdf)), United Nations Commission on International Trade Law (in issuing Legislative Guide on Insolvency

Commission on International Trade Law (UNCITRAL) have issued guidelines to assist countries in assessing and developing their domestic insolvency regimes.<sup>169</sup> For instance, the aim of the UNCITRAL Legislative Guide on Insolvency Law is to assist countries in establishing an effective legal framework to address the bankruptcy of the debtor which might lead to its insolvency.<sup>170</sup> “It is intended to be used as a reference by national authorities and legislative bodies when preparing new laws and regulations or reviewing the adequacy of existing laws and regulations”.<sup>171</sup> The UNCITRAL Legislative Guide does not provide a single set of model solutions to be adopted by countries, but rather it provides various approaches available worldwide.<sup>172</sup> Thus, it should be noted that in proposing

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Law, available at: [http://www.uncitral.org/pdf/english/texts/insolven/05-80722\\_Ebook.pdf](http://www.uncitral.org/pdf/english/texts/insolven/05-80722_Ebook.pdf)), The American Law Institute (in issuing Principles for Transnational Insolvency for the NAFTA Countries, available at: <http://www.ali.org/doc/InsolvencyPrinciples.pdf>) and International Association of Restructuring, Insolvency & Bankruptcy Professionals (in issuing a Guide to Recognition and Enforcement in regard to Cross-Border Insolvency, available at:

<https://www.insol.org/page/39/cross-border-insolvency>); for detailed discussions of various international and regional conventions, model laws, EC regulations and directives, uniform rules, guiding principles and practice standards that are relevant for improving national laws and for guidance in international practice: see the work of Wessels R., *Cross-Border Insolvency Law: International Instruments and Commentary*, (Kluwer International Law, 2007).

<sup>169</sup> See UNCITRAL Legislative Guide, above 100; also the World Bank ‘Principles and Guidelines for Effective Insolvency and Creditor Rights’, (2001) available at:

[http://www.worldbank.org/ifa/ipg\\_eng.pdf](http://www.worldbank.org/ifa/ipg_eng.pdf); It is worth noting in 2005 the Word Bank issued another additional guidance: for further information look at:

<http://siteresources.worldbank.org/GILD/Resources/FINAL-ICRPrinciples-March2009.pdf>. as accessed on 09/09/2014.

<sup>170</sup> See UNCTRAL legislative Guide, above 100, p. 1.

<sup>171</sup> Ibid.

<sup>172</sup> Ibid, p. 2.

future bankruptcy reform in Oman reference to the UNCITRAL legislative guide and the World Bank principles guide<sup>173</sup> will be made by this thesis.<sup>174</sup>

In the UNICTRAL Guide, it is stated that even though there is no universal solution to the design of insolvency law, there is a broad agreement that effective and efficient insolvency regimes should aim to achieve a number of key objectives,<sup>175</sup> such as striking a balance between liquidation and reorganisation; providing equitable treatment for similarly situated creditors; providing for timely, efficient and impartial resolution of insolvency; and recognising existing creditors' rights and establishing clear rules for the ranking of priority claims.<sup>176</sup> However, in addressing such issues, insolvency laws vary worldwide.<sup>177</sup> In this regard, some jurisdictions<sup>178</sup> favour stronger recognition and enforcement of creditors' rights and commercial bargains in insolvency and give creditors more control over the conduct of insolvency proceedings than the debtor (sometimes referred to as 'creditor-friendly regimes').<sup>179</sup> Other laws<sup>180</sup> lean towards giving the debtor more

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<sup>173</sup> The World Bank Principles, above 169.

<sup>174</sup> See below section 5.5.

<sup>175</sup> The UNCTRAL legislative Guide, above 100, p. 2.

<sup>176</sup> Ibid, pp. 9-14; However, as will be discussed in Chapter Two, a number of theories, having different views concerning the aims and policies underpinning bankruptcy law, have emerged: for a fuller discussion see below Chapter Two.

<sup>177</sup> The UNCTRAL legislative Guide, above 100, p.15.

<sup>178</sup> The UK and, to some extent, Germany are usually characterised as creditor-friendly: see Kraakman R., *The Anatomy of Corporate Law: A Comparative and Functional Approach*, (2<sup>nd</sup> edition, Oxford University Press, 2009), p. 78.

<sup>179</sup> The UNCTRAL legislative Guide, above 100, p. 15.

<sup>180</sup> It is stated that the main characteristics of a debtor-friendly regime are based on Chapter 11 of the US Bankruptcy Code: see Franken S., above 158, p. 650.

control over the proceedings (referred to as 'debtor-friendly regimes').<sup>181</sup> As will be shown in Chapter Three<sup>182</sup> of this thesis, during the administration regime the management is displaced and an insolvency practitioner is appointed to run the business.<sup>183</sup> However, during the US Chapter 11 proceedings, the management retains their position and secured creditors might be overcome by a new lender who will be granted a super-priority ranking.<sup>184</sup>

## **1.9 Methodology of this Study**

Since the main purposes of this study are as follows: (i) to examine the formal bankruptcy proceedings in England and the US and to identify differences and similarities between these jurisdictions; and (ii) to examine the formal bankruptcy proceedings in Oman and to offer specific proposals for bankruptcy reform to be adopted by the Omani legislator, this study opts for using both comparative and analytical approaches. Because bankruptcy procedures in these three jurisdictions are examined, the study is comparative. Furthermore, since an assessment of many bankruptcy principles<sup>185</sup> is undertaken, the study is analytical. Hence, Chapter Three provides an examination of the statutory rescue proceedings in England and the US and points out the differences and similarities between them. Then, this chapter offers a detailed analysis of a number of issues

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<sup>181</sup> The UNCTRAL legislative Guide, above 100, p. 15; as will be shown below, the US Chapter 11 can be considered as a debtor-friendly regime and England administration regime can be considered as a creditor-friendly regime: for the distinction between pro-debtor and pro-creditor: see below section 4.8.2.

<sup>182</sup> See below section 3.4.1.

<sup>183</sup> See below p. 123.

<sup>184</sup> See below p. 134.

<sup>185</sup> For examples see below sections 3.4, 4.6.2.1, 4.6.2.3, 4.6.2.4 & 4.6.2.5.

and how such issues are dealt with under both jurisdictions. In addition, Chapter Four examines the formal bankruptcy proceedings in Oman and critically assesses their efficiency. Furthermore, Chapter Five discusses the possibility of legal transplantations and provides a proposal for future bankruptcy reform in Oman by determining the extent to which Oman can adopt some of the bankruptcy principles that are found in both England and the US.

This thesis has been conducted primarily through library-based research, which has relied on a comprehensive review of existing literature, legislations, and court decisions. Relevant books and journals relating to the theories underpinning bankruptcy law are used in Chapter Two. Further, relevant books and journals relating to the UK insolvency laws and the US bankruptcy law are referred to. For the Omani bankruptcy regime, the main references are the Commercial Code of 1990 and the Commercial Companies Law of 1974. In this regard, a number of court cases are consulted to interpret some provisions in Omani law. Furthermore, relevant books and articles written on Oman's bankruptcy law are referred to.

### **1.10 Structure of the Thesis**

The next chapter deals with a number of theories underpinning bankruptcy law. The focus of these theories is upon what sort of objectives bankruptcy law should be designed to achieve. Is it the aim of the bankruptcy law to maximise merely the interest of the creditors or are there other interests that should be taken into consideration such as employees', customers', and suppliers' interests? In answering such a question a number of theories have been proposed. Chapter

Two explores five distinct theories, namely the creditors' bargain theory,<sup>186</sup> the bankruptcy choice theory,<sup>187</sup> the communitarian theory,<sup>188</sup> the forum theory,<sup>189</sup> the multiple values theory<sup>190</sup> and the explicit value theory.<sup>191</sup> However, as will be shown in that chapter, these theories can be categorised into two main camps.<sup>192</sup> The first camp has the view that it should not be within the aim of bankruptcy law to maximise the interests of employees, customers, suppliers and the local community. Rather, the sole objective of such law should exclusively be to maximise the return of creditors.<sup>193</sup> As a result, this camp does not recognise the concept of reorganising the business of the debtor unless following such a concept will maximise the interest of the creditors. On the other hand, the second camp takes the view that besides taking into consideration the interests of creditors, bankruptcy law should take into account other interests. At the end of that chapter, this thesis will evaluate these theories and opt for a combination of various theories.<sup>194</sup>

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<sup>186</sup> See below section 2.2.

<sup>187</sup> See below section 2.3.

<sup>188</sup> See below section 2.4.

<sup>189</sup> See below section 2.5.

<sup>190</sup> See below section 2.6.

<sup>191</sup> See below section 2.7.

<sup>192</sup> See below pp. 39-40.

<sup>193</sup> For this view see: Jackson T., *Logic and Limits of Bankruptcy Law*, above 18; Jackson T. & Scott R. above 18; Baird D. & Jackson T., above 18; Rasmussen R., 'Debtor's Choices: A Menu Approach to Corporate Bankruptcy', (1992) 71 T.L.R. 51; Baird D., 'The Uneasy Case for Corporate Reorganizations', (1986) 15 J.L.S. 127; Bebchuk L., 'A New Approach to Corporate Reorganization', (1988) 101 H.L.R. 755.

<sup>194</sup> For this view see: Gross. K., above 18; Keay A., above 18; Gross K., above 18; Warren E., above 18; Korobkin D., above 18; Finch V., above 91.

Chapter Three explores the experience of two jurisdictions which have developed insolvency systems. That chapter will study insolvency proceedings of England and the US. A brief examination of four insolvency procedures in England will be undertaken, namely administration, receivership, voluntary arrangement and scheme of arrangement. Then the US Chapter 11 will be dealt with. Here, the focus will be on examining some bankruptcy issues<sup>195</sup> to ascertain how they are regulated under both England and the US laws. Whether or not management should be displaced during bankruptcy processes is one of the issues discussed.<sup>196</sup> As will be shown in that chapter, the position in England differs from that of the US.<sup>197</sup> Also, the issue of staying creditors' action will be dealt with. In this regard, the importance of such stay will be highlighted and how the rights of secured creditors are protected.<sup>198</sup> Then, the issue of post financing will be approached and how such financing might affect the success of the rescue attempt will be discussed. In this regard, the difference between England and the US will be highlighted.<sup>199</sup> Further, the notion of cramming-down dissenting creditors during insolvency processes will be dealt with. Finally, at the end of that chapter, the thesis will evaluate the experience of both England and the US.<sup>200</sup>

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<sup>195</sup> For the rationale behind the selection of specific issues to be addressed in this thesis: see above pp. 14-15.

<sup>196</sup> See below section 3.4.1.

<sup>197</sup> Ibid.

<sup>198</sup> See below section 3.4.2.

<sup>199</sup> See below section 3.4.3.

<sup>200</sup> See below section 3.5.

Chapter Four provides an overview of the general features of the current bankruptcy regime in Oman,<sup>201</sup> for instance, the definition of bankruptcy according to the Commercial Code, persons administering bankruptcy processes, the position of employees and the treatment of small bankruptcies.<sup>202</sup> Also, an overview of the current bankruptcy regime in Oman will be given by identifying various alternatives available to distressed debtors.<sup>203</sup> First, bankruptcy procedures under Oman's Commercial Code and the eligibility for applying will be discussed. In this regard, that chapter will focus on the main problems with the current bankruptcy procedures.<sup>204</sup> For example, unlike the case in both England and the US, under the current bankruptcy regime in Oman, secured creditors' actions are not stayed and they have the right to enforce their securities despite the initiation of such proceedings. Secondly, the aims and procedures of the preventive composition scheme will be explored by identifying the reasons for its inefficiency.<sup>205</sup> After that, an assessment of the current bankruptcy regime in Oman will be undertaken.<sup>206</sup>

Having discussed the theories of insolvency law, observed the experience of both England and the US and examined the current bankruptcy regime in Oman, Chapter Five is an attempt to propose a bankruptcy regime that suits Oman. That chapter will start by exploring the theories underpinning legal transplantations. As will be discussed,<sup>207</sup> some scholars argue that legal transplants are possible and

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<sup>201</sup> See below section 4.4.

<sup>202</sup> Ibid.

<sup>203</sup> See below section 4.3.

<sup>204</sup> See below section 4.5.

<sup>205</sup> See below section 4.6.

<sup>206</sup> See below section 4.8.

<sup>207</sup> See below section 5.3 (A).

even necessary for legal development.<sup>208</sup> However, others argue that legal rules mirror the needs of a specific society and, as a result, it is impossible to transplant such rules to other jurisdictions.<sup>209</sup> However, as will be explained further, the later view overlooks the vast amount of legal transplantations occurring worldwide.<sup>210</sup> Then, the effect of legal transplantations on the receiving countries<sup>211</sup> and the ways to measure the success of such transplantations will be dealt with.<sup>212</sup> After that, that chapter will discuss legal transplants in the area of bankruptcy laws.<sup>213</sup> Also, the experience of Oman in transplanting legal rules will be observed. In addition, this thesis will demonstrate how important it is for Oman to transplant bankruptcy principles from other developed jurisdictions.<sup>214</sup> However, it will be argued that in adopting such principles caution should be taken since what is workable in other jurisdictions might not be so in Oman.<sup>215</sup> Furthermore, that chapter will demonstrate how necessary it is for Oman to introduce a bankruptcy law reform.<sup>216</sup> In this regard, reference will be made to Oman's Economic Vision 2020 and to the role played by Small and Medium Enterprises in enhancing the national economy. That chapter will conclude by suggesting a map for future bankruptcy reform in

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<sup>208</sup> For this view see: Watson A. *Legal Transplants*, (Edinburgh, Scottish Academic Press, 1974); Watson A., 'Legal Transplants and Law Reform', (1976) 92 L.Q.R. 79; Kahn- Freund, 'One Uses and Misuses of Comparative Law', (1974) 37 (1) M.L.R. 1.

<sup>209</sup> For this view see: Mousourakis G., 'Transplanting Legal Models Across Culturally Diverse Societies: A Comparative Law Perspective', (2010) 57 O.U.L.R. 87; Legrand P., 'What 'Legal Transplants'?', in Nelken D. & Feest J., *Adopting Legal Culture*, (Hart Publisher, 2001).

<sup>210</sup> See below section 3.5. (A).

<sup>211</sup> See below section 5.3 (B).

<sup>212</sup> See below section 5.3 (E).

<sup>213</sup> See below section 5.3.1.

<sup>214</sup> See below section 5.3.2.

<sup>215</sup> See below pp. 273-275 & pp. 318-319.

<sup>216</sup> See below section 5.4 (A), (B) & (C).

Oman.<sup>217</sup> It will be emphasised that future bankruptcy law should have a clear statutory vision and various bankruptcy procedures should be designed in a way that reflects such a mandate. Also, as will be argued, designing a bankruptcy law in a way that provides a level of certainty and predictability is important and this might be achieved, for instance, by offering clarity in regard to the bankruptcy tests and priority entitlements rules. Further, the call for the establishment of a rescue regime is one of the suggestions put forward by this thesis and Chapter Five emphasises the necessity of taking into account a number of issues in a designing future rescue regime. Finally, the importance of having qualified bankruptcy practitioners and of assessing the implementation of the bankruptcy law by establishing a reviewing mechanism will be highlighted.

### **1.11 Conclusion**

The aim of this chapter was to provide a general overview of the themes of this thesis. This chapter started by highlighting some issues with the current bankruptcy regime in Oman that this thesis will address. Then, clarification of the terminology that will be used in this thesis was outlined. Also, the scope, the importance and the questions of this study are explained. Further, this chapter stated the reasons for selecting Oman as the subject of this study and the reasons for selecting to observe the experience of both England and the US. In addition, the role played by international organisations in proposing the development of national insolvency laws has been highlighted. Also, the methodology used to accomplish this study has been clarified. Finally, this chapter outlined the structure of this thesis.

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<sup>217</sup> See below section 5.5.

## Chapter Two: Theoretical Approaches to Bankruptcy Law

### 2.1 Introduction

A broad range of interests can be affected by the bankruptcy of a company,<sup>1</sup> such as the interests of secured and unsecured creditors and the interests of employees.<sup>2</sup> As a consequence of bankruptcy, shareholders may lose their investment.<sup>3</sup> Employees may have direct claims in the form of unpaid wages and may be concerned about their future employment.<sup>4</sup> Suppliers might be brought into bankruptcy<sup>5</sup> and the Government may lose out on tax revenue.<sup>6</sup> Employees may

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<sup>1</sup> As will be discussed below, the Cork Report describes the law of bankruptcy as referring to three parties: the debtor, his creditors and society: see, *Report of the Review Committee on Insolvency Law and Practice*, (Cmnd 8558, Great Britain Parliament, 1982), known as the 'Cork Report', para. 192; also, as will be shown in the next chapter, both the US Bankruptcy Law of 1978 and the UK Enterprise Act of 2002 recognise the impact of bankruptcy on a broad range of interests: see below sections 3.2.1 & 3.3.1.

<sup>2</sup> Goode R., *Principles of Corporate Insolvency Law*, (4<sup>th</sup> edition, Sweet & Maxwell, 2011), p. 68; In *Re Barlow Clowes Gilt Managers Limited*, Millett J said that "The liquidation of an insolvent company can affect many thousands, even tens of thousands, of innocent people...[I]n the case of a major trading company it can affect its customers and suppliers and the livelihood of many thousands of persons employed by other companies whose viability is threatened by the collapse of the company in liquidation": [1991] BCLC 750, p. 760; Keay A., 'Insolvency Law: A Matter of Public Interest' (hereinafter 'Public Interest'), (2000) 51 N.I.L.Q. 509, pp. 527-528.

<sup>3</sup> It is also argued that in the event of bankruptcy, shareholders may not receive any payment since secured creditors will seek court permission to enforce their collateral and unsecured creditors may suffer significant losses because they may not be given their money in full: see Fabozzi F., *Bond Portfolio Management*, (John Wiley & Sons, 2001), p. 57.

<sup>4</sup> Bose T., 'Resolving Financial Distress- Justice as Fairness and Reciprocity', (2004) UCL Jurisprudence Review 230, p. 243.

<sup>5</sup> As regards the impact on their business of the insolvent company's failure. Particularly, if their businesses are heavily reliant on the existence of the insolvent company: see Goode R., above 2, p. 72.

<sup>6</sup> In this regard, the US Bankruptcy Act, in particular, sections 523 (a), 507 (a) (2) & 507 (a) (8) permits the discharge of many tax debts: see Waldman P. & Berke K., 'Bankruptcy Discharge of Tax Debts: Navigating the Minefield', (2004) 18 P.T.L. 41, p. 47; see also Swain A., 'The Effect of

be left without jobs.<sup>7</sup> As a consequence, if a company becomes bankrupt,<sup>8</sup> a number of questions are raised, such as whether bankruptcy law should be directed at maximising returns for creditors? Or should the aim of bankruptcy law be to protect the interests of creditors and non-creditors, such as employees and the community? Should bankruptcy law be directed at striking balance between the rights of creditors, debtors and those parties affected by the bankruptcy of the company? Also, how should bankruptcy law respond to the competing interests of different creditors?

In an attempt to address such questions, a number of theories having different views concerning the aims and policies underpinning bankruptcy law have emerged.<sup>9</sup> Examples of such theories are the creditors' bargain theory,<sup>10</sup> the

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Bankruptcy on State Tax Enforcement and Proceedings', Tax Analyst, Special Report, (March 19<sup>th</sup>, 2012) available at: <http://taxprof.typepad.com/files/63st0947.pdf>. as accessed on 20/01/2014.

<sup>7</sup> For instance, an official report in the US revealed that companies that have been declared bankrupt in asbestos-related bankruptcy cases employed more than 200,000 workers before their bankruptcies. However, asbestos-related bankruptcies led to the direct loss of as many as 60,000 jobs: see *Senate Reports: numbers 1-39- United States, Congress*, (Government Printing Office, 2003), pp. 19-20.

<sup>8</sup> There are a number of circumstances in which a merchant (including individual traders and companies) might be regarded as bankrupt. For example, Article 579 of the Oman's Commercial Code 1990 states that any merchant whose financial affairs are in difficulty and who ceases to pay due debts might be bankrupt: see below pp. 208-210.

<sup>9</sup> See Goode R., above 2, pp. 68-79; Finch V., *Corporate Insolvency Law: Perspectives and Principles* (hereinafter *Corporate Insolvency*), (2<sup>nd</sup> edition, Cambridge University Press, 2009), pp. 32-62; Keay A. & Walton P., *Insolvency Law: Corporate and Personal*, (Longman, 2003), pp. 24-30.

<sup>10</sup> For this view: see Jackson T., *The Logic and Limits of Bankruptcy Law* (hereinafter *Logic and Limits*), (Harvard University Press, 1986); Jackson T. & Scott R., 'On the Nature of Bankruptcy: An Essay on Bankruptcy Sharing and the Creditors' Bargain' (hereinafter 'The Nature of Bankruptcy') (1989) 75 V.L.R. 155; Baird D. & Jackson T., 'Bargaining After the Fall and the Contours of the Absolute Priority Rule' (hereinafter 'Absolute Priority Rule') (1988) 55 U.C.L.R. 738; Rasmussen R., 'Debtor's Choices: A Menu Approach to Corporate Bankruptcy', (1992) 71 T.L.R. 51; Baird D., 'The

bankruptcy choice theory,<sup>11</sup> the communitarian theory,<sup>12</sup> the forum theory,<sup>13</sup> the multiple values theory<sup>14</sup> and the explicit value theory.<sup>15</sup> As Walton rightly stated, there are almost as many theories as there are writers in this particular area.<sup>16</sup> However, these theories can be, in broad terms, categorised into two groups. The first group holds the view that the main role and objective of bankruptcy law should be to maximise the collective returns to creditors,<sup>17</sup> while the other group is of the opinion that bankruptcy creates a community of parties who are affected by the debtor's financial distress, which not only includes creditors, but covers a wider group which may include workers, customers, suppliers and local authority.<sup>18</sup> Therefore, it has been said that focus of the whole debate on bankruptcy theories

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Uneasy Case for Corporate Reorganizations', (1986) 15 J.L.S. 127; Bebchuk L., 'A New Approach to Corporate Reorganization', (1988) 101 H.L.R. 755.

<sup>11</sup> Korobkin D., 'Contractarianism and the Normative Foundations of Bankruptcy Law' (hereinafter 'Contractarianism'), (1993) 71 T.L.R. 541; Mokal R., 'The Authentic Consent Model: Contractarianism, Creditors Bargain and Corporate Liquidation' (hereinafter 'The Authentic Consent Model'), (2001) 21 J.L.S. 400; see below section 2.3.1.

<sup>12</sup> Gross K., 'Taking Community Interests into Account in Bankruptcy' (hereinafter 'Community Interests'), (1994) 72 W.U.L.O.Q. 1031, p. 1042; Keay A., 'Public Interest', above 2; Gross K., *Failure and Forgiveness: Rebalancing the Bankruptcy System* (hereinafter *Failure and Forgiveness*), (Yale University Press, 1999), p. 205; see below section 2.4.1.

<sup>13</sup> Flessner A., 'Philosophies of Business Bankruptcy Law: An International Overview', in Ziegel J., *Current Developments in International and Comparative Corporate Insolvency Law*, (Clarendon Press, 1994), p. 24; see below section 2.5.1.

<sup>14</sup> Warren E., 'Bankruptcy Policy', (1987) 54 (3) U.C.L.R. 755; Korobkin D., 'Rehabilitating Values: A Jurisprudence of Bankruptcy (hereinafter 'Rehabilitating Values'), (1991) 91 R.C.L. 717; see below section 2.6.1.

<sup>15</sup> Finch V., *Corporate Insolvency*, above 9, pp. 52-63; see below section 2.7.1.

<sup>16</sup> Walton P. 'When is Pre-Packaged Administration Appropriate? A Theoretical Consideration', (2011) 20 N.L.J. 1, p. 1.

<sup>17</sup> See above, footnote 10.

<sup>18</sup> See, for example, the works of Gross K., 'Community Interests', above 12, Warren E., 'Bankruptcy Policy', above 14 and Korobkin D., 'Rehabilitating Values', above 14.

involves deciding who and what is to be protected and recognised by bankruptcy law.<sup>19</sup>

Unlike the situation in the United States where scholars have long been interested in the philosophy of bankruptcy law, in the United Kingdom there have been few developed comments on the theories underpinning bankruptcy law.<sup>20</sup> This, as argued by Goode,<sup>21</sup> might be because of the pragmatic way in which English law has developed. In addition, Keay and Walton argued that the focus of scholars in the UK has been on statutory developments and case law instead of 'divining theoretical framework'.<sup>22</sup> However, recently, some scholars from the UK have begun to concern themselves more with normative theories of insolvency law, for instance, the Explicit Value Theory promoted by Finch and the Authentic Consent Theory promoted by Mokal.<sup>23</sup>

In Oman, there is also no developed discussion on the theory underpinning bankruptcy law. This thesis takes the view that there are a number of reasons behind the absence of such discussion in Oman. First, as was the case in the UK

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<sup>19</sup> Keay A. & Walton P., above 9, p. 25.

<sup>20</sup> Goode R., above 2, p. 69; In 1997, Vanessa Finch has established a theoretical base for herself by promoting her Explicit Value Theory: see Finch V., *Corporate Insolvency*, above 9, pp. 48-63; Finch V., 'The Measures of Insolvency Law' (hereinafter 'Insolvency Measures') (1997) 17 O.J.L.S. 227.

<sup>21</sup> Goode R., above 2, p. 69

<sup>22</sup> Until the late 1980s insolvency law in the UK was rarely subject of scholarly articles or texts, and was rarely discussed on undergraduate and postgraduate courses: see Keay A. & Walton P., above 9, p. 4 & p. 25.

<sup>23</sup> See, for example, Mokal R., *Corporate Insolvency Law: Theory and Application* (hereinafter *Corporate Insolvency*), (Oxford University Press, 2005), pp. 61-91; Finch V., *Corporate Insolvency*, above 9, pp. 48-63.

before the 1980s,<sup>24</sup> until now Bankruptcy Law in Oman has rarely been the subject of scholarly articles and texts.<sup>25</sup> This might be because of the fact that, at present, there is no separate bankruptcy law in Oman. In this regard, even though both Oman's Commercial Code of 1990 and the Commercial Companies Law of 1974 incorporate a number of bankruptcy provisions,<sup>26</sup> few scholars have examined these laws.<sup>27</sup> Secondly, over the past forty years, bankruptcy law has not enjoyed significant government focus. As will be discussed below,<sup>28</sup> the focus was on enacting legislations that facilitate and promote the access of domestic and foreign investments instead of regulating the exit of such investments.<sup>29</sup>

The aim of this chapter is to explore some of the theories which may underpin bankruptcy law. However, it is worth noting that this chapter on theoretical frameworks is not exhaustive and could hardly do full justice to the enormous debate that has been advocated.<sup>30</sup> Yet the discussion below will point out some of the theories that have been put forward by the US and the UK scholars. Thus, first of all, the creditors' bargain theory will be discussed. Mokal stated that "there is no doubt that insolvency law scholarship has long been dominated by the creditors'

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<sup>24</sup> See Keay A. & Walton P., above 9, p. 4.

<sup>25</sup> For a brief overview of the existing literatures in Oman: see above pp. 20-22.

<sup>26</sup> Generally speaking, this Code covers the adjudication of bankruptcy, bankruptcy officials, the legal effects of bankruptcy, management of bankruptcy, the termination of bankruptcy (including composition with creditors scheme), bankruptcy of companies, discharge of bankrupts and bankruptcy-related offences. The Commercial Companies Law of 1974 governs companies' liquidation procedures.

<sup>27</sup> See above footnote 25.

<sup>28</sup> See below pp. 302-304.

<sup>29</sup> Examples of such laws are: the Commercial Companies Law of 1974, the Commercial Code of 1990, the Foreign Capital Investment Law of 1994, Arbitration Law of 1997, Privatisation Law of 2004, Industrial Property Rights Law of 2008 and Copyright Law of 2008: see below p. 304.

<sup>30</sup> This statement has been borrowed from Keay A. & Walton P., above 9, p. 25.

bargain theory. For almost two decades, insolvency scholars have either argued within its assumptions, or have proceeded by making it their first (and often primary) target.”<sup>31</sup> Then, the bankruptcy choice theory, the communitarian theory, the forum theory and multiple values theory will be dealt with. Further, the alternative approach to those existing theories promoted by Finch in terms of the explicit value theory will be discussed. Finally, this chapter will conclude by evaluating those normative theories and by discussing the approach that is favoured by this thesis.

It is worth noting that once bankruptcy theories have been examined and evaluated, a separate chapter will explore the experience of both England and the United States by identifying to what extent such theories are adopted by the legislators. Also, the notions underpinning some of the theories discussed in this thesis will be utilised in proposing a bankruptcy regime to be adopted by the Omani legislator. As will be discussed below,<sup>32</sup> this thesis will emphasise the fact that policy makers in Oman should have recourse to these normative theories when considering further development to bankruptcy law. Further, as will be shown in Chapter Four,<sup>33</sup> even though the current bankruptcy regime in Oman is in favour of secured creditors’ interests, the notions of the creditors’ bargain theory are not fully

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<sup>31</sup> Mokal R., *Corporate Insolvency*, above 23, p. 33; it is also stated that ‘this theory of insolvency law has, arguably, dominated the field in the past 20 years and continues to have a profound influence despite the fact that its main champion, Prof. Jackson, no longer writes in the area: see Keay A. & Walton P., above 9, p. 25.

<sup>32</sup> See below pp. 107-110.

<sup>33</sup> See below section 4.8.2.

adopted. This is because of the fact that staying secured creditors' actions<sup>34</sup> is not one of the features of the current bankruptcy regime in Oman.<sup>35</sup>

## 2.2 The Creditors' Bargain Theory

The most widely debated bankruptcy law theory<sup>36</sup> can be said to be the creditors' bargain theory. This theory was proposed by Thomas Jackson through his lectures and writing in the 1980s'.<sup>37</sup> Subsequently, Douglas Baird<sup>38</sup> and Robert Scott<sup>39</sup> joined him as the main supporters of the creditors' bargain theory. The premises of this theory, more particularly, are influenced prominently by the law and economics movement which was born in the United States in the mid- 1970s

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<sup>34</sup> The moratorium is considered part of the compulsory debt collection system: see below section 2.2.1.

<sup>35</sup> For in-depth discussion of the case in Oman: see below sections 4.4 (D) & 4.6.2.4.

<sup>36</sup> Mokal R., *Corporate Insolvency*, above 23, p. 33; Keay A. & Walton P., above 9, p. 25.

<sup>37</sup> The decade of the 1970s brought forth a number of important corporate –finance works on bankruptcy and related issues. However, before the 1980s, the focus of scholars has not been in divining theoretical framework. In the 1980s, it is Thomas Jackson who has been most explicit in seeking to establish a theoretical base for himself: see Ayer J., 'So Near to Cleveland, So Far From God: An Essay on the Ethnography of Bankruptcy', (1992) 61 U.Cin.L.Rev. 407, pp. 416-417; examples of some works on bankruptcy and related issues in the 1970s are: Bulow J. & Shoven J., 'The Bankruptcy Decision', (1978) 9 Bell J. Econ. 437; Galai D. & Masulis R., 'The Option Pricing Model and the Risk Factor of Stock', (1971) 26 J. Fin. 347; Warner J., 'Bankruptcy, Absolute, Priority, and the Pricing of Risky Debt Claims', (1977) 4 J. Fin.Econ. 239; Warner J., 'Bankruptcy Costs: Some Evidence', (1977) 32 J. Fin. 337.

<sup>38</sup> Baird D., 'Loss Distribution, Forum Shopping, And Bankruptcy: A Reply to Warren' (hereinafter 'A Reply to Warren'), (1987) 54 U.C.L.R. 815; also Baird D. & Jackson T., 'Absolute Priority Rule', above 10.

<sup>39</sup> See the work of Jackson T. & Scott R., 'The Nature of Bankruptcy', above 10.

and which had a substantial impact on scholarship, not only in the United States, but also in the UK and around the world.<sup>40</sup>

Since the creditors' bargain theory is considered<sup>41</sup> to be the most controversial theory,<sup>42</sup> the focus of this part of this chapter will be on the principles of this theory, its advantages and the critiques of the creditors' bargain theory.

### **2.2.1 The Principles of the Creditors' Bargain Theory**

Jackson,<sup>43</sup> followed by his supporters,<sup>44</sup> argued that the main role and objective of bankruptcy law should be to maximise the collective return to creditors of the insolvent debtor. It is concerned with neither the interests of the debtor nor the interests of the community.<sup>45</sup> Bankruptcy law, based on Jackson's view, is a collective debt-collection device and it only deals with the rights of the creditors of the insolvent company.<sup>46</sup> This theory does not recognise rehabilitation<sup>47</sup> of the distressed enterprise as a legitimate objective of bankruptcy law unless, and to the

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<sup>40</sup> Keay A. & Walton P., above 9, p. 25; Goode R., above 2, p. 69; Ayer J., above 37, pp. 417-418.

<sup>41</sup> See above p. 42 & footnote number 31.

<sup>42</sup> *Ibid.*

<sup>43</sup> Jackson T., *Logic and Limits*, above 10.

<sup>44</sup> Baird D., 'World without Bankruptcy', (1987) L.C.P. 173, p. 184; Baird D., 'A Reply to Warren', above 38; Baird D. & Jackson T., 'Absolute Priority Rule', above 10; Jackson T. & Scott R., 'The Nature of Bankruptcy', above 10.

<sup>45</sup> Jackson T., *Logic and Limits*, above 10, p. 5.

<sup>46</sup> *Ibid.*

<sup>47</sup> Jackson clearly stated that "it is wrong to think that there should be an independent substantive policy of reorganisation law to give firms breathing space or to reorganise them to preserve jobs. These policies should not be bankruptcy policies": Jackson T., *Logic and Limits*, above 10, p. 201; Bose T., above 4, p. 231.

extent that, it leads to maximise returns to creditors.<sup>48</sup> Thus, according to Jackson, bankruptcy law can and should help a firm stay in operation when it is worth more to its creditors alive than dead.<sup>49</sup> Even though the regime should help a firm to continue its business if it is worth more to the debtor's creditors as a going concern than selling it piecemeal, rehabilitation *per se* should not be an independent policy because it does little to reconcile the diverse interests of creditors.<sup>50</sup> Baird argued that "embracing a "rehabilitation" goal as a matter of bankruptcy policy does little to resolve many bankruptcy disputes".<sup>51</sup> One of the most common disputes in bankruptcy law is over the issue of priorities. When there are not enough assets to go around, some creditors are not going to be paid in full.<sup>52</sup> In this regard, Baird argued that there is nothing bankruptcy law can do to change this, irrespective of what goals it embraces.<sup>53</sup> He, further, claimed that a dispute over priorities has nothing to do with the question whether a firm should stay in operation to save

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<sup>48</sup> Jackson viewed bankruptcy law as a collective debt-collection device, and it merely deals with the rights of creditors: *Ibid.*

<sup>49</sup> This might be the case if the value of a firm as a going concern is greater than its value as piecemeal. Baird provided an example of a restaurant in a small town which serves heavy, overpriced food that few wanted. The restaurant is a firm that has failed. In this regard, all creditors might agree, if they were able to meet and bind one another, that it was in their best interest to give the restaurant owner a second chance. The restaurant might work with a new chef and a new menu, and the value of a successful restaurant is much greater than the value of a restaurant's equipment sold piecemeal: Baird D., 'World without Bankruptcy', above 44, p. 183; Jackson T., *Logic and Limits*, above 10, p. 2; furthermore, Jackson and Scott stated that "the assumption of greater going concern value depends upon the existence of two factors: the debtor's assets must be worth more in combination than if they were broken up and sold, and the long-term prospects of the debtor must be brighter than the short-term prospects": Jackson T. & Scott R., 'The Nature of Bankruptcy', above 10, p. 159.

<sup>50</sup> Jackson T., *Logic and Limits*, above 10, p. 2.

<sup>51</sup> Baird D., 'World without Bankruptcy', above 44, p. 184.

<sup>52</sup> *Ibid.*

<sup>53</sup> *Ibid.*

jobs.<sup>54</sup> A rehabilitation goal should not lead to favour denying secured creditors the time value of their claims during bankruptcy proceedings.<sup>55</sup>

Under the creditors' bargain theory, regulating the inherent conflicts among diverse groups having separate claims against debtor's assets are a primary objective of any bankruptcy process.<sup>56</sup> As a result, the bankruptcy normative policy objective is to collectivise the process by which debtors' assets are made available to claimants.<sup>57</sup> According to Jackson,<sup>58</sup> bankruptcy law is a response to a 'common pool' problem arising when diverse co-owners<sup>59</sup> affirm rights against a common pool of assets. Baird, in addition, clarified this by maintaining that the self-interest of creditors leads to a collective action problem,<sup>60</sup> and it is important to have a compulsory mechanism to ensure that the self-interest of individuals does not conflict with the interests of the group.<sup>61</sup> In order to tackle such a problem, this theory suggests that there should be a compulsory collective system where the law "must usurp individual creditor remedies in order to make the claimants act in an

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<sup>54</sup> Ibid.

<sup>55</sup> For further discussion of Baird's view about the rehabilitation of corporate debtors: see *ibid*, pp. 181-186.

<sup>56</sup> *Ibid*, p. 158.

<sup>57</sup> Jackson T., *Logic and Limits*, above 10, pp. 16-17.

<sup>58</sup> See Jackson T., *Logic and Limits*, above 10, p. 16; Finch V., *Corporate Insolvency*, above 9, p. 32.

<sup>59</sup> Whose rights against the assets make all of them species of "owners": see Jackson T., 'Avoiding Powers in Bankruptcy', (1984) 36 S.L.R. 725, p. 728.

<sup>60</sup> Because without a collective bankruptcy proceeding, each creditor will tend to rush towards the debtor's assets before other creditors: see Baird D., 'World without Bankruptcy', above 44, p. 183.

<sup>61</sup> Baird D., 'World without Bankruptcy', above 44, p. 184; see also Jackson T., 'Avoiding Powers in Bankruptcy', above 59, pp. 728-229.

altruistic and cooperative way”<sup>62</sup> and all the debtors’ creditors should be bound to it.<sup>63</sup> Thus, according to this theory, a mandatory mechanism of debt collection should be in place, instead of an individual debt collection system that is in place outside bankruptcy law.<sup>64</sup> In this regard, imposing a stay on creditors’ actions should be an integral part of the compulsory mechanism of debt collection.<sup>65</sup> As will be show in Chapter Three,<sup>66</sup> the concept of collectivity cannot achieve its aim unless creditors are prohibited from pursuing their claims.

Further, the creditors’ bargain theory is in contradiction with the idea that bankruptcy law should take into account all of the interests of the substantial numbers of public rights.<sup>67</sup> Baird and Jackson argued that it is not within the policy

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<sup>62</sup> Jackson T., *Logic and Limits*, above 10, p. 17.

<sup>63</sup> *Ibid.*

<sup>64</sup> Jackson T., ‘Bankruptcy, Non-Bankruptcy Entitlement, and the Creditors’ Bargain’ (hereinafter ‘Non-Bankruptcy Entitlement’), (1991) Y.L.J. 857, p. 862.

<sup>65</sup> See Bhandari J. & Weiss L., *Corporate Bankruptcy: Economic and Legal Perspectives*, (Cambridge University Press, 1996), p. 42; Jackson T., ‘Non-Bankruptcy Entitlement’, above 64, p. 867.

<sup>66</sup> See below section 3.4.2.

<sup>67</sup> Keay argued that there is little consistency in defining the public interest and, as a result, there is no general consensus as to what the public interest involves: see Keay A., ‘Public Interest’, above 2, pp. 522 & 533.; Veach stated that public interests are defined by scholars ‘as the interests of those, beside the debtor, who have not invested capital in whatever business is in bankruptcy’. However, he argued that this definition is too narrow. He argued that secured and unsecured creditors are members of the public, and their financial wealth is essential to the stability of the national economy and, hence, their interests cannot be excluded from the ‘public interest’. He argued that the interests of debtors need also to be taken into consideration as part of the public interest since preserving the business might lead to the growth of the national economy: see Veach J., ‘On Considering the Public Interest in Bankruptcy: Looking to the Railroad for Answers’, (1997) 72 (4) *Indian L.J.* 1711, p. 1214; for Keay’s criticisms of Veach’s definition: see Keay A., ‘Public interest’, above 2, pp. 524-525.; moreover, for the purposes of insolvency law, Keay stated that it is preferable ‘rather than formulating a comprehensive definition which may well be unworkable, to

of bankruptcy law to take into consideration the interests of others who have no claims against the assets<sup>68</sup> of the insolvent company.<sup>69</sup> Baird, in addition, stated that “legal rights should turn as little as possible on the forum in which one person or another seeks to vindicate them”.<sup>70</sup> “Whenever we must have a legal rule to distribute losses in bankruptcy, we must also have a legal rule that distributes the same loss outside of bankruptcy.”<sup>71</sup> Baird,<sup>72</sup> in addition, questioned why bankrupt company should have a special obligation to protect their employees if the company outside bankruptcy does not have any obligation of this sort. If, according to Baird, social policy rationally favours workers, employee protection legislations could favour workers in all businesses not just those that are unable to meet their debt obligation or find themselves bankrupt for some other reason.<sup>73</sup> As a consequence, Baird argued that there is no satisfactory reason why it is legitimate to tackle only the outside effects of business failure within bankruptcy law.<sup>74</sup> If

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say that the public interest involves taking into account interests which society has regard for and which are wider than the interests of those parties directly involved in any given insolvency situation, that is, the debtor and the creditors’: see Keay A., ‘Public Interest’, above 2, p. 525.

<sup>68</sup> Baird and Jackson stated that workers, for example, have no substantive rights against the assets. Thus, the owners (with substantives rights- e.g. secured creditors, shareholders) are free to close the business without considering the interests of workers if doing so brings the owners more money: see Baird D., ‘World without Bankruptcy’, above 44, p. 186; Jackson T., *Logic and Limits*, above 10, p. 25; Mooney also stated that “to take any other interests of those constituencies into account would constitute *prima facie* theft”: Mooney C., ‘A Normative Theory of Bankruptcy Law: Bankruptcy As (Is) Civil Procedure’, (2004) 61 W.L.L.R. 931, p. 964.

<sup>69</sup> *Ibid.*

<sup>70</sup> Baird D., ‘Reply to Warrant’, above 38, p. 822.

<sup>71</sup> *Ibid.*, p. 822.

<sup>72</sup> *Ibid.*; Bhandari J., *Corporate Bankruptcy: Economic and Legal Perspectives*, (Cambridge University Press, 1996), p. 28.

<sup>73</sup> Baird D., ‘Reply to Warren’, above 38, p. 822.

<sup>74</sup> *Ibid.*

some interests are in need of such protection, it is better to tackle this problem and provide protection within the whole legal system in order to provide a uniform and certain protection.<sup>75</sup> Thus, according to this theory, accommodating these rights,<sup>76</sup> such as employees (with regard to job preservation claims), local suppliers (with regard to the impact on their business of the insolvent company's failure), environmental (in regard to payment of clean-up costs and pollution) and community rights (with regard to cessation of trading), under bankruptcy law is mistaken and inappropriate.<sup>77</sup>

Moreover, the creditors' bargain theory viewed bankruptcy as a system designed to mirror the agreement one would expect the creditors to reach among themselves (*ex ante*) were they have the opportunity to negotiate such agreement before entering into a transaction with the debtor.<sup>78</sup> It is claimed, by Jackson,<sup>79</sup> that this theory is an application of the famous Rawlsian<sup>80</sup> notion of bargaining from

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<sup>75</sup> For further details see: Baird D. & Jackson T., 'Corporate Reorganization and the Treatment of Divers Ownership Interests: A Comment on Adequate Protection of Secured Creditors in Bankruptcy', (1984) U.C.L.R. 97, pp. 102-103.

<sup>76</sup> See Goode R., above 2, pp. 72-73.

<sup>77</sup> For criticising this view: see below pp. 57-60.

<sup>78</sup> Jackson T., 'Non-Bankruptcy Entitlement', above 64, p. 860; However, it is difficult to envisage how agreements can be reached *ex ante* between various creditors: for further discussion: see below pp. 55-57.

<sup>79</sup> Jackson T., *Logic and Limits*, above 10, p. 17.

<sup>80</sup> Jackson claimed that he bases his theory on Rawls concepts of 'original position' behind a 'veil of ignorance': Jackson T., *ibid*: in summarising Rawls' theory, Bose stated that Rawls presents a theory of the principles of justice in which he establishes a suitable connection between a particular conception of the person and principles of justice. His fundamental claim is that 'justice as fairness'. 'Fairness to Rawls means reciprocity. All people are treated as worthy of equal consideration.' In his view, co-operation between persons is central in order to come to an agreement and at the same time further their own good. 'Rawls' thought experiment imagines an 'original position' where people are subject to a 'veil of ignorance'. Under these conditions, since people are stripped of any

behind a 'veil of ignorance'. Accordingly, this theory reflects the hypothetical agreement that creditors would reach if they had the chance before (*ex ante*) extending credit to the insolvent debtor.<sup>81</sup> Although the bargain is hypothetical, the creditors have the attributes that creditors in real world transactions possess, as it is claimed, that "the hypothetical bargain analysis provides indirect evidence of what real world parties would, in fact, agree to".<sup>82</sup>

## 2.2.2 The Possible Advantages of the Creditors' Bargain Theory

According to this theory, the main role and objective of bankruptcy law is to maximise the collective return to creditors through a compulsory collective debt-collection system and to solve the 'common pool'<sup>83</sup> of assets problem arising from diverse claims to limited assets.<sup>84</sup> Jackson argued that having such a compulsory system will help to reduce the cost of debt collection, and help to maximise the aggregate pool of assets and it is thus argued to be administratively effective.<sup>85</sup> In illustrating the advantages of a compulsory collective debt-collection system, Jackson<sup>86</sup> provided the following simple hypothetical case:

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knowledge about themselves they decide what is just independently of any vested interests, bias or partiality so their reasoning is impartial.': see Bose T., above 4, p. 242; see Rawls J., 'Kantian Constructivism in Moral Theory', (1980) 77 J.P. 515, p. 516.

<sup>81</sup> Jackson T., *Logic and Limits*, above 10, p. 17.

<sup>82</sup> Jackson T. & Scott R., 'The Nature of Bankruptcy', above 10, p. 160.

<sup>83</sup> This problem is discussed in the work of Baird D. & Jackson T., above 75.

<sup>84</sup> Baird D., 'World without Bankruptcy', above 44, p. 183; Jackson T., *Logic and Limits*, above 10, p. 17.

<sup>85</sup> Jackson T., 'Non-Bankruptcy Entitlement', above 64, p. 861; Jackson T., *Logic and Limits*, above 10, p. 14.

<sup>86</sup> Jackson T., 'Non-Bankruptcy Entitlement', above 64, p. 861.

*“D has a small printing business. Potential creditors estimate that there is a twenty percent chance that D will become insolvent. At the point of insolvency, the business is expected to be worth \$80,000 as an operating entity and \$60,000 if sold piecemeal. D borrows \$50,000 from each of two creditors, C1 and C2. C1 and C2 expect to spend \$2,000 each in pursuit of individual creditor remedies should D become insolvent and fail to repay them. Are there any reasons to believe that under these circumstances D, C1 and C2 would jointly agree to contract for a collective liquidation system to deal with the twenty percent chance that D will not be able to pay C1 and C2 in full? From the creditors' point of view (and ultimately from D's, since inefficiencies in a non-collective system will be charged back to D- either wholly or in part- in the form of higher credit costs), three reasons suggest themselves: reduction of strategic costs; increased aggregate pool of assets; and administrative efficiencies.”*

Baird also stressed the importance of having in place a legal mechanism to ensure that the self-interest of individuals does not run counter to the interests of the group.<sup>87</sup> The aim of this part of this chapter is to summarise the benefits of adopting a compulsory collective debt-collection system as it is viewed by the supporters of the creditors' bargain theory.

#### **A- Reduction of Strategic Costs**

Jackson<sup>88</sup> claimed that a collective debt-collection system would reduce the 'first in time, first in priority' race which is a 'race to the court-house' between creditors. Without having such a compulsory system, creditors will have to spend time and money monitoring each of their debtors' assets; and once bankruptcy is suspected, they will run to the court to take action to win the race to enforce their

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<sup>87</sup> Baird D., 'World without Bankruptcy', above 44, p. 184.

<sup>88</sup> Jackson T., 'Non-Bankruptcy Entitlement', above 64, pp. 861-864.

debt more quickly than other creditors.<sup>89</sup> According to Jackson,<sup>90</sup> mandatory bankruptcy procedures will help in avoiding ‘the prisoner’s dilemma’<sup>91</sup> for creditors. He stated that the fundamental feature of a prisoner’s dilemma is rational individual behaviour that, in absence of cooperation with other individuals, leads to a sub-optimal decision when viewed collectively.<sup>92</sup> In the absence of a collective process, each creditor has an incentive to take advantage of individual collection remedies, and to do so before the other creditor acts.<sup>93</sup> According to Jackson, besides creating costs on individual creditors, this race also may leads to a premature

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<sup>89</sup> Jackson stated that “since each creditor knows that it must “beat out” the others if it wants to be paid in full, it will spend time monitoring debtors and the other creditors- perhaps frequently checking the courthouse records- to make sure that it will not worse than second in the race (and therefore still be paid in full)”: Jackson T., *Logic and Limits*, above 10, p. 16.

<sup>90</sup> Jackson T., ‘Non-Bankruptcy Entitlement’, above 64, p. 862.

<sup>91</sup> The central feature of a prisoner’s dilemma is rational individual behavior. In the absence of cooperation with other individuals, each individual has an incentive to take advantage of individual collection remedies. This individual behavior is likely to lead to a premature termination of a debtor’s business: see Bhandari J. & Weiss L., above 65, pp. 41-42; Jackson stated that a ‘prisoner’s dilemma’ rests (as does a common pool problem) on three essential premises. First, the participants are unable to get together and make a collective decision. Secondly, the participants are selfish and not altruistic. Thirdly, the result reached by individual action is worse than a cooperative solution: *Logic and Limits*, above 10, p 10; also in summarising the idea of the prisoner’s dilemma and its application to the creditors’ bargain theory Bose stated that “The Prisoner’s Dilemma is an example from the field of game theory. Game theory studies the ways in which strategic interactions among rational players produce outcomes with respect to the preferences, or utilities, of those players. Applying the Prisoner’s Dilemma to the Creditors’ Bargain each creditor will have an incentive to take advantage of individual collection remedies before any other creditor does. If not, he will be beaten by the others. This race creates inefficient costs for the individual creditors, e.g. checking to see if any other creditors have instigated actions against the debtor. Creditors here participate in non-optimal ‘advantage-taking’ to avoid being taken advantage of, which is not in their collective interest.”: Bose T., above 4, pp. 239-240; see Jackson T., ‘Non-Bankruptcy Entitlement’, above 64, p. 862;

<sup>92</sup> *Ibid.*

<sup>93</sup> *Ibid.*

termination of a debtor's business since each creditor will consider only that creditor's own gain from racing, instead of the disadvantage imposed on creditors collectively.<sup>94</sup> Hence, having in place a compulsory debt collection scheme will prohibit this kind of race between creditors and, accordingly, will overcome creditors' co-ordination problems regarding the common pool of assets.<sup>95</sup>

### **B- Aggregate Pool of Assets will be Increased**

In the absence of a compulsory collective debt-collection system, creditors will waste assets in order to be first to seize their security or to obtain a judgment against the debtor.<sup>96</sup> However, such behaviours may lead to the dismantlement of the debtor's assets and to a loss of value for all creditors if the debtor's assets are worth more as a whole than as a collection of pieces.<sup>97</sup> This is derived, according to Jackson, "from a commonplace notion that a collection of assets is sometimes more valuable together than the same assets would be if spread to the winds. It is often referred to as the surplus of a going-concern value over a liquidation value".<sup>98</sup> Therefore, the most obvious reason for a collective process is that, in pursuing

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<sup>94</sup> Ibid.

<sup>95</sup> Ibid, pp. 861-864.

<sup>96</sup> Jackson T., *Logic and Limits*, above 10, pp. 14-16; Jackson T., 'Non-Bankruptcy Entitlement', above 64, p. 864.

<sup>97</sup> The use of individualist remedies might lead to a piecemeal dismantling of a debtor's business by the untimely removal of necessary operating assets: see Bhandari J. & Weiss L., above 65, p. 42; Jackson T., 'Non-Bankruptcy Entitlement', above 64, p. 867; see also Aghion P., Hart O. & Moore J., 'The Economics of Bankruptcy Reform', (1992) 8 (3) J.L.E.O. 523.

<sup>98</sup> Jackson T., *Logic and Limits*, above 10, p. 14.

their individual remedies, creditors may decrease the aggregate value of the assets that will be used to repay them.<sup>99</sup>

### **C- Administrative Efficiencies**

Jackson<sup>100</sup> sees the collectivist compulsory system as administratively efficient. Issues such as the detailed amount of the debtor's assets and the nature and quantity of secured claims must be solved in almost every collection procedure.<sup>101</sup> Also, a single inquiry into frequent collection questions is likely to be less expensive than the multiple inquiries necessary in an individualistic remedies scheme.<sup>102</sup> Hence, based on this theory, a single compulsory collective debt system may be administratively efficient in avoiding these kinds of unnecessary procedures.<sup>103</sup> However, Jackson acknowledged that even though it would be in the interest of all creditors, no single creditor would accept to be bound to a collective process unless it was a compulsory system binding all other creditors.<sup>104</sup> Therefore, he argued that in order to tackle this problem, it is necessary to establish a bankruptcy rule by making available a mandatory collective system after bankruptcy has occurred.<sup>105</sup> It could most obviously be implemented through a formal stay of claims, under the 'automatic stay' of the US Bankruptcy Law.<sup>106</sup> A similar effect is had upon the claims of unsecured creditors by the commencement

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<sup>99</sup> Ibid.

<sup>100</sup> Jackson T., 'Non-Bankruptcy Entitlement', above 64, pp. 866-868.

<sup>101</sup> Ibid, p. 866.

<sup>102</sup> Ibid.

<sup>103</sup> Ibid.

<sup>104</sup> Jackson argued that allowing the debtor to contract with other creditors on an opt-out basis, would destroy the advantages of a collective proceeding: *ibid.*

<sup>105</sup> Ibid, p. 867.

<sup>106</sup> Section 362 of the US Bankruptcy Code.

of winding-up proceedings in England,<sup>107</sup> or on all those creditors by the bringing of a successful petition for administration.<sup>108</sup> In this regard, a 'stay on creditors' actions plays a vital role in achieving the aim of such a compulsory debt collection scheme.

### **2.2.3 Criticisms of the Creditors' Bargain Theory**

Under the creditors' bargain theory all policies and rules must be designed, through the compulsory collective system, to ensure that the return to creditors as a group, is maximised.<sup>109</sup> However, this theory which has been developed into very well-designed and sophisticated theories of bankruptcy law has not been passed without criticisms.<sup>110</sup>

The creditors' bargain theory developed the notion that bankruptcy law should be seen as a system designed to mirror the contract one would expect creditors to

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<sup>107</sup> Sections 128, 130 (2), 183 & 184 of the UK Insolvency Act 1986.

<sup>108</sup> Ibid, sections 10 & 11; see Armour J., 'The Law and Economics of Corporate Insolvency: A Review', (2001) Working Paper No. 197, ESRC Centre for Business Research, University of Cambridge, available at: [http://www.econ.jku.at/members/Buchegger/files/Juristen/armour\\_2001\\_corporate%20insolvency.pdf](http://www.econ.jku.at/members/Buchegger/files/Juristen/armour_2001_corporate%20insolvency.pdf). accessed on 15/01/2014.

<sup>109</sup> Baird D., 'World without Bankruptcy', above 44, p. 184; This theory asserted that bankruptcy law exists solely for the benefit of creditors and the interests of employees, suppliers, customers and communities should be taken into account only to the extent that particular members of those constituencies are creditors with enforceable legal rights against debtor's assets under general law; Mooney stated that "to take any other interests of those constituencies into account would constitute prima facie theft": Mooney C., above 68, p. 964; see also Baird D., 'Bankruptcy's uncontested Axioms', (1998) 108 Y.L.J. 573; Jackson T. & Scott R., 'The Nature of Bankruptcy', above 10.

<sup>110</sup> Goode R., above 2, p. 43; Finch V., *Corporate Insolvency*, above 9, pp. 36-37; Westbrook J., 'A Functional Analysis of Executory Contracts', (1989) 47 M.L.R. 227, p. 337; Newborn M., 'The New Rawlsian Theory of Bankruptcy Ethics', (1994) 16 C.L.R. 111, pp. 112-114.

reach were they able to negotiate such agreement *ex ante* from behind the veil of ignorance.<sup>111</sup> However, it has been argued that to presume that creditors in the bargain are capable of reaching a united agreement is to stand against reality, since in practice real parties are diverse in their legal perception and power.<sup>112</sup> This theory treats creditors as if they are all equal in terms of their knowledge, experience and power, and focuses, merely, on voluntary creditors who are able to bargain freely in their contracts with the insolvent debtor.<sup>113</sup> Carlson and Finch argued that creditors normally differ in their leverage and knowledge, their skills in obtaining payment or liens, and their costs of litigating.<sup>114</sup> Finch argued that the assumption that powerful creditors would agree to a collective process is highly questionable.<sup>115</sup> In addition, secured creditors who are powerful *vis-à-vis* other unsecured creditors would not agree to give up power to 'weaklings' unless proper compensation has been provided.<sup>116</sup> In her article,<sup>117</sup> Finch stated that 'employee' creditors who face displacement costs separate from their claims for back wages might not agree to creditor equality because they consider such costs should be reflected in a higher priority for their back wages claims'.<sup>118</sup> Therefore, what creditors would agree if they had a chance to bargain *ex ante* might reflect the

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<sup>111</sup> Jackson T., *Logic and Limits*, above 10, p. 17.

<sup>112</sup> Carlson D., 'Philosophy in Bankruptcy', (1987) 85 M.L.R. 1341, p. 1349; Korobkin D., 'Contractarianism', above 11, p. 555.

<sup>113</sup> Jackson T., *Logic and Limits*, above 10, p. 17; Keay A. & Walton P., above 9, p. 26.

<sup>114</sup> Carlson D., above 112, p. 1349; Finch V., *Corporate Insolvency*, above 9, p. 36.

<sup>115</sup> Finch V., *Corporate Insolvency*, above 9, p. 36.

<sup>116</sup> Carlson D., above 112, p. 1349.

<sup>117</sup> Finch V., 'Insolvency Measures', above 20, p. 233.

<sup>118</sup> *Ibid.*

inequalities in rights, authority and practical benefit that shape their perspectives.<sup>119</sup>

Further, the idea that a race between various creditors is costly and, as a consequence, a compulsory debt collection system will help in reducing such costs, is subject to criticism. In response to this assertion, Carlson stated that “rights are always ‘costly’ to enforce, but if an investment in enforcement promises a gigantic return, mere costliness will not persuade a creditor to give up profitable rights. All gains come at the expense of some investment. You cannot plead the fact that investment requires capital in support of the view that investors would prefer not to invest.”<sup>120</sup> Also, McCormack stated that in the real world, creditors do not always act cooperatively in taking decisions and as a result, we have no accurate knowledge of how they would proceed or the sorts of factors that they would bring to bear on the decision-making process.<sup>121</sup>

The argument that the interests of non-creditors<sup>122</sup> should be protected outside bankruptcy law also faced critiques from a number of scholars. Goode<sup>123</sup> and

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<sup>119</sup> Korobkin D., ‘Contractarianism’, above 11, p. 552.

<sup>120</sup> Carlson D., above 112, p. 1350.

<sup>121</sup> See McCormack G., *Corporate Rescue Law- An Anglo- American Perspective* (hereinafter *Corporate Rescue*), (Edward Elgar Publishing Limited, 2008), p. 24.

<sup>122</sup> These include the interests of employees with regard to job preservation claims, local suppliers as regards the impact on their business of the insolvent company’s failure and the local community at large when a major employer ceases trading: see Baird D., ‘Reply to Warren’, above 38, p. 822; Goode R., above 2, p. 72.

<sup>123</sup> Goode stated that there are a number of values that deserve protection which go beyond the interests of those with accrued rights at the commencement of the insolvency process: *ibid*, p. 73.

Gross<sup>124</sup>, for example, stated that there are other values to be safeguarded that go beyond the interests of existing creditors.<sup>125</sup> Among these interests, according to them, are the interests of shareholders in the preservation of their future expectations, as well as the interests of the community at large, for instance in the continuation of the business.<sup>126</sup> Goode,<sup>127</sup> further, claimed that to focus solely on maximising returns to debtor's creditors, is to ignore the fact that there may be different means of protecting creditors, some of which will also benefit other interests such as those of employees, suppliers, shareholders and the local community, and in so doing may even advance creditors' interests.<sup>128</sup> In other words, it is suggested that rehabilitation may benefit all creditors, secured and unsecured, in the long term as well. The supporters of the creditors' bargain theory, nevertheless, have asserted that the aim of bankruptcy law should be, merely, to

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<sup>124</sup> In response to Jackson and Baird, Gross stated that "I do not share the view of these scholars. I believe that the community interests must be taken into account in both the corporate and personal system": Gross K., 'Community Interests', above 12, p. 1031.

<sup>125</sup> See, for example, Keay A., 'Public Interest', above 2; Warren E., 'Bankruptcy Policy', above 14.

<sup>126</sup> Goode R., above 2, p. 73.

<sup>127</sup> Ibid.

<sup>128</sup> Warren, for example, stated that 'Bankruptcy policy also takes into account the distributional impact of a business failure on parties who are not creditors and who have no formal legal rights to the assets of the business. Business closings affect employees who will lose jobs, taxing authorities that will lose rateable property, suppliers that will lose customers, nearby property owners who will lose beneficial neighbours, and current customers who must go elsewhere. Congress was acutely aware of the wider effects of a business failure on the surrounding community and it adopted the 1978 Bankruptcy Code specifically to ameliorate those harmful effects ...": Warren E., 'Bankruptcy Policymaking in an Imperfect World' (hereinafter 'Bankruptcy Policymaking'), (1993) 92 M.L.R. 336, pp. 354-355; see also Keay A., 'Balancing Interests in Bankruptcy Law', (2001) 30 C.L.W.R. 206; Goode R., above 2, p. 73; for the principles of communitarian theory and its criticisms: see below section 2.4.1 & 2.4.2.

maximise the interests of the debtors' creditors.<sup>129</sup> However, Goode<sup>130</sup> has described such an assertion as 'neat but ultimately unpersuasive' for a number of reasons. First, the creditors' bargain theory never takes into account that there are certain confronting claimants<sup>131</sup> outside the common pool creditors arise specifically due to the debtor's bankruptcy, and as a result, need to be recognised.<sup>132</sup> He stated,<sup>133</sup> for example, that Labour Law in England already gives rights and remedies to employees who are wrongly or unfairly dismissed or are made redundant.<sup>134</sup> However, in pursuit of these remedies against a solvent firm the former employees are not competing with other creditors because there are enough assets to meet employees' claims due to the debtor's solvency.<sup>135</sup> According to Goode, there is no scope for the general law to prescribe priority for employees or tort claimants; as a result, such a priority rule would make no sense except in the context of bankruptcy law.<sup>136</sup> Secondly, he continued by stating that to treat bankruptcy law as exclusively for creditors' confronting the common pool problem is prejudging the very question at issue, it being incompatible with bankruptcy laws around the world which incorporate provisions for claimants

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<sup>129</sup> See above section 2.2.1.

<sup>130</sup> For the following discussion: see Goode R., above 2, pp. 73-74.

<sup>131</sup> Two of these are the investigation of the directors' conduct of the directors with a view to sanctions for improper trading and disqualification so as to protect the public against future misconduct and the interests of workforce in preserving its investment of labour: Goode R., above 2, p. 73.

<sup>132</sup> See also Finch V., 'Insolvency Measures', above 20, p. 237; Goode R., above 2, p. 73.

<sup>133</sup> Goode R., above 2, pp. 73-74.

<sup>134</sup> Ibid, p. 74.

<sup>135</sup> During insolvency the ranking of unsecured claims arises: see *ibid.*

<sup>136</sup> *Ibid.*

outside the common pool creditors.<sup>137</sup> However, it is stated that simply because a concern can arise in bankruptcy does not by itself mean that it should be dealt with by bankruptcy law.<sup>138</sup> Mokal, for example, stated that there is no reason why bankruptcy law should concern itself with other issues, such as job saving and community interests, if the general law deals with identical issues in the same way regardless of whether the company in question is insolvent or not, thus bankruptcy law is not playing any role at all.<sup>139</sup>

As shown above, the creditors' bargain theory highlights the importance of establishing a compulsory debt collection system<sup>140</sup> which may lead<sup>141</sup> to the maximisation of the aggregate pool of assets<sup>142</sup> since the assets of the debtor might be sold as a going concern basis and not as a piecemeal sale.<sup>143</sup> It is rightly

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<sup>137</sup> This theory fails to recognise the non-efficiency objectives that are often recognised by many legislations around the world: see Korobkin D., 'The Role of Normative Theory in Bankruptcy Debates', (1996) 82 L.U.L.R. 75, p. 86.

<sup>138</sup> Mokal R., *Corporate Insolvency*, above 23, p. 66.

<sup>139</sup> *Ibid*, p. 67.

<sup>140</sup> As will be shown below, the multiple values theory agrees with the creditors' bargain theory in this point; A compulsory debt collection system requires having in place what is called 'automatic stay on creditors actions' to prevent the race to the court-house between creditors: see below section 2.6.1; Jackson T., 'Non-Bankruptcy Entitlement', above 64, p. 862; Baird D., 'World without Bankruptcy', above 44, p. 184; Jackson T., *Logic and Limits*, above 10, p. 17.

<sup>141</sup> In this regard, Goode argued that the value of a company's assets on a going concern basis is generally substantively greater than on a liquidation basis: Goode R., above 2, p. 408.

<sup>142</sup> Jackson T., *Logic and Limits*, above 10, p. 14.

<sup>143</sup> In the event of insolvency, there are normally two main routes that an insolvent debtor can take, namely: (a) to restructure its debts to manageable levels and continue trading as a going concern, or (b) to liquidate the business, selling off business or physical assets piecemeal, and returning the proceeds to creditors: see Rosen H., Nicholson J. & Rodgers J., 'Going Concern Versus Liquidation Valuations, the Impact on Value Maximisation in Insolvency Situations', April 2011, available at:

argued that the debtor's assets are worth more as a whole than as a collection of pieces.<sup>144</sup> Hence, it is important to establish a collective debt-collection system in order to encourage bankruptcy practitioners/ liquidators to sell the assets of the distressed traders on a going-concern basis not on a piecemeal basis. It is stated<sup>145</sup> that the recovery rate for creditors depends on whether the distressed company emerges from the proceedings as a going-concern basis or its assets are sold piecemeal. As will be discussed in Chapter Four,<sup>146</sup> according to the latest World Bank doing business report,<sup>147</sup> most bankruptcy cases in Oman end up with selling the assets of the company piecemeal which, as result, leads to the reduction of the recovery rate of creditors.<sup>148</sup>

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<http://www.fticonsulting.com/global2/media/collateral/united-states/going-concern-versus-liquidation-valuations-the-impact-on-value-maximization-in-insolvency-situations.pdf>. accessed on 02/09/2014.

<sup>144</sup> Jackson T., 'Non-Bankruptcy Entitlement', above 64, p. 867; see also Aghion P., Hart O. & Moore J., above 97.

<sup>145</sup> Calculation of the recovery rate takes into account the outcome: whether the business emerges from the proceedings as a going concern or the assets are sold piecemeal. Also, the costs of the proceedings and the value lost as a result of the time the money remains tied up in insolvency proceedings are also taken into account: see The World Bank, 'Doing Business 2013: Smarter Regulations for Small and Medium-Size Enterprises', 10<sup>th</sup> edition, p. 94 & 127, available at: <http://www.doingbusiness.org/reports/global-reports/doing-business-2013>. accessed on 09/02/2014.

<sup>146</sup> See below section 4.5.1.

<sup>147</sup> The World Bank, 'Doing Business: Oman 2014', available at: <http://www.doingbusiness.org/data/exploreeconomies/oman/~media/giawb/doing%20business/documents/profiles/country/OMN.pdf?ver=2>. accessed on 09/02/2014.

<sup>148</sup> Since the assets are normally sold piecemeal, the recovery rate of creditors in Oman is 37.3 cents on the dollar: *ibid*, p. 91; see below section 4.5.1.

The concept of collectivity is widely employed by bankruptcy laws worldwide.<sup>149</sup> For instance, the US,<sup>150</sup> France,<sup>151</sup> and England<sup>152</sup> adopted the notion of moratorium<sup>153</sup> and, as a result, creditors' actions are stayed during bankruptcy processes. The aim of such moratorium is to enhance the collective returns of all creditors.<sup>154</sup> However, as will be shown below,<sup>155</sup> the concept of collectivity is not adopted in Oman since during both bankruptcy and liquidation procedures secured creditors are not prevented from enforcing their securities.<sup>156</sup>

The aim of the concept of collectivity and the concept of automatic stay, as viewed by the creditors' bargain theory, is to solve merely the collective problem that is created by the presence of several claimants.<sup>157</sup> So, the aim of such concept is to maximise merely the interests of creditors and not to take into account other

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<sup>149</sup> For a fuller discussion: see Franks J. & Torous W., 'Lessons from A Comparison of US and UK Insolvency Code', (1992) 8 (3), O.R.E.P. 70; Franks J., Nyborg K. & Torous W., 'A Comparison of US, UK and German Insolvency Codes', (1996) 25 (3) F.M.J. 86; O'kane D. & Bawlf P., 'Global Guide to Corporate Bankruptcy: A Comprehensive Guide to Corporate Bankruptcy and a Survey of Global Corporate Bankruptcy Regimes', (Nomura International, July 2010), pp. 45-79, available at: <http://www.scribd.com/doc/59845050/Bankruptcy-Guide>. accessed on 19/02/2014.

<sup>150</sup> Section 362 of the US Bankruptcy Code 1978.

<sup>151</sup> See for example Article 620 of the Bankruptcy Law 2005; Cavalier G., 'French Bankruptcy Law and Enforcement Procedure', (2008), available at: [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=1174292](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1174292), as download on 09/02/2014.

<sup>152</sup> Sch. B1, paras 42, 43 and 44 of UK Insolvency Act 1986.

<sup>153</sup> See below section 3.4.2; The concept of collectivity cannot achieve its purpose unless creditors are prevented from pursuing their claims. The stay is *core* to bankruptcy law and without it bankruptcy is not a collective procedure: see Jackson T., *logic and limits*, above 10, pp. 12-13; Jackson T., 'Non-Bankruptcy Entitlement', above 64, p. 862.

<sup>154</sup> Finch V., 'The Recasting of Insolvency Law', (2005) 86 M.L.R. 713, p. 728.

<sup>155</sup> See below section 4.8.4.

<sup>156</sup> Article 620 of the Commercial Code of 1990; see also below section 4.4 (D).

<sup>157</sup> Azar Z., 'Bankruptcy Policy, Legal Heritage, and Financial Development: An Agenda for Further Research', (2008) 24 E.B.D.J. 379, p. 385.

interests.<sup>158</sup> However, bankruptcy laws should not merely be designed to maximise the interests of the creditors, rather it should be articulated to deal with wider issues.<sup>159</sup> As stated above,<sup>160</sup> there are also other means of maximising the return of the creditors, some of which will also benefit other interests.<sup>161</sup> For instance, rehabilitating the firm may benefit all creditors, whether secured or unsecured, in the long term. In this regard, an empirical study has revealed that post-Enterprise Act administrations deliver more returns to secured creditors than pre-Enterprise Act administrations.<sup>162</sup>

### **2.3 The Bankruptcy Choice Theory**

In contrast to the creditors' bargain theory, Korobkin established his theory for bankruptcy law which he described as the 'bankruptcy choice model'.<sup>163</sup> Korobkin claimed that the bankruptcy choice theory diverged radically from Jackson's creditors' bargain theory.<sup>164</sup> His theory, as he affirmed, follows the paradigm of the

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<sup>158</sup> See above pp. 44-45.

<sup>159</sup> This has been acknowledged in the Cork Report where it was noted that "a concern from the livelihood and well-being of those dependent upon an enterprise which may well be the lifeblood of a whole town or even a region, is a legitimate factor to which a modern law of insolvency must have regard.": see 'The Cork Report', above 1, para. 204.

<sup>160</sup> See above p. 57.

<sup>161</sup> Goode R., above 2, p. 73.

<sup>162</sup> Frisby S., 'Interim Report to the Insolvency Service on Returns to Creditors from Pre-and-Post Enterprise Act Insolvency Procedures', p. 14, Baker & McKenzie Lecturers in Company and Commercial Law, 24 July 2007, available at:

<http://webarchive.nationalarchives.gov.uk/+http://www.insolvency.gov.uk/insolvencyprofessionandlegislation/research/returntocreditors.pdf>. accessed on 25/01/2014.

<sup>163</sup> Korobkin D., 'Contractarianism', above 11, p. 544.

<sup>164</sup> Korobkin stated that the creditors' bargain theory denies representation to the interests of managers, employees, and the community by limiting participation to those creditors who have acquired their rights by contracts. In this regard, the creditors' bargain theory excludes those

hypothetical choice situation as originally developed by John Rawls in *A Theory of Justice*.<sup>165</sup> Nonetheless, it is worth noting that the creditors' bargain theory and the bankruptcy choice theory are both forms of *ex ante* analysis and they presume a hypothetical bargain between stakeholders.

### 2.3.1 The Principles of this Theory

According to this theory, all interested parties are involved at the bargaining table.<sup>166</sup> It is unlike the creditors' bargain theory in which bankruptcy law is justified with reference to the rules which creditors would agree to from behind the veil of ignorance.<sup>167</sup> On this theory, all potentially affected parties have the right to choose *ex ante* the principles that would determine their legal status in the event of bankruptcy.<sup>168</sup> All bargainers are aware of the fact that they may be affected by the bankruptcy of their debtor, but none of them knows if he or she will be a debtor, an unsecured creditor (whether contractual or involuntary), a creditor with a valid security interest in assets critical to the debtor's survival, a manager, an unskilled

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persons who have legal rights against the debtor that do not arise as a result of a contractual relationship, including persons who seek compensation for injuries caused by the debtor's tortious conduct: see Korobkin D., 'Contractarianism', above 11, p. 544 & pp. 554-555; Finch noted that while Jackson seeks to justify bankruptcy law with reference to the rules that creditors would agree to from behind the veil of ignorance, Korobkin places behind the veil not only contract creditors but representatives of all those persons who are potentially affected by a company's bankruptcy: Finch V., *Corporate Insolvency*, above 9, p. 38.

<sup>165</sup> However, Korobkin stated that whereas the bankruptcy choice theory follows Rawls's paradigm, 'it will by no means mirror Rawls's model in all respects'. According to him, identifying the normative principles underlying bankruptcy law is a different enterprise than locating principles of justice to govern the basic structure of society: see Korobkin D., 'Contractarianism', above 11, p. 544 & p. 551; for a brief explanation of Rawls' theory of justice: see above footnote 80.

<sup>166</sup> Korobkin D., *ibid*, p. 553.

<sup>167</sup> See Finch V., *Corporate Insolvency*, above 9, p. 38.

<sup>168</sup> Korobkin D., 'Contractarianism', above 11, p. 545.

worker, a member of the community that is otherwise unconnected to the debtor, or the occupier of any other particular relationship.<sup>169</sup>

The parties in the bankruptcy choice theory are charged with the task of opting for principles to govern their relationship in the case of the debtor's financial distress.<sup>170</sup> Since the problem of financial distress has an impact on all individuals in society, all parties should have representation in the choice of these principles.<sup>171</sup> However, Korobkin maintained that the parties in such a position of choice would normally opt for two principles to govern their relationship in the occurrence of bankruptcy.<sup>172</sup> The first principle is the 'principle of inclusion' in which all parties affected by the financial distress would be eligible to press their demands by themselves or through their representatives.<sup>173</sup> The principle of inclusion provides that no individual should be excluded from pursuing their aims merely by virtue of the position that they occupy.<sup>174</sup> The second is the principle of 'rational planning'<sup>175</sup> in which a determination of whether, and to what extent, individuals are allowed to enforce their legal rights, to retain and use their positions of authority, and to exercise their practical leverage.<sup>176</sup> According to Korobkin,<sup>177</sup> the principle of rational planning must have two vital components. First, it must be

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<sup>169</sup> Korobkin stated that "the parties in the bankruptcy choice situation know that, once the veil is lifted, they will occupy one or more of these positions, although they have no idea where they will end up": *ibid*, p. 574.

<sup>170</sup> *Ibid*, p. 552.

<sup>171</sup> *Ibid*, p. 554.

<sup>172</sup> For in-depth discussion of these principles: see *ibid*, pp. 572-589.

<sup>173</sup> *Ibid*, p. 575.

<sup>174</sup> *Ibid*.

<sup>175</sup> *Ibid*. pp. 575-589.

<sup>176</sup> *Ibid*, p. 575.

<sup>177</sup> *Ibid*, p. 581.

broadly effective, promoting as many aims as possible.<sup>178</sup> Second, when it is not possible to achieve all the aims, it must work to achieve the aims that are most essential.<sup>179</sup> Thus, the principle of rational planning would lead to the formulation of a rational long-term plan by subjecting persons<sup>180</sup> in financial distress to rational guidelines.<sup>181</sup> The purpose of this long-term plan is to coordinate “the diverse efforts of persons occupying the various positions so as to promote most fully as many aims as possible”.<sup>182</sup> However, Korobkin argued that since it might be impossible rationally to coordinate these efforts without frustrating specific aims, the principle of rational planning should demand that the aims of persons who have the most to lose be promoted over those who have relatively less to lose.<sup>183</sup>

This inclusive hypothetical bargaining approach has been developed by Rizwaan Mokal into an authentic consent theory which also aims to investigate and justify the principles of bankruptcy law.<sup>184</sup> This theory is based on authentic consent<sup>185</sup> of the ‘true and genuine person’ which is ‘based on asking what the

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<sup>178</sup> Ibid.

<sup>179</sup> Korobkin stated that these components suggest that ‘the preferred approach to financial distress would be the adoption of a maximizing strategy –a principle that promotes most fully and effectively the greatest part of the most important aims’: *ibid.*

<sup>180</sup> Who hold differing combinations of legal rights, authority, and practical leverage and thus occupy distinct positions: *ibid.*, p. 582.

<sup>181</sup> *Ibid.*, p. 684.

<sup>182</sup> *Ibid.*

<sup>183</sup> *Ibid.*

<sup>184</sup> See Mokal R., ‘The Authentic Consent Model’, above 11, pp. 414-443; Mokal R., *Corporate Insolvency*, above 23, pp. 61-91.

<sup>185</sup> In explaining the nature of this consent, Mokal stated that this consent is a hypothetical consent. Thus, the consent is not of ‘real world parties’, nor are the parties permitted to use ‘actual endowment of skill and energy’ in the bargaining process, nor are they in ‘Natural Ignorance’. “Rather, hypothetical consent is given by all the relevant parties, conceived of as *free, equal, and*

relevant parties would agree to, if given the chance to bargain under the appropriate conditions about how their claims should be dealt with' in the event of their debtor's insolvency.<sup>186</sup> As is the case under the creditor's bargain theory, the authentic consent theory presupposes a hypothetical *ex ante* bargain between various parties. However, Mokal has argued that his theory differs from the creditors' bargain theory in three main aspects.<sup>187</sup> First, whereas the creditors' bargain theory promotes creditors' individual and collective self-interest, his theory is concerned with 'the moral equality of all those subject to insolvency laws by showing equal respect and concern for their interests.'<sup>188</sup> Second, the creditor's bargain theory takes only creditors' preferences into account, whereas his theory respects other interests as well.<sup>189</sup> Third, unlike Jackson's theory, Mokal's theory is founded on the idea of 'dramatic ignorance'.<sup>190</sup> Mokal's theory which extends participation to parties other than creditors, is based on the concept of 'dramatic ignorance'<sup>191</sup> in which the parties to the creditors' bargain are unaware not only of the bankruptcy outcome and of how other creditors would act but also of their own

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*reasonable*, under conditions which will be referred to as *Dramatic Ignorance*. As such, this theory is based on 'authentic consent', the consent of the 'true and genuine person': Mokal R., 'The Authentic Consent Model', above 11, p. 415.

<sup>186</sup> Mokal R., *Corporate Insolvency*, above 23, p. 61.

<sup>187</sup> For a detailed discussion see *ibid*; Mokal R., 'The Authentic Consent Model', above 11, pp. 426-432.

<sup>188</sup> Mokal R., *Corporate Insolvency*, above 23, p. 11 & pp. 70-71.

<sup>189</sup> *Ibid*, pp. 69-70.

<sup>190</sup> According to Mokal, in "Dramatic Ignorance' parties are stripped of knowledge of their own attributes, circumstances, social positions, degree of risk aversion, and conception of the good...[Dramatic Ignorance] prevents the parties knowing whether they will be faster in collecting debts, or friendlier with the debtor, or particularly badly hit by the debtor's insolvency. This the obscuring role of Dramatic Ignorance": *ibid*, p. 73.

<sup>191</sup> *Ibid*.

attributes, such as whether they are voluntary or involuntary creditors, whether they are in a dominant or subordinate position.<sup>192</sup> Thus, according to Mokal, *ex ante* agreement must not be extracted under conditions of 'Natural Ignorance',<sup>193</sup> but should be made on the assumption that all parties are free and equal to enter into a bargain that is fair and just.<sup>194</sup>

### 2.3.2 Criticisms of this Theory

In supporting his theory, Korobkin claimed that his bankruptcy choice theory corresponds in fundamental ways to the kind of insolvency system encountered in the United States, since one purpose of the current Bankruptcy Code is to prevent individual creditors from forcing an immediate piecemeal sale of the business if the survival or a more orderly liquidation of the business would bring in a better return.<sup>195</sup> However, this theory is open to criticism on a number of fronts. First, a 'risk-averse and risk-neutral individual'<sup>196</sup> may create very diverse principles of

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<sup>192</sup> Ibid, pp. 73-74

<sup>193</sup> The concept of 'Natural Ignorance' allows parties to be aware of their identities, attributes and values. It only precludes knowledge of the outcome of a particular transaction for these Real Parties: see *ibid*, p. 73.

<sup>194</sup> Ibid, p. 74; Mokal R., 'The Authentic Consent Model', above 11, p. 430.

<sup>195</sup> Korobkin D., 'Contractarianism', above 11, p. 593; Korobkin argued that under the current US Bankruptcy Code, liquidation and reorganisation represent alternative vehicles for achieving the larger end of aims maximisation; for a detailed discussion: see Korobkin D., *ibid*, pp. 595-609.

<sup>196</sup> Risk averse and risk neutral are economic terms. It is stated that "how a person responds to situations involving risk depends on the extent to which he or she is risk averse. A person is risk averse if she or he prefers a certain amount to risky amounts with the same expected value. A person is a risk neutral if she or he is indifferent between certain amount and risky amounts with the same expected value": Png I., *Managerial Economics*, (4<sup>th</sup> edition, Routledge, 2012), p. 268; to clarify, for example, if both C1 and C2 have a 50 percent chance of winning through the use of individualistic remedies, then each faces a 50 percent chance of being paid in full (\$50,000) and a 50 percent chance of being paid only \$ 10.000. But if C1 and C2 agree to share equally in the event

justice.<sup>197</sup> So, it is unclear why an uninformed individual may not opt for a regime marked by low-cost credit and low protection for vulnerable parties to one with high costs of credit and high levels of protection.<sup>198</sup> Secondly, Korobkin claimed that his bankruptcy choice theory corresponds with the major features of the US bankruptcy law.<sup>199</sup> However, Mooney and McCormack stated that even though *ex ante* hypothetical theories of bankruptcy law, elegantly dressed up, are open to the objection that they seem little more than an argument that thoughtful, interested, objective and neutral lawmakers' would come to the supporters' conclusions about bankruptcy.<sup>200</sup> In addition, such an approach tends to suppose an original position in which the various players act in an economically rational manner according to a single set of criteria.<sup>201</sup> Nonetheless, individuals tend to adopt decisions not merely on economic consideration grounds.<sup>202</sup> Thus, it is rather difficult to envisage how any single set of *ex ante* assumptions can be expected to match the complexity of real life business or even to accommodate the many categories of decision makers and the variety of circumstances in which their decisions may have to be made.<sup>203</sup>

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of D's misfortune, each would assured of \$30,000. If C1 and C2 are risk-averse, one would expect them, prior to extending credit to D, to agree on a distributional system in the event of D's insolvency in which each would receive this partial, but certain, payment of \$30,000: Bhandari J. & Weiss L., above 65, p. 42.

<sup>197</sup> Finch V., *Corporate Insolvency*, above 9, p. 39.

<sup>198</sup> *Ibid.*

<sup>199</sup> Korobkin D., 'Contractarianism', above 11, p. 593.

<sup>200</sup> Mooney C., above 68, p. 966; see also McCormack G., *Corporate Rescue*, above 121, p. 29.

<sup>201</sup> Goode R., above 2, p. 78.

<sup>202</sup> Goode stated that "this may be an elegant model, but has no necessary connection with fact. Human beings and even corporations are usually actuated by wider consideration than pure economic rationality", *ibid.*

<sup>203</sup> *Ibid.*

Moreover, it might be argued that the bankruptcy choice theory fails to explain how agreements can be reached *ex ante* between various participants and who in a potential bankruptcy is most at risk<sup>204</sup> and thus, based on this theory, should enjoy priority of protection over those occupying a strong position.<sup>205</sup> In this regard, Korobkin freely admitted the difficulties of comparing positions in terms of vulnerability and he suggested that weakness can be measured in terms of the product of the potential loss to, and the degree of influence exercised by, an individual.<sup>206</sup> Thus, he claimed that individuals with more influence in the context of financial distress usually are better able to protect their own interests than individuals with less power.<sup>207</sup> Nevertheless, Finch argued that there is no reason why such an approach would be accepted by all parties behind the veil of ignorance.<sup>208</sup> This theory, further, regards all participants of the imaginary *ex ante* bargain as being free and equal as well as being reasonable and rational.<sup>209</sup> Thus the principles chosen would be fair and just. However, McCormack argued that individual conceptions of fairness or justice might vary very significantly depending on one's political, philosophical or religious beliefs.<sup>210</sup> Thus, unlike the creditors'

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<sup>204</sup> As stated above, according to the bankruptcy choice theory, the purpose of the principle of rational planning is to promote the aims of persons who have the most to lose over those who have relatively less to lose: see above p. 66.

<sup>205</sup> Finch V., *Corporate Insolvency*, above 9, p. 40.

<sup>206</sup> Ibid; Korobkin D., 'Contractarianism', above 11, pp. 584-585.

<sup>207</sup> In supporting his claim Korobkin noted that directors, senior managers, and corporate insiders occupy relatively less vulnerable positions. In contrast, a number of unsecured creditors, such as employees are more likely candidates for occupying the most vulnerable positions: Korobkin D., 'Contractarianism', above 11, p. 585.

<sup>208</sup> Finch V., *Corporate Insolvency*, above 9, p. 40.

<sup>209</sup> See Mokal R., *Corporate Insolvency*, above 23, p. 87.

<sup>210</sup> See McCormack G., *Corporate Rescue*, above 121, p. 29.

bargain theory, the bankruptcy choice theory expands the participation of all affected parties who can choose, *ex ante*, the principles that would govern their relationship in the event of insolvency. However, as discussed above, the bankruptcy choice theory has not escaped criticisms.

The bankruptcy choice theory is in agreement with the creditors' bargain theory in that bankruptcy law should impose a stay on creditors' actions<sup>211</sup> in order to prevent individual creditors from forcing an immediate piecemeal sale. However, unlike the case under the creditors' bargain theory, the bankruptcy choice theory broaden its scope<sup>212</sup> by including people who have no formal legal rights<sup>213</sup> or who derive their rights from non-contractual relationships.<sup>214</sup> Thus, according to this theory, all these people are affected by the financial distress of the debtor and, as a consequence, they should participate in the bargaining table.<sup>215</sup> However, even though this theory recognises the impact of financial distress on various parties,<sup>216</sup> it is difficult to predict how these parties, who differ in their knowledge, experience

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<sup>211</sup> Also, Mokal stated that insolvency law, and in particular the automatic stay on unsecured claims, can be justified by asking what all parties concerned would agree to if given the chance to bargain under suitable condition: Mokal R., 'The Authentic Consent Model', above 11, p. 415; However, as will be shown below, it is difficult to envisage how agreements can be reached *ex ante* between various participants: see below section 2.3.2.

<sup>212</sup> By not focusing merely on maximising the interests of creditors.

<sup>213</sup> For instance, the interests of managers, employees, and the community: see Korobkin D., 'Contractarianism', above 11, p. 555.

<sup>214</sup> For example, victims of tortious act.

<sup>215</sup> As discussed above, the aim of their participation is to choose the principles that would govern their relationship in the occurrence of bankruptcy: see Korobkin D., 'Contractarianism', above 11, pp. 572-589; above pp. 65-66.

<sup>216</sup> See above pp. 63-64.

and power, would be able to negotiate *ex ante*<sup>217</sup> and choose the principles that would determine their position in the event of bankruptcy.

## **2.4 The Communitarian Theory**

In response to the perceived problems with the creditors' bargain and the bankruptcy choice theories, other perspectives have been presented. One of these perspectives is the communitarian theory of bankruptcy law. Instead of focusing merely on the private rights of creditors such as under the creditors' bargain theory, the communitarian theory seeks to balance a wide range of different interests in the bankruptcy of the debtor and take into account the welfare of the community at large.<sup>218</sup>

### **2.4.1 The Principles of this Theory**

According to this theory, not only should the interests of creditors of the debtor be taken into account in the case of bankruptcy, but the interests of other stakeholders, who are also affected by the bankruptcy of the debtor, should be considered.<sup>219</sup> The list of these stakeholders is long and it may include employees, suppliers, customers, government and the local community in which an enterprise operates.<sup>220</sup> What communitarianists want is that the interests of these parties

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<sup>217</sup> Also, it is not definite that secured creditors will accept such bargain *ex ante*: see Finch V., *Corporate Insolvency*, above 9, p. 40.

<sup>218</sup> Gross K., 'Community Interests', above 12, p. 1031; Keay A., 'Public Interest', above 2.

<sup>219</sup> Gross K., 'Community Interests', above 12, p. 1031.

<sup>220</sup> Symes C., *Statutory Priorities in Corporate Insolvency Law: An Analysis of Preferred Creditor Status*, (Ashgate Publishing Ltd, 2008), p. 63.

should be considered in bankruptcy law.<sup>221</sup> For instance, Gross<sup>222</sup> argued that some interests, besides those of creditors, might be worth considering. Even though he acknowledged the fact that interests such as community interests are extremely difficult to quantify,<sup>223</sup> difficulty alone is not justification of exclusion from an economic model of bankruptcy.<sup>224</sup> Based on his view, in the bankruptcy of the debtor, the interests of the community at large should be taken into account.<sup>225</sup>

However, there is no explicit definition of what is meant by “community” or what amounts to public interests.<sup>226</sup> In approaching such a question, Keay, for example, stated that when it comes to the question of public interest, it is extremely challenging, if not impossible to come, to any consensus.<sup>227</sup> Nonetheless, he advocated that instead of trying to formulate an inclusive definition of the public interest which may well be unworkable, it is appropriate to say, for the purposes of bankruptcy law, that the public interest involves taking into consideration interests for which society has regard and which are broader than the interests of those

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<sup>221</sup> Gross K., *Failure and Forgiveness*, above 12, p. 205.

<sup>222</sup> Gross K., ‘Community Interests’, above 12, p. 1035.

<sup>223</sup> Because they are diverse and it is difficult to be measured in economic terms. However, Gross argued that this does not mean that community interests lack value: *ibid*, p. 1046.

<sup>224</sup> *Ibid*.

<sup>225</sup> However, Gross stated that “saying that community interests are important and must be taken into account in the bankruptcy process does not mean that the other interests that bankruptcy seeks to protect, such as those of creditors and equity shareholders, are forgotten”: *ibid*, p. 1032-1033; However, as will be discussed below, this theory does not provide guidance for implementing its principle in practice: see below section 2.4.2.

<sup>226</sup> Gross K., ‘Community Interests’, above 12, pp. 1031-1032.

<sup>227</sup> Keay A., ‘Public Interest’, above 2, p. 523.

parties directly involved in any given bankruptcy situation, that is, the debtor and the creditors.<sup>228</sup>

In order that bankruptcy law acts to benefit the community at large, communitarianism appears to favour the survival of companies where there it is viable, as well as orderly winding up when reorganisation is not a viable option.<sup>229</sup> In this regard, the Cork Report<sup>230</sup> (United Kingdom) in 1982 seemed to endorse implicitly some of the communitarian concepts.<sup>231</sup> This Report refers to the law of bankruptcy as embodying a “compact to which there are three parties: the debtor, his creditors and society”.<sup>232</sup> Thus, it is argued that any system designed to deal with the consequences of a bankruptcy should take into account the interests of these three parties.<sup>233</sup> In affirming that, the Cork Report states that “we believe that a concern from the livelihood and well-being of those dependent upon an enterprise which may well be the lifeblood of a whole town or even a region, is a legitimate factor to which a modern law of insolvency must have regard. The chain reaction consequent upon any given failure can potentially be as disastrous to creditors, employees and the community that it must not be overlooked.”<sup>234</sup> Also, in

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<sup>228</sup> Ibid, p. 525.

<sup>229</sup> Finch V., *Corporate Insolvency*, above 9, p. 41.

<sup>230</sup> See above footnote 1.

<sup>231</sup> See Keay A. & Walton P., above 9, p. 28.

<sup>232</sup> The Cork Report, above 1, para 192.

<sup>233</sup> See Tolmie F., *Introduction to Corporate and Personal Insolvency Law*, (2<sup>nd</sup> edition, Cavendish Publishing Limited, 2003), p. 3.

<sup>234</sup> The Cork Report, above 1, para. 204; The Cork Report propose the creation of a streamlined administration procedure which will ensure that all the interest group get fair say and have an opportunity to influence the outcome: see the White Paper, ‘Productivity and Enterprise: Insolvency- A Second Chance’, (2001), para. 4, available at:

Australia, for example, the Harmer Report<sup>235</sup> in 1988 affirmed that bankruptcy law should concern itself with the impact of bankruptcy on employees, family, customers, and government agencies such as those concerned with the revenue and administration of law.<sup>236</sup> Thus, both the United Kingdom and Australian Law Reforms Commissions have made it clear that the bankruptcy law is not merely about creditors' interests, rather there are other interests which should be taken into account as well.<sup>237</sup>

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<http://webarchive.nationalarchives.gov.uk/+http://www.insolvency.gov.uk/cwp/cm5234.pdf>.

accessed on 18/08/2014; However, as will be discussed in the next chapter, it is argued that the new administration regime appears to provide a more generous outcome to the secured creditors than it intended to be under the original terms of the *Enterprise Bill*: Fletcher F., 'UK Corporate Rescue: Recent Development- Changes to Administrative Receivership, Administration, and Company Voluntary Arrangements- the Insolvency Act 2000, the White Paper 2001, and the Enterprise Act 2002', (2004) 5 (1) E.B.O.L.R. 120, p. 129; McCormack G., 'Apples & Oranges? Corporate Rescue and Functional Convergence in the US and UK', (2009) 18 (2) I.I.R. 109, p. 115; See below pp. 118-119.

<sup>235</sup> Australia Law Reform Commission, General Insolvency Inquiry, Report No 45 (1988), known as 'the Harmer Report'.

<sup>236</sup> Harmer Report, *ibid*, para 1; see also Symes C., 'Submission to CAMAC on Corporate Social Responsibility', University of Flinders, available at:

[http://www.camac.gov.au/camac/camac.nsf/byHeadline/PDFSubmissions\\_2/\\$file/CSymes\\_CSR.pdf](http://www.camac.gov.au/camac/camac.nsf/byHeadline/PDFSubmissions_2/$file/CSymes_CSR.pdf). accessed on 02/12/2011.

<sup>237</sup> However, it is stated that in Australia there is little evidence to support the view that non-creditors are taken into account by the Corporations Act, particularly Part (5.3A). It is for the creditors to determine the fate of the company and the court plays only a supervisory role and it is not usual for it to focus on issues of broader community policy beyond the financial protection of creditor interests. Thus, there is little evidence to support that the law in Australia favors rehabilitation of the distressed companies over liquidation: see Omar P., *International Insolvency Law: Reforms and Challenges*, (Ashgate Publishing, 2013), pp. 15-17.

## 2.4.2 Criticisms of this Theory

In criticising the communitarian theory, Finch argued that the breadth of interests encompassed within communitarianism gives rise in itself to problems of indeterminacy.<sup>238</sup> The problem is not just that community interest is difficult to identify but that there are so many expected interests in any bankruptcy and the selection of interests worthy of legal protection is likely to give rise to substantial disagreement.<sup>239</sup> Further, it is claimed that it is impossible to define community in geographical boundaries since in each bankruptcy there may be many community interests at stake outside geographical boundary.<sup>240</sup> For example, Schermer rightly stated that “if the community interests were defined as that portion of the citizenry that is affected by a debtor’s business, the breadth of the community could reach a potentially infinite number, since almost anyone, from local employee to distant supplier, can claim some remote loss due to the failure of a once-viable local business.”<sup>241</sup> Hence, the problem is not just that community interest cannot be articulated, but there are many potential interests in each bankruptcy case.

Further, Schermer argued that even though some community interests could be defined, there is a problem with application.<sup>242</sup> As there are so many community interests in each bankruptcy case, there will inevitably be conflicts between those interests that would need to be considered.<sup>243</sup> Nonetheless, it might be argued that

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<sup>238</sup> Finch V., *Corporate Insolvency*, above 9, p. 42.

<sup>239</sup> Ibid.

<sup>240</sup> Schermer B., ‘Response to Professor Gross: Taking the Interests of the Community into Account in Bankruptcy’, (1994) 72 W.U.L.Q. 1049, p. 1051.

<sup>241</sup> Ibid, p. 1051.

<sup>242</sup> Ibid.

<sup>243</sup> Ibid.

it is the role of the court to undertake a balancing exercise in order to resolve such conflict,<sup>244</sup> or at least alleviate the impact of such conflict. However, in response to this assertion, Schermer stated that a bankruptcy court should not be the decision maker for any community interest investigation.<sup>245</sup> According to him, a bankruptcy court cannot weigh, for example, a local community's interests in maintaining its employment base against possible long term environmental damage.<sup>246</sup> Further, a bankruptcy court is not necessarily qualified to decide what should, or what should not, be considered a community problem, or what should be in society's interests.<sup>247</sup> Thus, based on Schermer's view, bankruptcy judges should not be involved in investigating so many community interests since it is difficult to quantify such interests. However, it might be asserted by the communitarians that courts usually and in all sectors of the law take into account public and community interest and, as a result, that should be the case of bankruptcy law.<sup>248</sup>

Unlike the case under the creditors' bargain theory, the communitarian theory, partly in line with the bankruptcy choice theory,<sup>249</sup> takes on board the interests of

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<sup>244</sup> Keay A. & Walton P., above 9, p. 28.

<sup>245</sup> Schermer B., above 240, p. 1051.

<sup>246</sup> For a discussion concerning one kind of conflict that might emerge: see Keay A. & Prez P., 'Insolvency and Environmental Principles: A Case Study in a Conflict of Public Interests', (2001) 3 E.L.R. 90.

<sup>247</sup> Schermer B., above 240, p. 1051.

<sup>248</sup> Finch V., *Corporate Insolvency*, above 9, p. 43.

<sup>249</sup> I said partly because, unlike the bankruptcy choice theory, the communitarian theory does not presuppose a hypothetical *ex ante* bargain between various parties. However, both theories highlight the importance of having into account the interests of various stakeholders without identifying the scope of these interests.

other stakeholders<sup>250</sup> who are also affected by the financial distress. The communitarian theory supports the concept of rehabilitation of distressed debtors where these would generate a better result for the community in protecting jobs even at the expense of some other rights.<sup>251</sup> This is in contrast with the creditors' bargain theory where rehabilitation of the distressed enterprise is not viewed as a legitimate goal of bankruptcy law unless it leads to maximise returns to creditors.<sup>252</sup> Thus, rehabilitation should not lead to favour denying secured creditors the time value of their claims during bankruptcy proceedings.<sup>253</sup>

## 2.5 The Forum Theory

Unlike the creditors' bargain, the bankruptcy choice and the communitarian theories, the forum theory looks at bankruptcy law in terms of procedural objectives.<sup>254</sup> In this part, the principles and critiques of this theory will be dealt with.

### 2.5.1 The Principles of this Theory

According to this approach, bankruptcy law should be viewed in procedural terms instead of viewing it in terms of substantive objectives.<sup>255</sup> Based on this

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<sup>250</sup> These interests include the interests of employees, suppliers, customers and the local community.

<sup>251</sup> Finch V., *Corporate Insolvency*, above 9, p. 41; Azmi R. & Razak A., 'Theories, Objectives and Principles of Corporate Insolvency Law: A Comparative Study Between Malaysia and UK', (2013), 3<sup>rd</sup> International Conference on Management 667, p. 669, available at: [www.internationalconference.com.my](http://www.internationalconference.com.my). as accessed on 05/08/2014.

<sup>252</sup> Jackson T., *Logic and Limits*, above 10, p. 201.

<sup>253</sup> See Baird D., 'World without Bankruptcy', above 44, pp. 181-186.

<sup>254</sup> Flessner A., above 13, p. 24; see below section 2.5.1.

<sup>255</sup> Flessner A., *ibid*; Finch V., *Corporate Insolvency*, above 9, p. 43.

theory, a forum should be established in which all interests affected by the failure of the business can be heard.<sup>256</sup> Thus, the function of the bankruptcy process is to establish a forum where all interests, whether directly in monetary terms or not, should be taken into account.<sup>257</sup>

It is maintained, by Flessner,<sup>258</sup> that modern economies are constituted from various enterprises, and that each of these enterprises is seen as encompassing not merely the interests of its owners and creditors but also other interests such as the employees and customers. Thus, in the event of business failure, workers, suppliers, customers, neighbours, and the local community can be as much affected by the destiny of the business as creditors and shareholders.<sup>259</sup> Therefore, Flessner argued that the interests of all those stakeholders might not be 'directly translatable into monetary claims' but they are nonetheless 'very real', and those who hold them might be ready to offer 'money or money's worth to protect them'.<sup>260</sup> According to this theory, the function of bankruptcy procedures is seen as establishing space in which all participants, whether they have financial claims or not, are involved.<sup>261</sup> This kind of space, therefore, would allow the stakeholders either to 'adjust gradually and more easily' to the unavoidable closure of the enterprise, or, if it is viable, to approve a rescue plan and agree on the

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<sup>256</sup> Flessner A., *ibid*; However, as will be discussed below, this theory does not provide guidelines for implementing its principles in reality. Thus, it is unclear how various claims are judged and how should they be represented?: see below section 2.5.2.

<sup>257</sup> *Ibid*.

<sup>258</sup> Flessner A., above 13, p. 24.

<sup>259</sup> *Ibid*.

<sup>260</sup> *Ibid*.

<sup>261</sup> Finch V., *Corporate Insolvency*, above 9, p. 43.

contributions necessary to support such a rescue.<sup>262</sup> Further, Walton asserted that even though those with no monetary claims have no decisive say eventually in the fate of the failed enterprise, there should be some mechanism in which unsecured creditors, such as employees, suppliers and customers, have some effective say in the future of the firm.<sup>263</sup> This can be implemented through providing a means of representation of the various interested parties.<sup>264</sup> Such a mechanism, as a result, would shift the focus beyond creditors to all stakeholders in the financial distress of the firm.<sup>265</sup>

### 2.5.2 Criticisms of this Theory

Unlike the case in the creditors' bargain theory, the forum theory suggests that bankruptcy law should create a forum where all participants are recognised.<sup>266</sup> However, it is argued, by Finch, that even though the forum theory does address and highlight an important role to be played by bankruptcy law<sup>267</sup> in the financial distress of the enterprise, it remains ambiguous since it does not provide guidelines for implementing its concepts in reality.<sup>268</sup> In addition, the concept of representation proposed by Flessner under this theory gives rise to a number of difficult questions relating to the quantity of representation to be offered to different

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<sup>262</sup> Flessner A., above 13, p. 24.

<sup>263</sup> Walton stated that forum theory is consistent with the Cork Committee recommendation on creditor involvement: Walton P., above 16, p. 9.

<sup>264</sup> Finch V., *Corporate Insolvency*, above 9, p. 44.

<sup>265</sup> However, since this theory does not provide guidance, it is unclear how this can be implemented in reality: see below section 2.5.2.

<sup>266</sup> Flessner A., above 13, p. 24.

<sup>267</sup> The role to provide a means of representation of the various affected parties.

<sup>268</sup> Finch V., *Corporate Insolvency*, above 9, p. 44.

participants; how to strike the 'right' balance between provisions for representation and efficiency in decision and policy-making; and the scope to which representation should be reinforced with legal rights.<sup>269</sup>

Further, Finch stated that if the Company Voluntary Arrangement (CVA) procedure<sup>270</sup> is viewed in wider terms, it can be said to be based on a forum theory of bankruptcy in which all creditors will reach mutually acceptable solutions if all prospects can be discussed openly and at low cost.<sup>271</sup> Nonetheless, she argued that CVA is 'unlikely ever to offer the most popular or effective route to rescue' because in most areas of firm distress creditors, secured and unsecured, tend to have such conflicting interests.<sup>272</sup> Thus, it is not clear how the concept of such a theory would be implemented in reality.

The forum theory does not view bankruptcy laws as a response to common pool problems arising when diverse co-owners<sup>273</sup> affirms rights against a common pool of assets.<sup>274</sup> But it considers bankruptcy laws as procedural laws in which special procedures are designed to enable all affected parties to voice their concerns through their representatives.<sup>275</sup> Further, the forum theory is similar to both the bankruptcy choice and the communitarian theories because it recognises the interests of other parties who are affected by the failure of the business. Thus, according to this theory, the objective of bankruptcy procedures should be to

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<sup>269</sup> Ibid.

<sup>270</sup> See below section 3.2.3.

<sup>271</sup> Finch V., *Corporate Insolvency*, above 9, p. 355.

<sup>272</sup> Ibid.

<sup>273</sup> See above footnote 10.

<sup>274</sup> This is in contrast with the creditors' bargain theory: see above section 2.2.1.

<sup>275</sup> Flessner A., above 13, p. 24

establish a forum in which all parties are heard. However, as shown above,<sup>276</sup> this theory fails to explain how should this forum be established? And how should it be implemented in reality?

## 2.6 The Multiple Values Theory

Elizabeth Warren, supported by Donald Korobkin,<sup>277</sup> has offered her theory which contradicts with the creditors' bargain theory. Unlike the case under the creditors' bargain theory, the multiple values theory sees that the effects of corporate decline are broader than just creditor's interests.<sup>278</sup>

### 2.6.1 The Principles of this Theory

The approach taken by Warren overlaps, to some extent, with the communitarian theory discussed above,<sup>279</sup> in asserting that besides considering creditor interests there is a need to take into consideration other values that are also affected by the bankruptcy of the debtor.<sup>280</sup> In summarising her theory, Warren stated that:<sup>281</sup>

*'I see bankruptcy as an attempt to reckon with a debtor's multiple defaults and to distribute the consequences among a number of different actors. Bankruptcy encompasses a number of competing - and sometimes conflicting- values in this distribution. As I see it, no one value dominates, so that bankruptcy policy*

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<sup>276</sup> See above section 2.5.2.

<sup>277</sup> Warren E., 'Bankruptcy Policy', above 14; Korobkin D., 'Rehabilitating Values', above 14.

<sup>278</sup> Warren E., 'Bankruptcy Policy', above 14, p. 811; Korobkin D., 'Rehabilitating Values', above 14, p. 766; Azmi R. & Razak A., above 251, p. 670.

<sup>279</sup> See above section 2.4.1.

<sup>280</sup> Gross K., *Failure and Forgiveness*, above 12, p. 205; Gross K., 'Community Interests', above 12, p. 1035; Warren E., 'Bankruptcy Policy', above 14, p. 778.

<sup>281</sup> Warren E., 'Bankruptcy Policy', above 14, p. 777.

*becomes a composite of factors that bear on a better answer to the question, how shall the losses be distributed?’*

The multiple values theory is in stark contrast with the creditors’ bargain theory, which provides a “narrow”<sup>282</sup> justification and denies a realistic<sup>283</sup> evaluation of the bankruptcy system;<sup>284</sup> Warren’s view is that bankruptcy law serves a series of values that cannot be organised into “neat priorities”.<sup>285</sup> She claimed that the creditors’ bargain theory cannot sufficiently explain the purpose of bankruptcy law<sup>286</sup> because economic value enhancement is only part of the goal of insolvency law.<sup>287</sup> Thus, Warren accepted the fact that collectivism<sup>288</sup> offers a useful means to examine some bankruptcy problems because having a compulsory collective debt

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<sup>282</sup> In this regard, Korobkin argued that “the economic model is incapable of accounting for noneconomic outcomes as independent values; nor can its alternative, the creditors’ bargain model, escape the constraints of the account’s view of bankruptcy law as a response to the economic aspects of the problem of collecting debt. Conceiving bankruptcy in these narrow terms, the economic account can explain bankruptcy law only as an instrument for maximizing wealth, not distributing it fairly”: see Korobkin D., ‘Rehabilitating Values’, above 14, p. 781.

<sup>283</sup> Warren stated that “Baird’s view of bankruptcy is more chic than mine, but I believe my view is more realistic and more likely to yield useful analysis”: Warren E., ‘Bankruptcy Policy’, above 14, p. 811.

<sup>284</sup> Warren E., ‘Bankruptcy Policymaking’, above 128, p. 338.

<sup>285</sup> See Finch V., *Corporate Insolvency*, above 9, p. 45.

<sup>286</sup> Warren E., ‘Bankruptcy Policy’, above 14, p. 812.

<sup>287</sup> Warren stated that “the value-enhancement principle is sufficiently well accepted that most policymakers need little encouragement to adopt procedures they perceive will result in net savings. Its inclusion here does little more than add fancy icing to a sturdy cake. In some cases, however, a more complete elaboration of a bankruptcy policy may change how a problem is framed or what solutions are proposed”: Warren E., ‘Bankruptcy Policymaking’, above 128, p. 373.

<sup>288</sup> Collectivism refers to the establishment of a collective debt-collection system that is proposed by the creditors’ bargain theory: see above section 2.2.1; Warren stated that Collectivism offers a useful means to examine some bankruptcy problems: Warren E., ‘Bankruptcy Policy’, above 14, p. 800.; Baird and Jackson described collectivism as the “unique function of bankruptcy” and noted that “at its core” bankruptcy law is designed only to further collectivism: Baird D. & Jackson T., ‘Absolute Priority Rule’, above 10, p. 105.

system will help in reducing the cost of debt collection and prevent multiple individual actions.<sup>289</sup> Nonetheless, she argued that this collectivism cannot be used to justify the whole bankruptcy system.<sup>290</sup> As a consequence, Warren advanced a case for consideration of broader interests that include employees, customers, and suppliers. She stated that bankruptcy law is “a more complex and ultimately less confined process” than supporters of the creditors’ bargain theory such as Jackson, Scott and Baird might view it.<sup>291</sup>

In addition, Warren utilised Congressional comments on the United States of America’s Bankruptcy Code to support concerns wider than the immediate problems of debtors and their creditors.<sup>292</sup> She asserted that in articulating bankruptcy policy Congress stated that bankruptcy law should take into account public interest beyond the debtor and creditor.<sup>293</sup> Also, Congress indicates an evident recognition of the large effects of a debtor’s wide-spread default and the consequences of allowing a few creditors to force a firm to close.<sup>294</sup> Thus, it is not the intention of Congress to focus merely in maximising the interests of the creditors.<sup>295</sup>

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<sup>289</sup> Warren E., ‘Bankruptcy Policy’, above 14, p. 800.

<sup>290</sup> Ibid; Warren argued that besides promoting the concept of collectivism, there are other principal goals of the bankruptcy system: see below pp. 85-86.

<sup>291</sup> Warren E., ‘Bankruptcy Policy’, above 14, p. 778.

<sup>292</sup> Ibid.

<sup>293</sup> Ibid.

<sup>294</sup> Ibid.

<sup>295</sup> Ibid.

In an attempt to formulate the aims of bankruptcy law, Warren<sup>296</sup> has identified four principal goals of the bankruptcy system. In this regard, she stated that as a system to deal with failing firms, the bankruptcy system<sup>297</sup> offers a number of potential advantages. First, “it fosters substantial enhancement of the value of the debtor”,<sup>298</sup> so the stakeholders obtain more than they would have under an alternative collective debt system.<sup>299</sup> Secondly, such a collective system will help in distributing the assets of the debtor “according to a deliberate scheme”,<sup>300</sup> so it will secure protection to a number of deserving parties who would otherwise, without having this system, receive little or nothing.<sup>301</sup> In addition, one of the principal goals of the bankruptcy system is to “force parties who deal with the debtor to bear the burden of their losses without externalizing them to others”.<sup>302</sup> Finally, one of the

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<sup>296</sup> See Warren E., ‘Bankruptcy Policymaking’, above 128, p. 368.

<sup>297</sup> In basing her theory, Warren referred mainly to the American bankruptcy system: see *ibid.*

<sup>298</sup> *Ibid.*

<sup>299</sup> Warren argued that creditors normally had the advantage of collective actions since the debtor is obligated to make a full accounting of its operations- explaining lost assets, revealing valuation information, and offering projections of future business. With the availability of a complete information, the debtor has the chance to seek buyers for the business and management could no longer sell off assets at bargain rates or divert assets to favored creditors. Thus, the chance to preserve the going-concern value of the business through sale or confirmation of a plan is high: see *ibid.*, pp. 375-376.

<sup>300</sup> *Ibid.*, p. 368.

<sup>301</sup> For the cases that converted to Chapter 7 or liquidated in Chapter 11, the court distributed assets *pro rata* to unsecured creditors. In this case, creditors could re-claim assets that have been paid to preferred creditors on the eve of filing. Also, payments that otherwise would have gone elsewhere were made to employees, tort claimants, taxing authorities, and pensioners. In insuring its adherence to the federal scheme, the court and the trustee normally supervised distribution of the assets: *ibid.*, p. 375.

<sup>302</sup> *Ibid.*, p. 368: Warren claimed that the benefits of such a policy (a policy to internalise the costs of failure to the parties dealing with the debtor) are obvious. Creditors’ ability to externalise losses significantly blunts their incentives to make carefully considered lending decisions or to monitor the

most crucial features of the bankruptcy system is to have in place an effective mechanism in order to “bring the system into play at the appropriate time”.<sup>303</sup>

According to Warren,<sup>304</sup> a bankruptcy policy that concentrates on the values to be protected in a bankruptcy distribution system and on the effective implementation of these values supports “the decision-making process even if it does not dictate specific answers”. She argued that such an approach illuminates the critical, normative and essential empirical questions.<sup>305</sup> In addition, she stated that the distributional objectives of the bankruptcy process cannot be considered unless a number of critical questions about the business failure are being asked,<sup>306</sup> such as: who might be hurt by an enterprise failure? How might they be hurt? Whether the hurt can be avoided and at what cost? Who is helped by the business failure? Whether aid to those helped offsets the injury to those hurt? Who can efficiently assess the risks of business failure? Who may have contributed to the business failure and how? Whether the contribution to failure serves other useful goals? Who can best bear the costs of business failure and who is expected to bear those costs?<sup>307</sup> Hence, such an approach is claimed to highlight the empirical

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debtor to assure repayment. “If a lender knows it must bear the bulk of the losses, the lender is more likely to develop appropriate levels of investigation and monitoring *ex ante*. With greater certainty of risk-bearing and a reduced load on the public fisc, incentives are higher to achieve appropriate diligence and caution in debtor-creditor relations”. In her article, Warren explained how bankruptcy restricts externalisation of costs: *ibid*, pp. 361-368.

<sup>303</sup> *Ibid*, p. 368.

<sup>304</sup> Warren E., ‘Bankruptcy Policy’, above 14, p. 796.

<sup>305</sup> *Ibid*.

<sup>306</sup> *Ibid*; However, it is unclear how this would be done in reality.

<sup>307</sup> *Ibid*.

assumptions underlying bankruptcy decisions<sup>308</sup> to ask difficult and direct questions.<sup>309</sup> Even though such answers might be incomplete, they are normally reasoned answers which render them better instead of relying on a single rational theory.<sup>310</sup>

In supporting the notion of the multiple values theory, Korobkin asserted that bankruptcy law is not merely a response to the problem of debt collection rather it is a distinct system for responding to the problem of financial distress.<sup>311</sup> Thus, he argued that in dealing with financial distress, bankruptcy law should and must modify rights recognised under substantive non-bankruptcy law.<sup>312</sup> Further, he stated that bankruptcy law is distinct exactly because it permits for a discourse in which the question of how the financial distress of the business should affect non-bankruptcy rights may be asked and eventually answered.<sup>313</sup> Thus, according to Korobkin, the goal of bankruptcy law should be to address the problem of financial distress and to create “conditions for a discourse in which values of participants

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<sup>308</sup> Ibid, p. 797.

<sup>309</sup> Ibid, p. 796.

<sup>310</sup> Korobkin D., ‘Rehabilitating Values’, above 14, p. 787; Finch V., *Corporate Insolvency*, above 9, p. 47.

<sup>311</sup> Ibid, p. 766; Altering pre-bankruptcy entitlements is “an essential and inevitable part of a full response to the problem of financial distress”: *ibid*, p. 768.

<sup>312</sup> Ibid; However, As discussed above, the promoters of the creditors’ bargain theory argued that it is not the aim of the bankruptcy law to redistribute losses in bankruptcy: see above section 2.2.1; Jackson T., ‘Non-Bankruptcy Entitlements’, above 64, p. 860; Baird D., ‘Reply to Warren’, above 38, p. 822.

<sup>313</sup> Korobkin stated that “This question is complicated, and requires serious discussion among all those who will be affected by the outcome. There may be good economic and noneconomic reasons for preserving state law entitlements, but in specific context, there will be compelling reasons to change them”: *ibid*.

may be rehabilitated into a coherent and informed vision of what the enterprise shall exist to do”.<sup>314</sup>

Finch<sup>315</sup> stated that multiple values theory viewed the bankruptcy process as attempting to achieve a number of ends. Such ends include distributing the effects of financial distress among a broad range of actors; establishing priorities between creditors; offering opportunities for continuation of the business and serving the interests of those who have no formal rights but who have an interest in the continuation of the business.<sup>316</sup> Thus, the multiple values theory seeks recognition of the interests of those who are not directly creditors such as employees who would struggle to retrain for other jobs, customers who would have to resort to less attractive suppliers of goods or services, suppliers who would lose current customers, nearby property owners who suffer declining property values and tax authorities suffering a reduction in taxation revenue.<sup>317</sup> Hence, it is said that this theory has much in common with the communitarian theory and the forum theory however this theory goes further and it is broad enough<sup>318</sup> to incorporate these theories.<sup>319</sup> In affirming this, Korobkin argued that the value-based theory

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<sup>314</sup> Ibid, p. 789.

<sup>315</sup> Finch V., *Corporate Insolvency*, above 9, p. 46.

<sup>316</sup> Ibid

<sup>317</sup> Ibid.

<sup>318</sup> It is similar to the case under both the communitarian and forum theories, the multiple values theory requires recognition of the interests of those who are not directly “creditors” such as older employees who would struggle to retain for other jobs, customers who would have to resort to less attractive suppliers of goods and services and suppliers who would loss current customers. However, the multiple values theory goes further by accepting the need for collectivism and by providing a non-exhaustive list of distributional priorities: see Warren E., ‘Bankruptcy Policy’, above 14, pp. 790-791 & p. 800; Walton P., above 16, p. 10.

<sup>319</sup> Finch V., *Corporate Insolvency*, above 9, p. 46; Walton P., above 16, p. 10.

recognises bankruptcy law's "economic and noneconomic dimensions, and the principles of fairness as a moral, political, personal, and social value".<sup>320</sup>

### 2.6.2 Criticisms of the Multiple Values Theory

The multiple values theory of bankruptcy law has not escaped criticisms, particularly from the proponents of the creditors' bargain theory.<sup>321</sup> The main criticism of such a theory is that it is so broadly expressed and does not offer clear and straightforward guidance to the decision-makers on the controlling of tensions and conflicts between the numerous values being affected by the debtor's insolvency.<sup>322</sup> Since there are no central principles developed to guide judges to determine trade-off or to establish weightings, this theory is accused of being ambiguous leading to uncertainty and indeterminacy, and as a consequence it

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<sup>320</sup> Korobkin D., 'Rehabilitating Values', above 14, p. 781; He also stated that "Bankruptcy law is a system in which such values can be expressed and sometimes recognized, as general rules as well as in particular cases. Thus, the value-based account explains the rule of equality of distribution in simple terms, as a legislative and judicial way of achieving a largely noneconomic outcome as an independent value. The value-based account provides a further explanation of this rule. Under the value-based account, bankruptcy law has the distinct function of creating conditions for a discourse in which values of participants may be rehabilitated into an informed and coherent vision of what the estate as enterprise shall exist to do. In this connection, the rule of equality of distribution may be understood as a means of orchestrating participant choices so as to foster rehabilitative discourse".

<sup>321</sup> See Baird D., 'Reply to Warrant', above 38, pp. 822-833; Finch V., *Corporate Insolvency*, above 9, pp. 47-48.

<sup>322</sup> Warren acknowledged the fact that "I have not offered a single-rational policy that compels solutions in particular cases. I have not given any answers to specific statutory issues. I have only identified normative considerations that may drive legislative and judicial decisions": see Warren E., 'Bankruptcy Policy', above 14, pp. 795-796; Finch V., *Corporate Insolvency*, above 9, p. 47; Keay A. & Walton P., above 9, p. 29.

might lead to lacking and confusion results.<sup>323</sup> Thus, it is difficult to employ bankruptcy law to offer protection to various values since it is difficult to identify the value of the interests held by the community and it is even unclear which kind of community interests should be protected.<sup>324</sup>

Further, Warren asserted that one of the central concerns of bankruptcy law should be to distribute losses that flow from the failure of businesses and in doing so bankruptcy law should contain wealth redistribution provisions and favour those who are least able to bear the costs of such a failure.<sup>325</sup> Nonetheless, Baird challenged such assertion by stating that “such a conception of bankruptcy would be so foreign that it would be hard to call it bankruptcy”.<sup>326</sup> He argued that the failure of the business is not necessarily linked with default and “default itself is not necessarily connected with bankruptcy”.<sup>327</sup> Baird, in addition, argued that redistributing losses in bankruptcy is the same as outside bankruptcy and as a result distribution of losses is not a bankruptcy concern rather it is a non-

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<sup>323</sup> See Finch V., *Corporate Insolvency*, above 9, p. 48; McCormack G., *Corporate Rescue*, above 121, p. 35.

<sup>324</sup> Ibid.

<sup>325</sup> Warren E., ‘Bankruptcy Policy’, above 14, p. 796.

<sup>326</sup> Baird D., ‘Reply to Warrant’, above 38, p. 819.

<sup>327</sup> In explaining his argument Baird stated that “At any time resources are shifted from one use to another or from one place to another, there are likely to be spill-over effects- both positive and negative. If I run a business that makes widgets, I might decide tomorrow to get out of that business and invest my money elsewhere. I can make that decision even if the business is not insolvent. I can make that decision even if the business is not in default. Indeed, I can make that decision even if the business has no creditors at all. The rust belt is littered with firms that have closed or moved elsewhere, not because these businesses did not have enough to pay off creditors, but because they had better opportunities elsewhere. Such a decision has exactly the same effect on workers and customers and nearby property owners as does the decision to close up shop of an insolvent business after default to numerous creditors and a bankruptcy petition is filed”: *ibid*, p. 829.

bankruptcy problem.<sup>328</sup> Thus, if there is a need to protect some values, he argued, it is adequate to protect them within the context of the whole legal system instead of within bankruptcy law.<sup>329</sup> However, as a response to this claim, Goode<sup>330</sup> argued that there is no scope for the non-bankruptcy law to prescribe priorities for other values, including employees and tort claimants since such issues arise specifically because of the business failure. As a result, inserting such a priority rule makes no sense except in the context of bankruptcy law.

It is worth noting that while both the forum theory and the communitarian theory recognise the interests of all interested parties who might be affected by the failure of the business,<sup>331</sup> the multiple values theory adds that bankruptcy law should focus also on the values to be protected through having in place an effective bankruptcy distribution scheme.<sup>332</sup> To clarify, whereas the supporters of the creditors' bargain theory argue that it is not within the objectives of the bankruptcy laws to redistribute losses in bankruptcy,<sup>333</sup> the supporters of the multiple values theory argue that one of the main objectives of the bankruptcy law is to allocate losses that arise by virtue of the bankruptcy law.<sup>334</sup> Thus, the view of the multiple

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<sup>328</sup> Ibid, p. 817.

<sup>329</sup> Ibid, p. 824.

<sup>330</sup> For the following discussion: see Goode R., above 2, pp. 73-74.

<sup>331</sup> As shown above, this might include the interests of employees, secured and unsecured creditors, customers, suppliers, local government and the community at large: see above sections 2.4.1 & 2.5.1.

<sup>332</sup> Warren E., 'Bankruptcy Policymaking', above 128, p. 368; Warren E., 'Bankruptcy Policy', above 14, p. 796.

<sup>333</sup> Baird D. & Jackson T., above 75, pp. 102-103; Jackson T., 'Non-Bankruptcy Entitlement', above 64, p. 861; Baird D., 'Reply to Warrant', above 38, p. 817; see above pp. 47-49.

<sup>334</sup> Warren E., 'Bankruptcy Policy', above 14; Korobkin D., 'Rehabilitating Values', above 14; see above pp. 85-86.

values theory is that bankruptcy law should contain wealth redistribution provisions<sup>335</sup> in which preference should be granted to certain claimants who are least able to bear the cost of bankruptcy.<sup>336</sup> In supporting the multiple values theory's view, Goode argues that since some claimants arise by virtue of the bankruptcy of trader,<sup>337</sup> it is necessary to prescribe priority for those claimants in the context of bankruptcy law.<sup>338</sup> Further, Cantlie rightly argued that in the event of bankruptcy, there is a need to relieve certain claimants because a number of claimants are normally competing for a share of a limited pool of assets which means there will not be enough assets to satisfy all claims.<sup>339</sup> In this regard, it can be argued that bankruptcy laws should be designed in a way that allows pre-

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<sup>335</sup> Redistribution is generally defined as any modification of pre-bankruptcy entitlements held by an agent- i.e., formation of a new bankruptcy entitlement or destruction of pre-bankruptcy entitlements- that occurs once the firm enters a formal collective bankruptcy procedure. In this regard, a provision of bankruptcy law is called redistributive as long as it creates a bankruptcy entitlements or destroys a pre-bankruptcy entitlements: see Rotem Y., 'Pursuing Preservation of Pre-bankruptcy Entitlements: Corporate Bankruptcy Law's Self-Executing Mechanisms', (2008) 5 B.B.L.J. 79, pp. 90-91.

<sup>336</sup> Warren E., 'Bankruptcy Policy', above 14, p. 811; However, as will be shown below, bankruptcy laws worldwide differ in regard to the priority they assign to secured creditors, insolvency expenses, employee wages and post-bankruptcy financing. According to a single study, the only jurisdictions that place secured creditors first in priority of payments are the UK, Germany, Japan, Hong Kong, Singapore and Australia. Jurisdictions such as: France, Canada and Spain grant employees the highest priority in liquidation. In England, the Enterprise Act 2002, certain employee claims such as: contributions to occupational pension schemes, unpaid holiday pay and unpaid wages for employees within a particular period of insolvency and subject to a maximum amount per employee are given preferential status over floating charge collateral: for a fuller discussion of the case in these countries and some Arab countries including Oman: see below pp. 329-332.

<sup>337</sup> See above pp. 57-60.

<sup>338</sup> Goode R., above 2, pp. 73-74.

<sup>339</sup> Cantlie S., 'Preferred Priority in Bankruptcy', in Ziegel J., *Current Developments in International Corporate Insolvency Law*, (Oxford, Clarendon Press, 1994), p. 421.

bankruptcy entitlements to be modified in order to pursue a legitimate objective<sup>340</sup> and in a way that provides protection to pre-bankruptcy creditors.<sup>341</sup> As will be shown below,<sup>342</sup> this thesis proposes that the future bankruptcy law in Oman should contain a clear priority rule in which pre-bankruptcy entitlements are adjusted. However, adjusting pre-bankruptcy entitlements does not mean to prejudice the rights of creditors established prior to the bankruptcy of the debtor.<sup>343</sup>

In addition, the supporters of the multiple values theory agree with the promoters of the creditors' bargain theory in that having in place a compulsory debt collection system will help in reducing the cost of debt collection and prevent multiple individual actions from a few anxious creditors.<sup>344</sup> However, unlike the creditors' bargain theory, the promoters of the multiple values theory do not accept the fact that collectivism alone can be used to justify the whole bankruptcy system.<sup>345</sup> According to them, regulating the rules of the collectivism system is only one function amongst others to be played by bankruptcy laws.<sup>346</sup> Thus, based on the multiple values theory, bankruptcy law should be designed to perform a number of functions.<sup>347</sup> Nevertheless, despite the fact that both the communitarian theory and the multiple values theory shed light on the importance of taking into

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<sup>340</sup> For instance, a policy encouraging reorganisation of the business of the distressed debtor and a policy to decrease the level of unemployment.

<sup>341</sup> For in-depth discussion of this thesis's view in regard to re-distributional role of bankruptcy laws: see below pp. 332-339.

<sup>342</sup> Ibid.

<sup>343</sup> To avoid repetition, for a fuller treatment of this point: see *ibid.*

<sup>344</sup> Jackson T., 'Non-Bankruptcy Entitlement', above 64, p. 861; Jackson T., *Logic and Limits*, above 10, p. 14; Warren E., 'Bankruptcy Policymaking', above 128, p. 368.

<sup>345</sup> Warren E., 'Bankruptcy Policymaking', above 128, p. 368.

<sup>346</sup> See above section 2.6.1.

<sup>347</sup> Ibid.

account the interests of other stakeholders, such as employees, customers and local community, they are both criticised for being too broad and give rise to the problems of indeterminacy.<sup>348</sup> So, it is not easy to determine the interests that worthy of legal protection since there are many potential interests in each bankruptcy cases and no guidelines are given to manage the tensions between various interests.

## 2.7 The Explicit Value Theory

Having examined and critiqued various theories of bankruptcy law, Finch<sup>349</sup> suggested a further model of bankruptcy law. She termed her model the 'Explicit Value Approach'<sup>350</sup> which, according to her, offers an alternative approach to the existing theories.<sup>351</sup> She asserted that even though various theories of bankruptcy law highlight different aspects of corporate bankruptcy law role, they did not provide the full picture of the appropriate measures of bankruptcy law.<sup>352</sup>

### 2.7.1 The Principles of the Explicit Value Theory

Finch contended that to promote the search for 'measures'<sup>353</sup> in the light of such conflicting and diverse theories, it is important to investigate further 'the purpose of

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<sup>348</sup> For the critiques of the communitarian theory: see above section 2.4.2; for the critiques of the multiple values theory: see above section 2.6.2.

<sup>349</sup> Finch V., *Corporate Insolvency*, above 9, pp. 48-63; Finch V., 'Insolvency Measures', above 20, pp. 242-250.

<sup>350</sup> Finch V., *Corporate Insolvency*, above 9, p. 52.

<sup>351</sup> *Ibid*, p. 64.

<sup>352</sup> *Ibid*, p. 48.

<sup>353</sup> Finch did not define the word 'measures'; However, the word 'measure' can be defined as a course of action taken to achieve a particular purpose: see *Oxford Advanced Learner's Dictionary of Current English*, (7<sup>th</sup> edition, Oxford University Press, 2005), p. 952.

a quest for benchmarks<sup>354</sup> for bankruptcy law.<sup>355</sup> In doing so two questions should be asked, namely: what specifically is being measured by previous theories and whether it is possible to justify bankruptcy law and its procedures given present approaches? According to her, in order to approach these issues reference should be made to the fundamental rules of company law, particularly in regard to the question of how corporate managerial power is legitimated.<sup>356</sup>

Since company law was said<sup>357</sup> to be about “the legitimation of managerial power in the hands of directors”, Finch stated that the bankruptcy process is more complicated since power is always taken out of the hands of management<sup>358</sup> and given to different parties, according to various circumstances, such as creditors, bankruptcy practitioners and the courts themselves.<sup>359</sup> Further, she argued that an insolvency regime needs this kind of legitimation since bankruptcy processes affect

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<sup>354</sup> See below p. 97; Finch did not define the word ‘benchmark’; However, the word ‘benchmark’ is defined as something which can be measured and used as a standard that other things can be assessed or compared with: see *Oxford Advanced Learner’s Dictionary of Current English*, (7<sup>th</sup> edition, Oxford University Press, 2005), p. 130.

<sup>355</sup> Finch V., *Corporate Insolvency*, above 9, p. 49.

<sup>356</sup> Ibid.

<sup>357</sup> Mary S., ‘Company Law and Legal Theory’, in Twining W., *Legal Theory and Common Law*, (Oxford, Blackwell, 1986), p.155; However, Eisenberg explained the divergences between the Political Model and the Economic Model. The two models diverge in a number of issues. These issues are: what is the fundamental nature of the corporation as an institution within a large society? How the power of the corporation legitimated? What should be the objective and what should be the conduct of the corporation? What should be the role of management in the corporation? What should be the role and composition of the corporation’s board of directors?; for a detailed discussion: see Eisenberg M., ‘Corporate Legitimacy, Conduct, and Governance- Two Models of the Corporation’, (1983) 17 *Creighton Law Review* 1.

<sup>358</sup> However, this is not the case in some jurisdictions such as the US where managements stay in their positions during reorganisation process.

<sup>359</sup> Finch V., *Corporate Insolvency*, above 9, p. 52.

both public and private interests.<sup>360</sup> It affects public interest because decisions are made about the future of the firms and such decisions have an impact on livelihoods and communities.<sup>361</sup> Bankruptcy processes also impact private rights in that securities can be frozen and individual attempts to impose other legal rights are, usually,<sup>362</sup> stayed.<sup>363</sup> She, therefore, argued that “the broad bankruptcy process in all its dimensions and with its variety of actors requires legitimation”<sup>364</sup> and such legitimation should take into account both public and private interests.<sup>365</sup> Accordingly, Finch expressed the view that “the attribution of legitimacy” should not be based merely on communitarian theory or the creditors’ bargain theory. In her view “the powers involved” in bankruptcy processes “can be seen as calling for strong justification”.<sup>366</sup> However, in searching for the measures<sup>367</sup> of bankruptcy law, various theories<sup>368</sup> of bankruptcy law can be seen as incorporating a number of important legitimating rationales for bankruptcy processes.<sup>369</sup> Thus, relying on some of the concepts underpinning these theories, Finch attempted<sup>370</sup> to suggest an approach in which a balance between different legitimating rationales, public and private, can be achieved.

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<sup>360</sup> Ibid, p. 53.

<sup>361</sup> Ibid.

<sup>362</sup> For the case in England and the US: see below section 3.4.2; for the case in Oman: see below sections 4.4 (D), 4.5.4 (B) & 4.6.2.4.

<sup>363</sup> Finch V., *Corporate Insolvency*, above 9, p. 53.

<sup>364</sup> Ibid.

<sup>365</sup> Ibid, p. 52.

<sup>366</sup> Ibid, p. 53.

<sup>367</sup> See above footnote number 353.

<sup>368</sup> These theories include the communitarian, the bankruptcy choice and the creditors’ bargain theories.

<sup>369</sup> Finch V., *Corporate Insolvency*, above 9, p. 63.

<sup>370</sup> Ibid, p. 52.

In Finch's view, assessing the legitimacy of a bankruptcy process differs from merely expressing political opinion on the topic.<sup>371</sup> However such an assessment which "involves a stepping back and reference, not to personal preferences or visions, but to values enjoying broad acceptance"<sup>372</sup> is relevant.<sup>373</sup> Accordingly, Finch argued that the legitimacy of the processes and principles of bankruptcy law can be established by reference to four values or 'benchmarks'.<sup>374</sup> These benchmarks are *Efficiency* which "looks to the securing of democratically mandated ends at lowest cost";<sup>375</sup> *Expertise* which "refers to the allocation of decision and policy functions to properly competent persons";<sup>376</sup> *Accountability* which "looks to the control of insolvency participants by democratic bodies or courts or through the openness of processes and their amenability to

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<sup>371</sup> Finch stated that persons of opposing political views might differ radically in their views on dealing with a trouble enterprise. One person might favour immediate closure, payment of creditors and reliance on new investment to create jobs. Another person might stress the significance of allowing time for rehabilitation of the business because of the high premium he or she places in continuity of employment and avoidance of the external costs that closure might bring: see *ibid*, p. 55 & 56.

<sup>372</sup> Finch did not specify the type of values that might enjoy broad acceptance. However, she argued that these values are endorsed by parties of differing political persuasions and, according to a 'values argument', proceeds to normativity from the factual assumption that certain values are broadly accepted and by asserting that it is, therefore, right that insolvency regimes should be designed and operated to serve those values: *ibid*, p. 56; a value approach offers an account of why bankruptcy law should be designed to pursue a certain objective or set of objectives, or even one purpose at the expense of others. However, a value approach is not immune from criticism: on the premises of 'value approach' see Korobkin D., above 173, pp. 104-411.

<sup>373</sup> Finch V., *Corporate Insolvency*, above 9, pp. 55-56.

<sup>374</sup> *Ibid*, p. 56; However, as will be shown below, these principles are quite general and Finch fails to make a distinction between them and she does not reveal the principles governing them, nor the factor which differentiates between them: see below pp. 102-103; see Mokal R., 'On Fairness and Efficiency', (2003) 66 M.L.R. 452, pp. 460-462.

<sup>375</sup> Finch V., *Corporate Insolvency*, above 9, p. 56.

<sup>376</sup> *Ibid*.

representations”,<sup>377</sup> and *Fairness* which “considers issues of justice and propensities to respect the interests of affected parties by allowing such parties access to, and respect, within decision and policy processes”.<sup>378</sup> Hence, according to Finch, in measuring the legitimacy of such rules or procedures under these legitimating headings reference to a number of questions should be made.<sup>379</sup> Examples of such questions are whether this is a process that permits Parliament’s (Congress) desires to be effectively implemented? Are levels of accountability satisfactory? Can the proposed procedures be considered fair<sup>380</sup> as giving due access to and respect for the interests of affected parties?

Further, Finch argued that transparency in relation to measures of bankruptcy law can be seen as clarity regarding values to be served by such laws.<sup>381</sup> Nonetheless, she indicated that such clarity does not offer complete answers on whether a particular balance between, for example, protection for secured creditors and for employees is desirable or not.<sup>382</sup> In addition, she stated that “the rightness and wrongness of particular trade-offs can only be argued for by giving weightings or priorities to the protection of different values or interests”.<sup>383</sup> Such weightings

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<sup>377</sup> Ibid.

<sup>378</sup> Ibid.

<sup>379</sup> Ibid.

<sup>380</sup> Finch stated that “we may all differ in our conceptions of the just society or the just distribution of rights in insolvency”: *ibid*, p. 58.

<sup>381</sup> Finch asserted that transparency cannot be complete. However, “such a state of affairs might be achieved by persuading all parties to agree to a single vision of the just insolvency regime as derived for a single vision of the just society. This sort of agreed vision would for a basis for clarity on, for example, the level of expertise that is appropriate in a process or how, precisely, we can delineate acceptable standards of access or qualifying interests”: *ibid*, pp. 57 & 58.

<sup>382</sup> Ibid.

<sup>383</sup> Ibid.

and priorities presume “substantive visions of the just society” and, therefore, individuals of diverse “political persuasions” might be expected to vary on the “right balancing” of different interests in bankruptcy.<sup>384</sup> Nevertheless, she asserted that such disagreement in striking the right balance between various conflicting values would disappear by final political judgments.<sup>385</sup>

In addition, the efficiency of a statutory mandate is one of the benchmarks of bankruptcy processes or decisions.<sup>386</sup> Finch argued that having a clear mandate on the ground, therefore, offers a very compelling yardstick for measuring a bankruptcy process or decision.<sup>387</sup> However, Finch argued that statutory mandates in bankruptcy laws are often unclear or even lacking.<sup>388</sup> In this case, she stated that in order to legitimate such processes or decisions a reference should be made to the expertise, accountability and fairness justifications.<sup>389</sup>

In describing her theory, Finch acknowledged that the “explicit value approach” provides no ultimate vision aimed at worldwide subscription however “a means of bringing a degree of clarity to evaluate discussions” while accepting that we may all be different in our notions of “the just society’ or ‘the just distribution of rights” in

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<sup>384</sup> Ibid.

<sup>385</sup> However, Finch argued that “final political judgments would be made with a transparency that would be lacking were reference not made to the array of values or rationales described here”: *ibid*, p. 58.

<sup>386</sup> *Ibid*, p. 59.

<sup>387</sup> One benchmark for processes or decisions is the extent to which a statutory mandate is efficiently implemented. In this regard, some aspects of insolvency processes do involve professional agents to implement tasks set down in the insolvency statute, for example, the liquidator’s statutory duty in voluntary winding up to distribute *pari passu*: see *ibid*.

<sup>388</sup> *Ibid*.

<sup>389</sup> *Ibid*.

bankruptcy.<sup>390</sup> Nonetheless, she claimed that unlike the multiple values and communitarian theories, her theory is limited in so far as relevant legitimating arguments are established under the four benchmarks headings, namely efficiency, expertise, accountability and fairness, and arguments outside of such headings are consequently not to be considered as relevant for purposes of legitimation.<sup>391</sup> Thus, judges and decision-makers are invited to reason with reference to these benchmarks instead of relying on a single theory of bankruptcy law.<sup>392</sup>

### 2.7.2 Criticisms of this Theory

The above explicit value theory has been criticised by Mokal,<sup>393</sup> one of the supporters of the bankruptcy choice theory. In his article ‘On Fairness and Efficiency’, Mokal examined Finch’s explicit value theory and whether her theory has some sort of consistency in reasoning or not.<sup>394</sup> Having examined the benchmarks underpinning the explicit value theory, he stated that Finch’s argument fails to make a distinction between the “diverse natures of her benchmarks” and she does not reveal the principles governing them, nor the factors which differentiates between them.<sup>395</sup> First, Mokal argued that even though Finch stated

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<sup>390</sup> Ibid, p. 58; As will be proposed in Chapter Five, a bankruptcy law should have a clear statutory vision in which appropriate procedures are designed to reflect such a vision; for a fuller discussion: see below section 5.5.1.

<sup>391</sup> Finch V., *Corporate Insolvency*, above 9, p. 64.

<sup>392</sup> Ibid, p. 65.

<sup>393</sup> Mokal R., above 374, pp. 453-462.

<sup>394</sup> Ibid.

<sup>395</sup> Ibid, p. 460 & p. 462.

that the efficiency benchmark employs different notions of efficiency,<sup>396</sup> what Finch does not explain is why she simply picks one of them and rejects the others.<sup>397</sup> In examining the efficiency benchmark, Finch stated that “technical efficiency” is concerned “with achieving the objectives being pursued by Parliament” with the minimal use of resources and costs and with the minimal waste of effort.<sup>398</sup> However, Mokal argued that Finch did not state exactly what sort of costs are desired to be avoided here and how effort may be wasted.<sup>399</sup> Further, Mokal raised a number of other concerns.<sup>400</sup> For example, since legitimacy is considered to be a moral concept, do the results that efficiency wishes to achieve at the lowest cost also need to satisfy certain moral obligations.<sup>401</sup> As a consequence, he argued that ignoring such concerns causes the explicit value approach to be “both incomplete and internally inconsistent”.<sup>402</sup>

In addition, based on Finch’s view, the justification of insolvency processes cannot be merely dependent on the efficient pursuit of mandates but it should also be dependent on the degree of expertise exercised by relevant parties, the adequacy of control and accountability schemes and the procedural fairness that is

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<sup>396</sup> Space does not allow for a fuller discussion of various notions of efficiency (for instance, Pareto efficiency and Kaldor-Hicks efficiency ) and their problems: see Kornhauser L., ‘Constrained Optimization: Corporate Law and the Maximization of Social Welfare’, in Kraus J. & Walt S., *The Jurisprudential Foundations of Corporate and Commercial Law*, (New York, UCP, 2000); Mokal R., above 374, pp. 454-456.

<sup>397</sup> *Ibid.*, pp. 453-454; see Finch V., *Corporate Insolvency*, above 9, pp. 54-56.

<sup>398</sup> Finch V., *Corporate Insolvency*, above 9, pp. 62-63.

<sup>399</sup> Mokal R., above 374, p. 460.

<sup>400</sup> *Ibid.*

<sup>401</sup> *Ibid.*

<sup>402</sup> *Ibid.*

shown in dealing with the affected parties' interests.<sup>403</sup> However, this benchmarking theory has been critiqued because it arguably fails in making a distinction between substantive and procedural goals.<sup>404</sup> Substantive goals are those "which justify the existence of this part of the law by showing it in its best light, by demonstrating why it is worth having it" whereas, procedural goals are "about how the law goes about attaining its substantive goals".<sup>405</sup> To simplify, a distinction should be made between the ultimate ends of the law, and the methods that the law adopts in order to achieve those aims.<sup>406</sup> "Once a set of substantive goals has been exogenously specified (e.g. using a theory of justice) efficiency can be used to judge between various proposed schemes for implementing it."<sup>407</sup> Nevertheless, Mokal argued that efficiency can neither be a substantive goal of any area of the law nor confer justification on any part of it.<sup>408</sup> However, it can be used to judge between various proposed schemes in order to implement only a specific substantive goal by choosing the method which is less costly to implement.<sup>409</sup> Mokal continued his argument by stating that efficiency in *itself* does not provide a goal that any area of the law should aim at, since it creates no sufficient reason for the law to be one way rather than another.<sup>410</sup> Furthermore, in regard to fairness

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<sup>403</sup> Finch V., *Corporate Insolvency*, above 9, p. 44.

<sup>404</sup> Mokal R., above 374, p. 457.

<sup>405</sup> Ibid.

<sup>406</sup> Ibid.

<sup>407</sup> Ibid.

<sup>408</sup> Mokal argued that efficiency analysis can be used to determine whether the law attains its substantive goals in the cheapest feasible way: *ibid*, p. 458.

<sup>409</sup> *Ibid*, p. 457.

<sup>410</sup> Mokal demonstrated his argument by providing the following example: "suppose we specify that a branch of the law should attain a set of substantive goals. Suppose also that there are two proposals about how to bring about these goals. Now it is obvious that no proposal can be

benchmark,<sup>411</sup> which is utilised throughout Finch's book to analyse the legitimacy of various parts of the law,<sup>412</sup> Mokal argued that "there is no general or abstract statement or theory of what Finch understands by 'fairness'".<sup>413</sup> As a way of example, Mokal stated that Finch appears to condemn the institution as 'unfair' because, among other things, the floating charge holder does not have an obligation to take into account the interests of any other parties, and could take decisions affecting their interests without their consent.<sup>414</sup> However, even though we assume that fairness requires the consent of those affected by a decision or a process, Finch did not explain *how* such consent might appropriately be obtained.<sup>415</sup>

The explicit value theory recognises the importance of taking into account the interests of creditors<sup>416</sup> and employees (in retaining their jobs), local government (in gaining future tax revenue) and the community at large (in benefiting from the

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operationalised and implemented costlessly. Some resources will inevitably be consumed simply in putting in place any such proposal, and in maintaining it in operation. So the more resources that are consumed in implementing a particular scheme, the fewer that will be available for other worthwhile objectives. It follows that if there are two methods of bringing about a certain goal in these circumstances, we must choose the method which is less costly to implement, other things being equal. Any other decision would amount to wasting resources, since the same objective could have been attained and in addition, a surplus would be available for application towards other valued goals": see *Ibid.*

<sup>411</sup> As mentioned above, according to Finch, *Fairness* "considers issues of justice and propensities to respect the interests of affected parties by allowing such parties access to, and respect, within decision and policy processes": Finch V., *Corporate Insolvency*, above 9, p. 56.

<sup>412</sup> Mokal R., above 374, p. 463.

<sup>413</sup> *Ibid.*

<sup>414</sup> *Ibid.*, p.464

<sup>415</sup> *Ibid.*

<sup>416</sup> As stated above, it is seen as private interests: see above p. 96.

goods and services of the distressed enterprise).<sup>417</sup> So, unlike the creditors' bargain theory, which focuses merely on the interests of creditors and pre-insolvency entitlements, this theory takes into consideration the preference to further communitarian interests and to protect creditors' interests. However, unlike the case under both the communitarian and the multiple values theories, under this theory the list of community interests is not open ended. This list is limited as far as the relevant justifying arguments are arranged under four benchmarks described by Finch, namely: efficiency, expertise, accountability and fairness.<sup>418</sup>

## 2.8 Evaluating Remarks

The above-discussed theories debate the theoretical foundations of bankruptcy law based on their promoters' views. However, as will be noticed,<sup>419</sup> in criticising the current bankruptcy regime in Oman and in calling for a bankruptcy reform, this thesis is in favour of a combination of various theories. This is due to the fact that the theories already discussed highlight the different roles that might be played by bankruptcy law and, as a result, each of them has its own merits. For instance, while the creditors' bargain theory highlights the importance of establishing a compulsory debt collection system,<sup>420</sup> the multiple values theory stresses the

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<sup>417</sup> Seen as public interests: see *ibid.*

<sup>418</sup> See also Azmi R. & Razak A., above 251, p. 672.

<sup>419</sup> See below sections 4.8.3 & 4.8.4 & , pp. 334-336 & section 5.5.4.

<sup>420</sup> However, as discussed above, the focus of this theory is merely on maximising the interest of creditors and, as a result, bankruptcy law, at its core, should establish a collective debt-collection system that deals with and maximises merely the interest of creditors: see Jackson T., *Logic and Limits*, above 10, p. 5.; Baird D., 'World without Bankruptcy', above 44, p. 184; see above section 2.2.1.

significance of a redistributive role of bankruptcy laws.<sup>421</sup> Hence, it is useful for the decision-makers<sup>422</sup> to have recourse<sup>423</sup> to these normative theories when considering further development of particular bankruptcy laws because these various theories incorporate a number of important justifications for bankruptcy law and its processes. For instance, even though the main deficiency of the creditors' bargain theory is that it merely focuses on the interests of secured creditors, this theory underscores the importance of having in place a mechanism whereby all creditors' claims are stayed during the process.<sup>424</sup> As will be shown below,<sup>425</sup> staying creditors' action<sup>426</sup> during reorganisation or liquidation proceedings is the main feature of the regimes in the US and England. However, as will be shown in Chapter Four,<sup>427</sup> one of the main issues with the current bankruptcy regime in Oman is that secured creditors are not prevented from pursuing their claims during bankruptcy and liquidation proceedings. Furthermore, while the communitarian<sup>428</sup>

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<sup>421</sup> See above p. 85; As is the case with the communitarian and the forum theories, the multiple values theory also argues that bankruptcy law should take into account the interests of all parties that might be affected by the bankruptcy of the debtor. However, as shown above, these interests are too wide and it is not clear how tensions between these interests are to be controlled: see Gross K., 'Community Interests', above 12, p. 1042; Warren E., 'Bankruptcy Policy', above 14, p. 777; see above section 2.4.1 & 2.6.1.

<sup>422</sup> This does not need to be a jurisdiction specific. However, in designing its own bankruptcy law, each country should take into account a number of factors, such as cultural factors (people's attitude towards proposed principles) and the institutional context (the qualification of judges and bankruptcy officers): for further discussion see below pp. 273-275 and section 5.3.1.

<sup>423</sup> However, resorting to these theories does not mean to overlook the critiques of each of them.

<sup>424</sup> See above section 2.2.1.

<sup>425</sup> See below section 3.4.2.

<sup>426</sup> For the significance of staying creditors' actions (moratorium): see below pp. 150-151.

<sup>427</sup> See below section 4.4 (D).

<sup>428</sup> See above section 2.4.1.

and multiple values theories<sup>429</sup> take the view that, besides protecting the interests of secured creditors, bankruptcy law should take into account other interests, Finch, through her explicit value theory, argues that bankruptcy law should strike a balance between various stakeholders.<sup>430</sup> For instance, as will be shown below,<sup>431</sup> in order to strike such a balance, in the US the rescue plan will not be imposed over the wishes of objecting creditors unless they are sufficiently protected.<sup>432</sup> This is similar to the case in England.<sup>433</sup> However, whereas in England the court is given total discretion in determining whether dissenting creditors are crammed-down or not, in the US there are statutory provisions that should be met before imposing the rescue plan over the wishes of dissenting creditors.<sup>434</sup> As will be seen in the next chapter,<sup>435</sup> bankruptcy regimes in the US and England tend to take into account the interests of various participants, although the scope of protection offered to creditors varies under these regimes.<sup>436</sup> Moreover, the forum theory underscores the important role that should be played by bankruptcy law, namely its

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<sup>429</sup> See above section 2.6.1.

<sup>430</sup> As stated above, she argues that when considering developing bankruptcy law, striking a balance between various conflicting interests should be taken into account: Finch V., *Corporate Insolvency*, above 9, p. 58; see above section 2.7.1.

<sup>431</sup> See below section 3.4.4.

<sup>432</sup> Klee K., 'All You Ever Wanted to Know About Cram Down Under the New Bankruptcy Code', (1979) 53 A.B.L.J. 133, p. 156.

<sup>433</sup> Ibid; O'Dea G., 'Craving a Cram-Down: Why English Insolvency Law needs reforming', (November, 2009), available at:

[http://www.weil.com/files/Publication/8db63e8a49b6471290ac0348746890a9/Presentation/PublicationAttachment/c196def8-cca3-49fd-a5ab071187e511c6/JIBFL\\_Nov\\_09.pdf](http://www.weil.com/files/Publication/8db63e8a49b6471290ac0348746890a9/Presentation/PublicationAttachment/c196def8-cca3-49fd-a5ab071187e511c6/JIBFL_Nov_09.pdf). accessed on 25/01/2014.

<sup>434</sup> Ibid.

<sup>435</sup> See below section 3.4.

<sup>436</sup> Ibid.

role in establishing a forum<sup>437</sup> in which all interests affected by the failure of the business can be heard.<sup>438</sup> Hence, all the above-discussed theories have their own advantages which can be used by policy-makers in developing and designing bankruptcy laws.

Based on the above discussion, this thesis argues that bankruptcy law should be designed in a way that leads to the achievement of a number of ends.<sup>439</sup> In this regard, it is important to acknowledge the fact that in the event of bankruptcy, besides creditors' interests, there are other interests that need to be taken into account, since they might also be affected by the bankruptcy of debtors.<sup>440</sup> Thus, maximising the welfare of debtors and all creditors, secured and unsecured,<sup>441</sup>

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<sup>437</sup> As will be discussed below, under both England and US insolvency regimes, creditors, secured or unsecured, are entitled to vote 'for' or 'against' the proposed plan: see below section 3.4.4; However, as will be stated in Chapter Four, although all secured creditors whose debts have been accepted may vote in favour or against the composition arrangement, in Oman secured creditors are prevented from participating in such voting unless they relinquish their rights as secured creditors: see below section 4.6.2.5.

<sup>438</sup> Flessner A., above 13, p. 24.

<sup>439</sup> This is also in line with the legislative guide that was made by the United Nations Commission on International Trade Law (UNCITRAL). In highlighting the key objectives of an effective and efficient insolvency law, it is stated that "there is broad agreement that effective and efficient insolvency regimes should aim to achieve the key objectives which include: maximising value of assets, striking a balance between liquidation and reorganisation, ensuring equitable treatment of similarly situated creditors, recognising existing creditors and establishing clear rules for ranking of priority claims": for a fuller treatment of these objectives: see United Nations Commission on International Trade Law, 'Legislative Guide on Insolvency Law', (2004), pp.9-14, available at: [http://www.uncitral.org/pdf/english/texts/insolven/05-80722\\_Ebook.pdf](http://www.uncitral.org/pdf/english/texts/insolven/05-80722_Ebook.pdf). accessed on 09/09/2014

<sup>440</sup> See above section 2.4.1.

<sup>441</sup> As discussed above, this is the view of the communitarian, the forum and the multiple values theories. All these theories assert that all parties affected by the bankruptcy of debtor should be taken into account by bankruptcy law.

through encouraging the rehabilitation<sup>442</sup> of viable businesses and liquidating the unviable businesses<sup>443</sup> should be some of the objectives of bankruptcy law. This is due to that fact that including the possibility of rehabilitation of distressed debtors as an alternative to liquidation might mean that jobs will be preserved,<sup>444</sup> secured creditors might receive better returns<sup>445</sup> and suppliers may opt for continuing their relationship with the distressed debtor.<sup>446</sup> Thus, immediately liquidating viable businesses without giving them a chance to be rehabilitated means that jobs will not be preserved, and shareholders might receive little or nothing.<sup>447</sup> Further, one of the aims of bankruptcy law should be to establish a collective debt-collection

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<sup>442</sup> As stated above, according to the creditors' bargain theory, rehabilitation should not be an independent policy because it does little to reconcile the diverse interests of creditors: see Jackson T., *Logic and Limits*, above 10, p. 2.

<sup>443</sup> Assessing the viability of the business should be determined by having in place qualified bankruptcy practitioners who are able to oversee the viability of continuing the trading.

<sup>444</sup> As will be discussed below, for instance, the rescue of Game Group Shop saved nearly 3200 jobs: see below p. 122.

<sup>445</sup> Rehabilitation of distressed debtors might generate more returns to secured creditors. For instance, through her empirical study, Frisby concluded that post-Enterprise Act administrators deliver more returns to secured creditors than pre-Enterprise Act administrators: see Frisby S., above 162, p. 42.

<sup>446</sup> However, it is not appropriate to require a supplier to continue their contractual relationship with the distressed debtor unless there is in place a clear guarantee that payment for future supply will be assured: see Milman D., 'Moratoria in UK Insolvency Law: Policy and Practical Implication', (2012 ) 317 C.L.N. 1, p. 3.

<sup>447</sup> See above footnote number 3; Many countries in the European Union have reformed their bankruptcy legislations (for example, France, Germany, the UK, Spain, Finland) and the goal of such reforms was to have in place a bankruptcy legislation that includes both reorganisation and liquidation chapters: see Dewaelheyns N. & Hulle C., 'Legal Reforms and Aggregate Small and Micro Business Bankruptcy Rates: Evidence from the 1997 Belgian Bankruptcy Code', p. 3, Working Paper 0607, Department of Accountancy Finance and Insurance, Katholieke Universiteit Leuven, Belgium, can be downloaded from:

[http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=905196](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=905196). accessed on 09/09/2014.

system<sup>448</sup> in which all claims must be stayed during bankruptcy proceedings. As shown above,<sup>449</sup> the aim of this system is to reduce the cost of debt collection in order to maximise the aggregate pool of assets.<sup>450</sup> Establishing a collective debt-collection system means that all creditors' actions are stayed to protect the assets of the debtor from hostile and damaging actions by creditors.<sup>451</sup> However, as will be discussed below,<sup>452</sup> since secured creditors are most particularly burdened by the imposition of such a stay, there should be a mechanism whereby secured creditors are given the necessary legal right to seek the lifting of the stay.<sup>453</sup> Moreover, one of the objectives of bankruptcy law should be to readjust and modify pre-bankruptcy entitlements by containing wealth redistribution provisions.<sup>454</sup> Such

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<sup>448</sup> This is the view of the creditors' bargain and the multiple values theories. However, it is worth noting that even though, based on the multiple value theory, establishing this system is one of the objectives of bankruptcy law, the aim of this system, based on the creditors' bargain theory, is to maximise the collective returns to the creditors' of the debtor as a whole, which is the sole objective of bankruptcy law: see above sections 2.2.1 & 2.6.1.

<sup>449</sup> See above pp. 51-53.

<sup>450</sup> This was also stressed in the UNCITRAL guide on Insolvency Law in which it is stated that "an insolvency law should preserve the estate and prevent premature dismemberment of the debtor's assets by individual creditors' actions to collect individual debts. Such activities often reduce the total value of the pool of assets available to settle all claims against the debtor and may preclude reorganization or the sale of the business as a going concern": see UNCITRAL Guide on Insolvency Law, above 439, p. 12.

<sup>451</sup> Milman D., 'Winding up of Companies: Recent Litigation and Legislative Development, (2003) 4 *Insolvency Lawyer* 157, p. 157.

<sup>452</sup> See below pp. 152-154 & pp. 351-352.

<sup>453</sup> For the case in the US and England: see below pp. 152-154.

<sup>454</sup> As will be shown below (section 5.5.2.2), whether or not bankruptcy law should be viewed as having a redistributive role is subject to debate. While the creditors' bargain theory argues that it is not the aim of bankruptcy law to redistribute losses in bankruptcy, the supporters of the multiple values theory argue that having a redistributive role should be one of the objectives of bankruptcy law: see Baird D., 'Reply to Warrant', above 38, p. 822; Warren E., 'Bankruptcy Policymaking', above 128; Korobkin D., 'Rehabilitating Values', above 14.

readjustment and modification is necessary to promote the concept of rescue culture. For instance, as will be shown below,<sup>455</sup> in order to encourage existing lenders or new lenders to provide the necessary funding to the distressed debtor, it is important for bankruptcy laws to offer them sufficient guarantee that they will be paid. This might include adjusting pre-bankruptcy entitlements by granting a post-petition lender a super priority status over pre-petition secured creditors.<sup>456</sup> However, this does not mean to leave secured creditors unprotected.<sup>457</sup> As will be suggested below,<sup>458</sup> such a super priority status should not be granted unless it is proven that there is adequate value in the collateral to protect pre-petition secured creditors.

## **2.9 Conclusion**

In the event of bankruptcy, one of the concerns raised is whose interests should be protected by bankruptcy law. Should bankruptcy law be designed merely to maximise the interests of creditors or should other interests be taken into account by policy makers, such as the interest of employees, customers, and local community? In determining the aims and policies underpinning bankruptcy law, a number of theories offering different views have been developed. This chapter

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<sup>455</sup> See below section 5.5.4.4.

<sup>456</sup> This is the case in the US: see below pp. 158-160; for the case in England: see below pp. 160-161.

<sup>457</sup> As will be detailed below (section 5.5.2.2), even though adjusting and modifying pre-bankruptcy entitlements should be one of the objectives of bankruptcy law, this thesis argues that the rights and priorities of creditors established prior to the bankruptcy of the trader should be upheld in order to preserve the legitimate expectation of creditors and encourage greater predictability in commercial relationships.

<sup>458</sup> See below pp. 356-357.

explored some theories which may underpin bankruptcy law, namely the creditors' bargain theory, the bankruptcy choice theory, the communitarian theory, the forum theory, the multiple values theory and the explicit value theory. In designing and developing bankruptcy laws, it is essential for policy makers to have recourse to these theories because each of them explained the roles that should be played by bankruptcy laws. Examples of the suggested roles are maximising the collective returns of the creditors' of the insolvent debtor as a whole through establishing a compulsory debt collection system,<sup>459</sup> establishing a compulsory mechanism to safeguard the assets of debtors and prevent creditors from enforcing their securities during bankruptcy proceedings,<sup>460</sup> readjusting pre-bankruptcy entitlements,<sup>461</sup> taking into account the interests of all parties affected by the bankruptcy of distressed debtors,<sup>462</sup> providing for the possibility of rehabilitating distressed debtors for the benefit of all affected parties,<sup>463</sup> and striking a balance between creditors' interests (seen as private interests) and other interests (seen as public interests).<sup>464</sup>

The next chapter will show how the roles that were proposed by the above-discussed theories are within the provisions of the US and England bankruptcy laws. For instance, as will be shown in the next chapter, it is similar to the view of some of the above discussed theories, Chapter 11 of the US and the first purpose

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<sup>459</sup> This the view of the creditors' bargain theory: see above section 2.2.1.

<sup>460</sup> This is the view of both the creditors' bargain theory and the multiple values theory: see above p. 46-47 & pp. 83-84.

<sup>461</sup> This is the view of the multiple values theory: see above p. 86.

<sup>462</sup> As shown above, this is nearly the view of all theories except the creditors' bargain theory.

<sup>463</sup> This is mainly the view of both the multiple values and the explicit values theories: see above p. 86 & p. 97.

<sup>464</sup> As discussed above, this is the view of the explicit value theory: see above pp. 98-99.

of the new administration regime in England are to rescue the business of the debtor as a going concern.<sup>465</sup> In this regard, rescuing the business would normally maximise the returns of all secured and unsecured creditors, customers and employees.<sup>466</sup> Further, as will be shown in the next chapter,<sup>467</sup> the concept of collectivity is promoted by bankruptcy laws in the US and England. For instance, under the US Chapter 11 and the administration regime, secured and unsecured creditors are not allowed to pursue their action during the process unless prior permission is granted by the court.<sup>468</sup> In addition, Chapter Four will demonstrate that even though the current bankruptcy regime in Oman tends to be in line with the creditors' bargain theory, not all principles proposed by such a theory are recognised by the Omani legislator.<sup>469</sup> For instance, although unsecured creditors' actions' are stayed, secured creditors are allowed to pursue their claims during bankruptcy proceedings and, as a consequence, the notion of collectivity is not recognised under the current bankruptcy regime in Oman.

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<sup>465</sup> The new Schedule B1 of IA1986, Para 3 (1) (a), (b) and (c); Dahl H., 'USA: Bankruptcy under Chapter 11', (1992) 5 I.B.L.J. 555; McCormack G., 'Control and Corporate Rescue: An Anglo-American Evaluation', (2007) 56 (3) I.C.L.Q. 505.

<sup>466</sup> For an empirical evidence see below p. 121.

<sup>467</sup> See below section 3.4.2.

<sup>468</sup> See below section 3.4.2.

<sup>469</sup> See below section 4.8.4.

## Chapter Three: Bankruptcy Proceedings in England and the US

### 3.1 Introduction

Reforming bankruptcy laws in order to promote the rescue of distressed debtors has been a common tendency around the world.<sup>1</sup> Examples of such countries are the UK in enacting the Enterprise Act 2002 to reform the administration proceedings, France in enacting the Business Safeguard Act of 2006, Germany in enacting the Company Restructuring Facilitation Act of 2012 and others.<sup>2</sup> However, the scope and the structure of these laws differ in a number of aspects.<sup>3</sup> For example, unlike the case in England, several bankruptcy laws contain the possibility to reorganise the company by giving it new finance and allowing the management to maintain their position.<sup>4</sup>

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<sup>1</sup> Azar Z., 'Bankruptcy Policy: A Review and Critique of Bankruptcy Statutes and Practices in Fifty Countries Worldwide', (2008) 16 C.J.I.C.L. 279, pp. 282-283.

<sup>2</sup> Ibid; as will be shown below (section 3.2.1), the Enterprise Act 2002 promoted the rescue culture in England by modernising the administration proceeding and limiting administrative receivership.

<sup>3</sup> In regulating a number of issues, bankruptcy laws worldwide differ. These issues include: does management retain control during liquidation or bankruptcy procedures? Is there a stay (moratorium) at the start of insolvency procedures? Is it possible to obtain new financing during reorganisation processes? What power do creditors have in accepting or rejecting a rescue plan? As will be shown below (section 3.4), in dealing with these issues, England and the US have adopted different approaches; for the position in Canada, Germany, France, Italy, Spain, Greece, Ireland, Japan, Hong Kong, Singapore and Australia: see O'kane D. & Bawlf P., 'Global Guide to Corporate Bankruptcy: A Comprehensive Guide to Corporate Bankruptcy and a Survey of Global Corporate Bankruptcy Regimes', (Nomura International, July 2010), pp. 53-145, available at: <http://www.scribd.com/doc/59845050/Bankruptcy-Guide>. accessed on 20/03/2014.

<sup>4</sup> This is the case in the US Chapter 11, during Conciliation proceedings in France, and during restructuring proceedings in Japan: see O'kane D. & Bawlf P., above 3, pp. 46-47, p. 75 & pp. 115-116.

The aim of this chapter is to provide a brief analysis of insolvency proceedings that are available in both England and the United States. Mainly, great emphasis will be placed on the administration procedure, administrative receivership, company voluntary arrangement (CVA) and scheme of arrangement under the Insolvency Act and Chapter 11 procedures under the US Bankruptcy Act. Discussing these proceedings will highlight the advantages of applying for a particular procedure and the main challenges that might be faced. Exploring the main merits and the main deficits of each procedure will help in proposing a bankruptcy regime to be followed by the Omani legislator. Hence, the next chapter will be based on the discussion and the outcome of this chapter. To clarify, the next chapter will examine whether the current Omani bankruptcy proceedings promote the concept of rescue culture and also examine the availability of bankruptcy principles that are found in both England and the US.

However, it is not within the scope of this chapter to study in great detail the bankruptcy procedures in England and the US, nor to examine the effectiveness of the entire bankruptcy proceedings in these jurisdictions. Rather, the purpose of comparing bankruptcy laws of these jurisdictions is to provide an understanding of bankruptcy laws in both England and the US in order to propose a bankruptcy regime to be considered by the Omani legislator. Thus, this chapter will start by highlighting briefly various available insolvency proceedings in England and the US. In this regard, administration, administrative receivership, CVA, and scheme of arrangement proceedings under the Insolvency Act of 1986 and the Enterprise Act of 2002; and Chapter 11 under the US Bankruptcy Act of 1979 will be highlighted briefly. Then, this chapter will proceed by examining a number of issues to see how

such issues are dealt with under both English and the US jurisdiction. These issues are the allocation of control rights during insolvency processes, stay on creditors' actions, the possibility of post-petition financing and the availability of the notion of 'cram-down' under both jurisdictions. It is worth noting that, wherever it is appropriate, reference to some of the theories discussed in the previous chapter will be made.

### **3.2 Insolvency Proceedings in England**

Although the UK insolvency proceedings have traditionally been known as a creditor oriented scheme, the enactment of the Enterprise Act of 2002<sup>5</sup> was a desire to encourage a more collective scheme towards the rescue of distressed debtors, whereby it is intended "to facilitate company rescue and to produce better returns for creditors as a whole".<sup>6</sup> This Act came into effect in the UK on 15 September 2003 for the purpose of making rescue proceedings administratively quicker and cheaper to operate.<sup>7</sup> Nevertheless, it is argued that the Enterprise Act of 2002 "offers no indication of a movement towards the development of a 'US

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<sup>5</sup> The 2002 Enterprise Act introduced new provisions into the 1986 Insolvency Act.

<sup>6</sup> Hansard, HC Deb 10 April 2002, 53 (Ms. Patricia Hewitt MP, Secretary of State for Trade and Industry); see also Armour J. & Mokal R., 'Reforming the Governance of Corporate Rescue: The Enterprise Act 2002', (2005) 1 L.M.C.L.Q. 28, pp. 29-30.

<sup>7</sup> The new administration procedure was intended to reduce the costs of entry by abolishing the need for a court hearing in every case and the requirement of submitting a report explaining the background to the company's position. However, an empirical study demonstrated that the new administration regime is costly because of a number of regulatory burdens: see Armour J., Hus A. & Walters A., 'The Impact of the Enterprise Act 2002 on Realisations and Costs in Corporate Rescue Proceedings', p. 26, A Report Prepared for the Insolvency Service, December 2006, available at: [www.insolvency.gov.uk/insolvencyprofessionandlegislation/research/corpdocs/ImpactofEARReport.pdf](http://www.insolvency.gov.uk/insolvencyprofessionandlegislation/research/corpdocs/ImpactofEARReport.pdf). accessed on 25/12/2013.

Chapter 11'- style rescue procedure" which is considered to be a debtor- friendly regime.<sup>8</sup>

There are five distinct formal insolvency proceedings in England: (1) administration; (2) receivership; (3) company voluntary arrangements (CVAs); (4) schemes of arrangement under the Companies legislation; and (5) winding-up or "liquidation". A comprehensive account of the insolvency proceedings in England is not within the scope of this part of the thesis. However, the aim of this section is to provide a brief discussion of some of these proceedings, namely: administration, receivership, CVA and scheme of arrangement proceedings. The liquidation proceedings in England are out of the scope of this part. The reason for discussing administration proceedings is that it enhances, as discussed below, the nature of collectivity in insolvency procedures and promotes the rescue culture.<sup>9</sup> Further, since administration procedures are measures that might lead to either CVA or scheme of arrangement, both of these proceedings will be examined. Moreover, the reason for including administrative receivership proceedings is to affirm the fact that it is not considered a true collective insolvency procedure; rather it is a method by which a floating charge holder, normally a bank, can enforce his security by appointing a receiver who must be a qualified insolvency practitioner.<sup>10</sup>

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<sup>8</sup> Fletcher F., 'UK Corporate Rescue: Recent Development- Changes to Administrative Receivership, Administration, and Company Voluntary Arrangements- the Insolvency Act 2000, the White Paper 2001, and the Enterprise Act 2002', (2004) 5 (1) E.B.O.L.R. 120, p. 151.

<sup>9</sup> See below pp. 118-119.

<sup>10</sup> Insolvency Act 1986, section 230 (2); Goode R., *Principles of Corporate Insolvency Law*, (4<sup>th</sup> edition, Sweet & Maxwell, 2011), p. 320.

### 3.2.1 Administration proceedings<sup>11</sup>

Based upon the recommendations on the Report of the Review Committee on Insolvency Law and Practice (1982),<sup>12</sup> the administration procedure was first introduced in England by the 1986 Insolvency Act in order to give companies a temporary breathing space through a statutory moratorium and to promote the concept of collectivity. Although the aim of the administration procedure under this

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<sup>11</sup> It is worth noting that the concept that is known as a pre-pack administration has been described as “a planned insolvency procedure in which the sale of all or part of a company’s business or assets is negotiated with a purchaser prior to the appointment of an insolvency practitioner as administrator”. This concept is not regulated in either the Insolvency Act 1986 or in the Insolvency Rules 1986. However, following a Statement of Insolvency Practice (SIP 16) which was issued in January 2009, in July 2013 the Government announced the establishment of an independent review of the pre-pack procedure (Graham Review into Pre-Pack Administration). On 16 June 2014 the review was published alongside “Pre-Pack Empirical Research: Characteristic and Outcome Analysis of Pre-Pack Administration” by the University of Wolverhampton: for a detailed highlight of the recommendation of the Graham Review and the practice of pre-pack administration in the UK under SIP 16: see Conway L., ‘Pre-Pack Administration Procedure’, (20 January 2015) Home affairs Section at House of Commons, Standard Note: SN05035, available at: <http://www.parliament.uk/business/publications/research/briefing-papers/SN05035/prepack-administration-procedure>, accessed on 09/03/2015; see also Finch V., ‘Pre-Packaged Administrations: Bargains in the shadow of Insolvency or Shadowy Bargains’, (2006) J.B.L. 568; Walton P., ‘Pre-Packaged Administrations- Trick or Treat’, (2006), 19 (8) I.I. 113; Frisby S., ‘The Pre-Pack Progression: latest empirical findings’, (2008) I.I. 154; Frisby S. ‘The Second Chance Culture and Beyond: Some Observations on the Pre-Pack Contribution’, (2009) Law and Financial Markets Review 242; Walton P., ‘Pre-Pack in the UK’, (2009) 18 INSOL International Insolvency Review 85 ; Haywood M., ‘Pre-Pack Administrations’, (2010), 23 (2) I.I. 17; Walton P., ‘When is Pre-Packaged Administration Appropriate? A Theoretical Consideration’, (2011), 20 N.L.J. 13; Armour J., ‘The Rise of the Pre-Pack: Corporate Restructuring in the UK and Proposals for Reform’, in Austin P. & Fady J., *Restructuring Companies in Troubled Times: Directors and Creditor Perspectives*, (Ross Parsons Centre, Sydney Law School, 2012).

<sup>12</sup> Review Committee on Insolvency Law, Insolvency Law and Practice (Cmnd. 8558, 1982). This report is generally known as the “Cork Report” since it was chaired by Kenneth Cork and was commissioned by the labour government in 1977. This report was followed by a White Paper in 1984, *A revised Framework for Insolvency Law* (1984), and these led to the enactment of the Insolvency Act 1986.

Act was also to adopt a 'rescue culture' capable of preserving the value of potentially viable businesses, it is argued that this regime "was quickly perceived to suffer from a number of inherent flaws which were detrimental to its prospects of serving as a user-friendly vehicle for the attainment of its intended purpose".<sup>13</sup> As a result, administration proceedings have been streamlined by the enactment of the Enterprise Act of 2002<sup>14</sup> in order to overcome the deficiencies of the old proceedings.<sup>15</sup> However, the old administration proceedings under Part II of the Insolvency Act 1986 still applies, with various appropriate modifications, to a number of specific types of organisations.<sup>16</sup> In England, for instance, there are special administration proceedings for water and sewerage undertakers, protected railway companies, air traffic service companies, public private partnership companies and building societies. All of these organisations are excluded from the new administration regime.<sup>17</sup>

It is believed that the primary purpose of the new administration regime is to enhance the nature of collectivity in insolvency procedures and to promote the

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<sup>13</sup> The old administration procedures were considered costly and inflexible. Discussing the principal deficiencies of the old administration procedures is not within the scope of this chapter: see Fletcher F., above 8, p. 125; Armour J., Hus A. & Walters A., above 7, p. iv; Campbell A., 'Company Rescue: The Legal Response to the Potential Rescue of Insolvent Companies', (1994) 5 (1) I.C.C.L.R. 16, pp. 22-23.

<sup>14</sup> Under the new procedure, Part II of the Insolvency Act 1986 has been replaced and a new Part II inserted in its place.

<sup>15</sup> Some of deficiencies of the old administration proceedings are the barriers to entry to the process, displacement of the directors and lack of a clear exit form administration: see Fletcher F., above 8, p. 125; Campbell Andrew, above 13, pp. 22-23.

<sup>16</sup> Fletcher F., above 8, p. 134.

<sup>17</sup> As a result of such exclusion, the holder of floating charge has the right to appoint an administrative receiver in order to enforce his security: see section 249 of the 2002 Enterprise Act.

“rescue culture”.<sup>18</sup> As discussed in the previous chapter,<sup>19</sup> according to Jackson the major benefit of having a collectivity system in place is that a collective system would reduce the “first in time, first in priority” which is considered to be a “race to the court-house” between creditors.<sup>20</sup> This has been emphasised by the White Paper where it has been stated that “there are many other important interests involved in the fate of such a company, including unsecured creditors, shareholders and employees. We propose to create a streamlined administration procedure which will ensure that all interest groups get a fair say and have an opportunity to influence the outcome.”<sup>21</sup> Thus, according to the view of the Cork Committee, a modern system of corporate insolvency adopts a rescue culture in which the interests of all parties affected by companies’ insolvencies should be taken into account.<sup>22</sup>

Even though one of the aims of the Enterprise Act 2002 is to foster a rescue culture, it is claimed that the remodeled administration proceedings appear to provide “a more generous outcome, in a commercial sense”, to the secured

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<sup>18</sup> Goode R., above 10, p. 34; In proposing the new administration proceedings, the United Kingdom took lessons from the United States’ Chapter 11 experience. In giving evidence at Standing Committee stage, Mr. Douglas Alexander stated that “the Bill has been informed not just by looking at the United States and finding out what lessons can be learned from its approach to enterprise and its entrepreneurial culture, but by looking around the world”: HC May 9, 2002 House of Commons Standing Committee B (pt 3) at Columns 547, available at: <http://www.publications.parliament.uk/pa/cm200102/cmstand/b/st020509/am/20509s03.htm>, accessed on 08/03/ 2015.

<sup>19</sup> See above section 2.2.2.

<sup>20</sup> See Jackson T., ‘Bankruptcy, Non-Bankruptcy Entitlement, and the Creditors’ Bargain’, (1982) 91 Y.L.J. 857 , pp. 861-864.

<sup>21</sup> The White Paper, above 12, para. 4.

<sup>22</sup> Ibid.

creditors than it intended to be under the original terms of the *Enterprise Bill*.<sup>23</sup> This leads some to argue that the administration procedure, as modernised by the Enterprise Act 2002, “appears to have creditor wealth maximisation at its core, although this core is well disguised since corporate rescue is ostensibly placed at the top of the legislative tree”.<sup>24</sup> Further, Finch criticised the whole English insolvency regime by stating that “present English rescue procedures might be portrayed as giving strong priority to the protection of creditors’ interests and limited priority to rescue”.<sup>25</sup> There are a number of rationales behind such criticism.<sup>26</sup> First, even though it is within the legislative intention to give primacy of purpose to the rescue of the company as a going concern, Fletcher argued that “the use of such inexact, and possibly subjective, expressions as ‘thinks’, ‘reasonably practicable’, and ‘a better result’ are likely to become the focus of future challenges to an office holder’s exercise of judgment in electing to pursue one of the alternative objectives”.<sup>27</sup> In supporting Fletcher’s argument, interviews with insolvency practitioners revealed the fact that based on their experience

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<sup>23</sup> Fletcher F., above 8, p. 129.

<sup>24</sup> McCormack G., ‘Apples & Oranges? Corporate Rescue and Functional Convergence in the US and UK’, (2009) 18 (2) I.I.R. 109, p. 115.

<sup>25</sup> Finch V., *Corporate Insolvency Law: Perspectives and Principles*, (2<sup>nd</sup> edition, Cambridge University Press, 2009), p. 278; in this regard, Goode also stated that “the general experience has been that the Enterprise Act 2002 has had little effect in restoring insolvent businesses to profitable trading. The most common outcome of insolvency proceedings, of whatever kind, is cessation or disposal of the company’s business and the winding up of the company”: Goode R., above 10, p. 60.

<sup>26</sup> Ibid; Fletcher F., above 8, p. 136; Armour J., Hus A. & Walters A., above 7, pp. 22-23.

<sup>27</sup> Fletcher F., above 8, p. 136; it is argued that even though the Insolvency Act 1986 contains reference to what the administrator “think”, the test to be applied by the administrator or the standard to be imposed by him is in his thought process: Simmons M., ‘Enterprise Act and Plain English’, (2004), 17 (5) I.I. 76, p. 76.

“administrations with a view to ‘rescuing the company as a going concern’ were rare”.<sup>28</sup> Secondly, in the “purpose of administration section’ there is no reference to the wider interests of shareholders (nor the continuation of employment) which implies, as argued by Fletcher, the fact that ‘the traditional disposition of English insolvency law to elevate the interests of creditors above the possible benefits of a corporate rescue” still preserved.<sup>29</sup> Moreover, insolvency practitioners vary in their views in relation to the Enterprise Act.<sup>30</sup> “Some stated that it simply enacted what they had always considered to be best practice; others indicated that the new duties encouraged them to take steps to promote the interests of unsecured creditors which they would not previously have taken”.<sup>31</sup> However, it is argued that it is the Government’s desire to make clear that the rescue of the company should not be pursued at the expense of the company’s creditors.<sup>32</sup>

Notwithstanding the insufficiency underpinning the modernised administration procedure, since the enactment of the Enterprise Act 2002 the level of administration cases has increased as an alternative to administrative receivership and company voluntary arrangement.<sup>33</sup> Further, despite such flaws, this thesis argues that the primary objective of the administration, as stated in the legislation,

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<sup>28</sup> Armour J., Hus A. & Walters A., above 7, pp. 22-23.

<sup>29</sup> Fletcher F., above 8, p. 137.

<sup>30</sup> Armour J., Hus A. & Walters A., above 7, p. iv.

<sup>31</sup> Ibid.

<sup>32</sup> Armour J. & Mokal R., above 6, p. 43.

<sup>33</sup> In their empirical study, A. Katz and M. Mumford traced the impact of the Enterprise Act 2002 on administration, receivership and company voluntary arrangement cases: ‘Study of Administration Cases’, (2007) 20 (7) *Insolvency Intelligence* 97. Their analysis showed that administration has continued to increase as a proportion of all corporate insolvencies since the implementation of the EA 2002 in September 2013. Thus, administration has continued to substitute both the administrative receivership and creditors’ voluntary liquidation: see in particular pp. 97-98.

is still to rescue the business of the company as a going concern and rescuing the business would normally maximise the returns of all secured and unsecured creditors, customers and employees.<sup>34</sup> This was evidenced, for instance, by the success of the administration proceeding of Game's British Operations Company which went into administration in March 2012 due to financial difficulties. Having sold Game Group shops to OpCapita firm, nearly 3,200 jobs<sup>35</sup> have been safeguarded and customers will not be affected since Games' shops will remain on the High Streets. On the other hand, secured and unsecured creditors will be paid sooner or later. Thus, rescuing the business of the distressed company usually does not prejudice the interests of secured creditors. In this case, an empirical study conducted by Frisby demonstrated that post-Enterprise Act administrations deliver more returns to secured creditors than pre-Enterprise Act administrations.<sup>36</sup>

Under the new administration proceedings, the purpose of administration has been clearly articulated in a single hierarchy of objectives.<sup>37</sup> Thus, under the new proceedings,<sup>38</sup> the overriding objective of an administrator is that of rescuing the company as a going concern.<sup>39</sup> However, if this is not, as he "thinks", "reasonably practical" and/or it is not in the interests of the creditors (as a whole) for the

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<sup>34</sup> The new Schedule B1 of the Insolvency Act 1986, Para 3 (1) (a), (b) and (c).

<sup>35</sup> A report in BBC website at this link <http://www.bbc.co.uk/news/business-17578451>, as viewed in 1<sup>st</sup> April 2012.

<sup>36</sup> Frisby S., 'Interim Report to the Insolvency Service on Returns to Creditors from Pre-and-Post Enterprise Act Insolvency Procedures', p. 14, Baker & Mckenzie Lecturers in Company and Commercial Law, 24 July 2007; available at: <http://webarchive.nationalarchives.gov.uk/+http://www.insolvency.gov.uk/insolvencyprofessionandlegislation/research/returntocreditors.pdf>. accessed on 29/03/2014.

<sup>37</sup> Goode R., above 10, pp. 400-401.

<sup>38</sup> See the new Schedule B1 of the Insolvency Act 1986, Para 3 (1) (a), (b) and (c).

<sup>39</sup> Ibid, Para 3 (1) (a).

company to be restored to profitable trading, the second objective is to achieve a better result for the company's creditors (as a whole) than would be likely if the company were wound up.<sup>40</sup> If neither of the above objectives can be achieved, then the final objective is to make a distribution to one or more secured or preferential creditors.<sup>41</sup> In performing his duty, an administrator must perform his function "in the interests of all the company's creditors as a whole"<sup>42</sup> and as "quickly and efficiently as is reasonably practicable".<sup>43</sup> In addition, the administrator is considered to be an agent of the company; and, as a result, he will not bear any personal liability in respect of contracts he may enter into on behalf of the company.<sup>44</sup>

As will be discussed below,<sup>45</sup> similar to the position under the US Chapter 11, administration gives the company a breathing space for a limited period of time since all creditors' claims are stayed during the process. However, unlike the case under the US Chapter 11, upon the appointment of an administrator, the management will be displaced at the administrator's request and the administrator will take control over any property belonging to the company.<sup>46</sup> Thus, the notion of debtor-in-possession is not a feature of the administration procedure in England. Further, it is worth noting that the administration proceeding is available to all companies irrespective of their size.

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<sup>40</sup> Ibid, Para 3 (1) (b).

<sup>41</sup> Ibid, Para 3 (1) (c).

<sup>42</sup> Ibid, Para 3 (2).

<sup>43</sup> Ibid, Para 4.

<sup>44</sup> Ibid, Section 14 (4).

<sup>45</sup> See below section 3.4.2.

<sup>46</sup> Sections 13 & 14 of the UK Insolvency Act 1986.

It is worth mentioning that administration is not in itself a reorganisation procedure at all, rather it is a temporary measure which either lays the foundations for the rescue of the company, for example, by the approval of the creditors' voluntary arrangement, or for the winding up on a more favourable basis than would be achieved by an immediate winding up.<sup>47</sup> Although administration is merely a temporary procedure (of finding the best exit route) rather than a destination in itself, it is argued that "administration is often initiated with a rescue possibility in mind", and, should in general be included under reorganisation.<sup>48</sup>

### **3.2.2 Administrative Receivership**

The administrative receiver which is partially abolished by the enactment of the Enterprise Act 2002, is not a true collective insolvency procedure, rather it is a method by which a floating charge holder, normally a bank, can enforce his security by appointing a receiver who must be a qualified insolvency practitioner.<sup>49</sup> Thus, the receiver owes his primary obligation to the person appointing him. However, Goode argued that even though the duty of the administrative receiver is, in principle, owed only to his appointor, not the general body of creditors, administrative receivership is considered by statute as an insolvency proceeding.<sup>50</sup> It is worth noting that following the Cork recommendation, the Enterprise Act 2002 restricted the floating charge holders from appointing an administrative receiver by

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<sup>47</sup> Keay A. & Walton P., *Insolvency Law: Corporate and Personal*, (Longman, 2003), p. 92; Roy Goode stated that "the main effect of the administration is to impose a moratorium on the enforcement of creditors": above 10, p. 393.

<sup>48</sup> Okoli P., 'Rescue Culture in the United Kingdom: Realities and the Need for a Delicate Balancing Act', (2012) 23 (2) I.C.C.L.R. 61, p. 62

<sup>49</sup> Section 230 (2) of the Insolvency Act 1986; Goode R., above 10, p. 320

<sup>50</sup> Goode R., above 10, p. 320.

a way of replacing, with some certain exceptions, the receivership with administration procedure. Nonetheless, even though the 2002 Enterprise Act replaced receivership with administration, it is still going to be one of the options available at least for the foreseeable future.<sup>51</sup> This is due to the fact that creditors with ‘qualifying’ floating charges<sup>52</sup> that were created before the 2002 Act,<sup>53</sup> or those with charges which, although created after that date, fall within one of the specified exceptions,<sup>54</sup> may still appoint administrative receivers.

Under this regime, an administrative receiver could be appointed by a creditor of a company who had taken security over “the whole or substantially the whole of a company’s property” by a package of security interests that must include a floating charge.<sup>55</sup> Once appointed, a receiver is deemed to be an agent acting for the interest of his principal.<sup>56</sup> This leads Goode to describe the receiver as “an independent contractor whose primary responsibility is to protect the interests of his appointor but also owes a duty to his deemed principal, the company, to refrain from conduct which needlessly damages its business or goodwill, and a separate

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<sup>51</sup> Finch V., above 25, p. 327; Fletcher F., above 8, p. 150.

<sup>52</sup> Sch. B1, Para. 14 of the Insolvency Act 1986.

<sup>53</sup> It is stated that “numerous banks rushed to take out floating charges before the 2002 Act came into effect on 15 September 2003 and ended the qualifying floating charge holder’s right to veto administration and curtailed the right of such floating charge holders to appoint an administrative receiver”: Finch V., above 25, p. 328.

<sup>54</sup> See Enterprise Act 2002 where a new section 72A was inserted into the Insolvency Act 1986 listing the exceptions.

<sup>55</sup> The administrative receiver is defined by section 29 (2) of the Insolvency Act 1986.

<sup>56</sup> Goode R., above 10, p. 332.

duty, by statute, to observe the priority given to preferential creditors over claims secured by a floating charge".<sup>57</sup>

Since the primary purpose of the receivership is to maximise the returns of the floating charge holder, the concept of 'corporate rescue' does not form part of the administrative receivership regime. It is argued that if the company's assets are worth more than the floating charge holder is owed, nothing obliges the administrative receiver to do anything to save the business.<sup>58</sup> For instance, if the company files petition for administration or Company Voluntary Arrangements, the floating charge holder can block such a petition by appointing an administrative receiver. Thus, it is claimed that the replacement of administrative receivership with administration procedure by the Enterprise Act 2002 signals the end of a regime under which a single creditor's proprietary rights could administer the resolution of insolvency proceedings.<sup>59</sup>

### **3.2.3 Company Voluntary Arrangement (CVA)**

As stated above, administration procedure is not in itself reorganisation procedures at all, rather it is a temporary measure which either lays the foundations for the rescue of the company, for example, by the approval of the creditors' voluntary arrangement, or for the winding up on a more favourable basis than would be achieved by an immediate winding up.<sup>60</sup> However, it is worth noting that the CVA procedure can be a stand-alone rescue mechanism since the

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<sup>57</sup> Ibid.

<sup>58</sup> Armour J. & Mokal R., above 6, pp. 28- 29.

<sup>59</sup> Ibid, p. 32.

<sup>60</sup> Keay A. & Walton P., above 47, p. 92; Goode R., above 10, p. 394.

company's directors can initiate a formal proposal for a voluntary arrangement unless a winding-up and administration order is made.<sup>61</sup> However, proposing a CVA without first putting the company into administration suffers from the weakness that there is no moratorium, except for small companies,<sup>62</sup> on actions against the company, and as a result secured creditors may frustrate a possible CVA by enforcing their securities prior to the meetings called to approve the proposal.<sup>63</sup> This leads some commentators to argue that a voluntary arrangement will be much more likely to succeed if it is put forward by an administrator after an administration order has been made since the suspension of creditors' rights during the administration process will give the administrator a better chance to put together a fully considered scheme.<sup>64</sup> However, recent research by Walters and Frisby has shown that the vast majority of insolvent companies surveyed had resort to a stand-alone CVA rather than a CVA within administration.<sup>65</sup> According to

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<sup>61</sup> Goode R., above 10, pp. 499-500.

<sup>62</sup> The criteria of "small companies" can be taken from the definition contained within section 382 (3) of the Companies Act 2006. According to this section, a company is considered to be small if it meets two of the following three criteria: (1) its annual turnover is not greater than £6.5m, (2) its balance sheet total is not more than £3.26m and (3) its employees is not more than 50.

<sup>63</sup> Keay A. & Walton P., above 47, p. 142; This lack of a moratorium may mean that even although the CVA proposal is supported by a majority of creditors, there is no guarantee that other creditors will not take action which could lead them gaining access to company assets: Campbell A., 'The New Company Voluntary Arrangement Proposals and Their Effect on Banks', (1995), 10 (10) I.B.L. 422, p. 424.

<sup>64</sup> Keenan S. & Bisacre J., *Smith and Keenan's Company Law*, (13<sup>th</sup> edition, Pearson Longman, 2005), p. 510; Sealy L. & Milman D., *Annotated Guide to the Insolvency Legislation*, (4<sup>th</sup> edition, CCH, 1994), p. 26; Campbell A., above 63, p. 424.

<sup>65</sup> Walters A. & Frisby S., 'Preliminary Report to the Insolvency Service into Outcomes in Company Voluntary Arrangements', (March 2011), available at: <http://www.insolvencydirect.bis.gov.uk/insolvencyprofessionandlegislation/research/corpdocs/CVA-Report.pdf>. accessed on 30/11/2013; See also Goode R., above 10, p. 410.

them, “the reasonably ‘simple’ capital structures of these companies, having only a single secured lender and relatively few major creditors, and perhaps having access to ‘insider’ funding’, will facilitate a standstill pending consideration of a CVA”.<sup>66</sup>

A CVA is an agreement between a company and its creditors for the satisfaction of the company’s debts<sup>67</sup> by which, for instance, in discharge of their claims creditors accept, in a single sum or by installments, an amount less than that which is due to them.<sup>68</sup> However, in England there are two types of CVA: firstly, there are the CVAs without a moratorium, which are governed by Part I of the Insolvency Act 1986 and the Insolvency Act 2000. Secondly, there are CVAs with a moratorium, which are governed by the Insolvency Act 1986 and the Insolvency Act 2000, which introduced a new Schedule into the Insolvency Act 1986.<sup>69</sup> Subject to a number of criteria which have to be met,<sup>70</sup> the former type is restricted to small companies, whereas the later type is open to medium, large companies and small companies if they wish. Thus, medium and large companies have to use the administration procedure route in order to undertake a CVA with the benefit of a moratorium available during administration processes. However, narrowing the entry criteria for CVAs with moratoria to small companies, as argued by Fletcher,

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<sup>66</sup> Walters A. & Frisby S., above 65, p. 11.

<sup>67</sup> Finch V., above 25, p. 179; It is described by Conway as “an informal but legally binding agreement between a company and its unsecured creditors in satisfaction of some, or all, of its debts”: Conway L., ‘Company Voluntary Arrangements’, (2014), (House of Commons, Home affairs Section), p. 2.

<sup>68</sup> Goode R., above 10, p. 39.

<sup>69</sup> Tribe J., ‘Company Voluntary Arrangements and Rescue: A new Hope and a Tudor Orthodox’, (2009) 5 J.B.L. 454, p. 468.

<sup>70</sup> See above footnote 62.

would “greatly diminish its practical value”.<sup>71</sup> Lack of the moratorium will open the door for secured creditors to enforce their securities without having regard to the interest of other creditors.

Although there are no statutory guidelines determining the purpose of a CVA, there are a number of reported cases that illustrate the purposes of such a regime.<sup>72</sup> For instance, in *Commissioners of Inland Revenue v The Wimbledon Football Club Ltd and others*, Neuberger, LJ stated that “... the CVA regime is intended to be an additional, and particularly flexible, option in the case of corporate insolvency, in addition to liquidation, administration and administrative receivership.”<sup>73</sup> Also, enabling the company to continue trading is another purpose of a CVA as affirmed by Roger Kaye QC, in *Re Arthur Rathbone Kitchen Ltd* where he stated that “the purpose of the CVA was to enable the company to trade out of its insolvency and make provision for creditors by stage payments whilst it did.”<sup>74</sup>

Unlike the case under the administration proceeding where the management is displaced upon the administrator’s request, in a CVA directors will remain in control of the company. Thus, the notion of the ‘debtor in possession’ which is embodied in the US Chapter 11 is opted for under CVA proceedings in England. However, under the US Chapter 11 the existing management runs the troubled business without any kind of supervision, whereas in the CVA the existing management runs

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<sup>71</sup> Fletcher F., above 8, p. 130.

<sup>72</sup> For more examples see: Tribe J., above 69, pp. 466-468.

<sup>73</sup> *Inland Revenue v Wimbledon* [2004] EWCA Civ 655 at [53].

<sup>74</sup> *Arthur Rathbone* [1998] B.P.I.R. 1.

the business under the supervision of the licensed insolvency practitioner.<sup>75</sup> Also, as it will be discussed further below,<sup>76</sup> CVA procedure follows the US Chapter 11 approach in the sense that it recognises the notion of ‘cram-down’, in which a dissenting class of creditors could be bound<sup>77</sup> by the will of the majority (75%) voting to adopt the terms of a proposed arrangement.<sup>78</sup> However, unlike the case under the US Chapter 11, Fletcher stated that “the CVA opted for simplicity by treating all creditors as a single class for voting purposes, with individual voting power measured by the financial value of each creditor’s claim”.<sup>79</sup> Thus, it can be argued that the CVA provides more flexibility than the US Chapter 11 in the sense that under Chapter 11 the voting process takes place in classes while under the CVA all creditors constitute a single class.

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<sup>75</sup> See section 1 Part 1 of the Insolvency Act 1986; A CVA must be supervised by a licensed IP, who acts as the nominee pending the approval of the arrangement and normally becomes the supervisor once it comes into effect. So, it will act in a monitoring role to ensure that the company complies with its obligations under the term of the CVA but will not be involved in the day to day management or ongoing trading activities of the company: ‘Insolvency in Brief: A Guide to Insolvency Terminology and Procedure’, Business Recovery Service, pp. 12-13, available at: <http://www.pwc.co.uk/assets/pdf/insolvency-in-brief.pdf>, accessed on 10/03/2015.

<sup>76</sup> See below section 3.4.4.

<sup>77</sup> CVA will legally bind all unsecured creditors who were entitled to vote, whether or not they had notice of the creditors’ meeting. However, secured and preferential creditors will not be bound unless they have given their consent: see Conway L., above 67, p. 4.

<sup>78</sup> See Insolvency Rules 1986, Rule 1.19 (2). This rule states that “A resolution to approve the proposal or a modification is passed when a majority of three-quarters or more (in value) of those present and voting in person or by proxy have voted in favour of it”.; Conway stated that “any creditor owed 25% or more of the overall indebtedness is in a strong position in influencing the term of the CVA”: Conway L., above 67, p. 8.

<sup>79</sup> Fletcher F., above 8, p. 127.

### 3.2.4 Scheme of Arrangement

A scheme of arrangement is a statutory procedure pursuant to Part 26 of the Companies Act 2006 whereby a ‘compromise’ or ‘arrangement’<sup>80</sup> concluded by a company with its members or creditors or any class of its creditors or any class of its members has submitted such an arrangement or compromise to the court for approval.<sup>81</sup> Such a scheme is not regarded as a rescue procedure rather it is considered “as a flexible restructuring tool in UK company law”.<sup>82</sup> Further, since administration proceedings are merely temporary measures, the administrator, besides considering the CVA, can use the scheme of arrangement as an alternative restructuring procedure in order to achieve the stated purposes of administration.<sup>83</sup>

Even though the scheme of arrangement is similar to the CVA in the sense that it adopts the concept of ‘debtor in possession’, the existing management remains in control of the company and runs the business without the supervision of the licensed insolvency practitioner.<sup>84</sup> This is considered to be one of the potential benefits of using the scheme of arrangement over the CVA since it represents an “in-house” restructuring tool that does not require external intervention and

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<sup>80</sup> Goode stated that “the term “arrangement” has a very wide meaning, embracing such diverse schemes as conversion of debt into equity, subordination of secured or unsecured debt, conversion of secured into unsecured claims and vice versa, increase or reduction of share capital and other forms of reconstruction and amalgamation”: see Goode R., above 10, p. 40.

<sup>81</sup> Ibid.

<sup>82</sup> Milman D., ‘Scheme of Arrangement and Other Restructuring Regimes under UK Company Law in Context’, (2011) C.L.N. 1, p. 1.

<sup>83</sup> Goode R., above 10, p. 409.

<sup>84</sup> Ibid, p. 394.

management by an insolvency practitioner.<sup>85</sup> However, unlike the case under CVA, a scheme of arrangement has a different voting process whereby creditors are divided into classes<sup>86</sup> and a scheme should be approved by a majority in number in each class, representing three-fourths in value.<sup>87</sup> Hence, it is argued that having such a structure in place creates a persistent problem in ascertaining what is a “class” of creditors since the more classes that are recognised, the more challenging it becomes to get the scheme approved by the requisite majorities in each class.<sup>88</sup>

Further, unlike the CVA, the scheme of arrangement requires the support of a court sanction and once it is approved by the court, it cannot be challenged by the company’s creditors or its members.<sup>89</sup> However, it is worth noting that even though the CVA does not require the approval of the court, an arrangement under the CVA can be challenged on a number of grounds (e.g. unfair prejudices).<sup>90</sup> Nonetheless, in comparing it with the CVA, the scheme is considered to be both burdensome and costly, “involving the presentation of a scheme proposal by the board on behalf of the company, the approval of the court to the convening of a meeting of the various classes of creditors and members involved so far as they have an

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<sup>85</sup> Milman D., above 82, p. 2.

<sup>86</sup> In this sense, a scheme of arrangement is similar to the US Chapter 11 in which creditors are also divided into classes: see Goode R., above 10, pp. 514-516.

<sup>87</sup> Each class of members present and voting either in person or by proxy: see section 899 (1) of the Companies Act 2006.

<sup>88</sup> Milman D., ‘Arrangement and Reconstructions: Recent Development in UK Company Law’, (2006) C.L.N. 1, p. 2

<sup>89</sup> Goode R., above 10, p. 492.

<sup>90</sup> Section 6 (2) of the Companies Act 2006.

economic interest and, if the scheme is adopted by the requisite majority, the court's approval".<sup>91</sup>

The notion of 'cram-down' is also embodied under the scheme of arrangement. However, in contrast with the CVA, under the scheme of arrangement secured creditors will be bound by the scheme, if it is adopted by the requisite majority and approved by the court, even without their express consent.<sup>92</sup> Thus, in order to avoid the implementation of such a concept, dissenters normally seek to contend that they represent a separate class, whereas the company that proposes the scheme tries "to reduce the classes to an absolute minimum".<sup>93</sup>

### **3.3 Bankruptcy Proceedings in the United States**

Unlike the case in England where there are several insolvency proceedings, in the US there are two bankruptcy proceedings: Chapter 11, known as a reorganisation chapter and Chapter 7 liquidation. This section will examine the US Chapter 11 bankruptcy proceedings since it promotes the rescue culture and it is necessary for the Omani legislator to take it into account.

#### **3.3.1 The US Chapter 11**

The US is committed to the 'rescue culture' through introducing a whole Chapter in the 1978 Bankruptcy Act. The aim of the US Chapter 11 is to save a company from closing down through rehabilitating the debtor's business and the

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<sup>91</sup> Goode R., above 10, p. 43.

<sup>92</sup> Section 899 (1) of the UK Companies Act 2006.

<sup>93</sup> Milman D., above 88, p. 2.

restructuring of its indebtedness.<sup>94</sup> It is argued that Chapter 11 is founded on certain fundamental assumptions.<sup>95</sup> For instance, Dahl argued that the underlying philosophy of such a Chapter is that “the creditors are investing their equity into the business, in the hope of being paid later on”.<sup>96</sup> In his view, rehabilitating the debtor’s business will achieve a number of goals, one of which is to repay the creditors through negotiating a payment plan.<sup>97</sup> Also, McCormack stated that the notion of a ‘going concern’ is one of the key assumptions of Chapter 11 in the sense that companies in financial distress are worth more as going concerns than they are if liquidated piecemeal,<sup>98</sup> and, as a result, any financial trouble must be settled through alteration of contractual relations with creditors, shareholders etc.<sup>99</sup> Thus, preservation of employees’ jobs and the local economy, which may be dependent on the continued existence of the business,<sup>100</sup> falls within the primary objectives of the US Chapter 11.

One of the main features of the US Chapter 11 is that, unlike the case under administration proceedings in England, the management of the company remains in place,<sup>101</sup> under the doctrine known as ‘debtor-in-possession (DIP)’. Under the

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<sup>94</sup> McCormack G., above 24, pp.116-117.

<sup>95</sup> Dahl H., ‘USA: Bankruptcy under Chapter 11’, (1992) 5 I.B.L.J. 555, p. 555; McCormack G., ‘Control and Corporate Rescue: An Anglo- American Evaluation’, (2007) 56 (3) I.C.L.Q. 505, p. 517.

<sup>96</sup> Dahl H., above 95, p. 555.

<sup>97</sup> Ibid.

<sup>98</sup> McCormack G., above 95, p. 517.

<sup>99</sup> Ibid.

<sup>100</sup> Coleman M. & Kirschner M., ‘The Case in Favour of the US Chapter 11 Reorganisation System: Debunking the Myths and Mischaracterisations’, (1993) 4 I.C.C.L.R. 363, p. 363.

<sup>101</sup> It is worthy to note that the notion of the ‘debtor in possession’ is also opted for under England CVAs proceedings. However, under the US Chapter 11 the existing management runs the troubled

notion of DIP, the management of the company acts as a ‘trustee’ having a fiduciary duty to the creditors, shareholders and all other parties, including employees, having interests in the debtor company imposed on them.<sup>102</sup> This leads a commentator to argue that Chapter 11 offers debtors a number of incentives to file for Chapter 11 proceedings, including the ability of management to stay in place.<sup>103</sup> However, it is worth noting that management displacement in favour of an outside trustee could be one of the options available in the US but only in exceptional cases such as fraud.<sup>104</sup>

Further, another basic feature of Chapter 11 is the moratorium or automatic stay on creditor enforcement actions in which a company will be given a breathing space for a limited period of time since all creditors’ claims are suspended during this process.<sup>105</sup> During this period, the DIP should review its affairs and must prepare a rescue plan through a process of bargaining and negotiation with creditors.<sup>106</sup> Once the plan is prepared, the court plays a central role in evaluating it and approving it. In this regard, creditors are divided into classes and the plan must be approved by a majority of 75 per cent in each class.<sup>107</sup> Once it is accepted by the majority, the dissenting minority will be bound by the plan in what is termed the

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business without any kind of supervision, whereas in the CVA the existing management runs the business under the supervision of the licensed insolvency practitioner.

<sup>102</sup> Casey K., ‘Irish Insolvency Law, English Administration and US Chapter 11: Examining the Examiner’, (1993) 8 (7) J.I.B.L. 284, p. 285.

<sup>103</sup> Wood P., *Principles of International Insolvency*, (London, Sweet & Maxwell, 2007), p. 42.

<sup>104</sup> “In *Marvel Entertainment Group, Re* case it was stressed that “a trustee appointment should be the exception rather than the rule”: see McCormack G., ‘Rescuing Small Businesses: Designing an “Efficient” Legal Regime’, (2009) 4 J.B.L 299, pp. 306-307.

<sup>105</sup> Section 362 of the US Bankruptcy Code 1978.

<sup>106</sup> *Ibid*, section 1121.

<sup>107</sup> *Ibid*, section 1126 (c) & (d).

notion of 'cram-down'.<sup>108</sup> In general, a dissented class of creditors may be crammed-down if it is demonstrated that they would receive the value of its collateral, plus interest according to the reorganisation plan.<sup>109</sup> Further, as will be discussed below,<sup>110</sup> dissenting creditors are protected by the "best interest" test- in which each opposing creditor must receive at least as much under the plan as it would in liquidation- and a "feasibility test"- whereby the debtor company must be able to implement the promises it makes in the plan.<sup>111</sup> However, it is argued that the danger of such a concept is that "the approval of the reorganisation plan can be prevented indefinitely if creditors holding more than one-third of the value of the relevant debt withhold their consent".<sup>112</sup> Nonetheless, it is argued that even though the cram-down procedure is used as a threat to persuade dissenting classes to accept a plan, it is rarely necessary to carry it out.<sup>113</sup>

Originally, Chapter 11 adopted the 'one size fits all' approach to business reorganisation since all businesses regardless of their size -small, medium or

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<sup>108</sup> Ibid, section 1129 (b).

<sup>109</sup> Ibid.

<sup>110</sup> See below section 3.4.4.

<sup>111</sup> Westbrook J., 'A Comparison of Bankruptcy Reorganisation in the US with the Administration Procedure in the UK', (1990) 6 I.I.P. 86, p. 87.

<sup>112</sup> The same can be found in England, where CVAs and Schemes of arrangement may not be concluded without the consent of a majority of creditors: Townsend J., 'Comparing UK and US Business Rescue Procedures: Are Administration and Chapter 11 Perceived to be Workable and Affordable', available at:

[http://www.insolvencylawforum.co.uk/index.php?option=com\\_content&view=article&id=130:comparing-uk-and-us-business-rescue-procedures-are-administration-and-chapter-11-perceived-to-be-workable-and-affordable-&catid=8:opinion-posts&Itemid=20](http://www.insolvencylawforum.co.uk/index.php?option=com_content&view=article&id=130:comparing-uk-and-us-business-rescue-procedures-are-administration-and-chapter-11-perceived-to-be-workable-and-affordable-&catid=8:opinion-posts&Itemid=20), accessed on 20/01/2014.

<sup>113</sup> Franks J. & Torous W., 'Lessons from A Comparison of US and UK Insolvency Code', (1992) 8 (3), O.R.E.P. 70, p. 76.

large- are subject to Chapter 11.<sup>114</sup> However, since Chapter 11 is a court- driven process which involves many court hearings, it is argued that “its use in small business cases has long been criticised as being too cumbersome, expensive and slow”.<sup>115</sup> In this regard, it has been stated that:

*“The current [Bankruptcy] Code is required to handle both the corporate reorganizations of a multibillion dollar international company and that of the small, rural grocery store. Trying to make the same set of laws apply to vastly different corporate enterprises have created problems and inefficiencies in the handling of individual bankruptcy cases.”*<sup>116</sup>

Hence, in order to overcome such drawbacks, the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 introduced an accelerated procedure that allows qualified small business<sup>117</sup> debtors to get through Chapter 11 faster and less expensively.

Unlike the view of the creditors’ bargain theory,<sup>118</sup> the aim of Chapter 11 is not merely to maximise the interests of the creditors, rather it is to preserve the value of a distressed company for the welfare of all parties.<sup>119</sup> Also, it is not similar to the view of the communitarian theory,<sup>120</sup> since Chapter 11 tries to strike a balance between the interests of the creditors and the interests of other stakeholders.<sup>121</sup>

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<sup>114</sup> McCormack G., above 104, p. 309.

<sup>115</sup> Ibid.

<sup>116</sup> American Bankruptcy Institute, Press Release, 19<sup>th</sup> November 1991: see [www.abiworld.org](http://www.abiworld.org).

<sup>117</sup> Small businesses are defined in section 101 (51 D) of the US Bankruptcy Code.

<sup>118</sup> See above section 2.2.1.

<sup>119</sup> McCormack G., above 95, p. 517.

<sup>120</sup> See above section 2.4.1.

<sup>121</sup> Coleman M. & Kirschner M., above 100, p. 363; McCormack G., above 95, p. 517.

For instance, as will be shown below,<sup>122</sup> even though in approving a reorganisation plan Chapter 11 adopts the notion of ‘cram-down’, dissenting creditors are still protected by the ‘best interest test’ and ‘feasibility test’. In this sense, it can be said that the view expressed by the explicit value theory<sup>123</sup> promoted by Finch is to some extent compatible with the aim of Chapter 11, since she proposed an approach in which the rights of different legitimating interests, public and private, should be balanced.<sup>124</sup> As a result, this leads some to argue that the US Chapter 11 restructuring process is not only debtor friendly but also creditor friendly.<sup>125</sup>

*“It is debtor friendly because it allows management to remain in place to develop and implement a restructuring plan. It is creditor friendly because of the degree of oversight and control, and the participation in the process allowed to creditors, both secured and unsecured. It is also highly pragmatic as it seeks to maximise the chances of the company re-emerging as a going concern. At the same time it attempts to treat all creditors fairly and to preserve economic value”.*<sup>126</sup>

### **3.4 A Comparative Analysis of Rescue Proceedings in England and the United States**

As stated above, England and the US insolvency/ bankruptcy laws adopted the concept of rescue culture. However, both jurisdictions differ in regard to the types of rescue proceedings provided.<sup>127</sup> As highlighted above,<sup>128</sup> whereas in the US there is only a Chapter 11 Bankruptcy for all companies irrespective of their size,

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<sup>122</sup> See below pp. 166-167.

<sup>123</sup> For this view see above section 2.8.

<sup>124</sup> Finch V., above 25, p. 57.

<sup>125</sup> O’kane D. & Bawlf P., above 3, p. 52.

<sup>126</sup> Ibid.

<sup>127</sup> See above sections 3.2 & 3.3.

<sup>128</sup> Ibid.

there are administration proceedings, CVA without moratorium, CVA with moratorium for small companies and scheme of arrangement in England. Hence, even though both jurisdictions acknowledge the importance of establishing rescue proceedings, the approach used in each of them diverges.

It is stated<sup>129</sup> that there are a number of requirements for having a successful rescue regime. The ease and speed of access to the process, the ability to request new funding during the reconstruction, the availability of a moratorium (stay on creditors), and providing incentives for directors in order to encourage them to file for the process as early as possible, are all examples of such requirements.<sup>130</sup> In this regard, even though both England and the US embodied, to some extent, these concepts in their insolvency/ bankruptcy laws, there are a number of divergences between the legal frameworks governing distressed debtors restructuring in the two jurisdictions.<sup>131</sup> Some divergences emerge from the fact that each jurisdiction has its own institutional characteristics<sup>132</sup> and from the fact that in England, culturally, shareholders' interests are generally regarded as of little or no account while in the US they are considered to have a stake in the outcome.<sup>133</sup> Moss summarised the fundamental differences of approaches between the two jurisdictions by affirming that:

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<sup>129</sup> In his article, Hunter provided a summary of 10 principles of a rescue culture, 'The Nature and Function of a Rescue Culture', (1999) J.B.L. 491; also see Tolmie F., *Introduction to Corporate and Personal Insolvency Law*, (London, Cavendish Publishing Limited, 2003), p. 64.

<sup>130</sup> Ibid.

<sup>131</sup> See Moss G., 'Chapter 11- An English Lawyer Critique', (1998) 11 *Insolvency International* 17; McCormack G., above 24; Franks J. & Torous W., above 113; Westbrook J., above 111, pp. 86-87.

<sup>132</sup> Goode R., above 10, p. 399.

<sup>133</sup> Moss G., above 131 p. 18; Goode R., above 10, p. 398.

*“In England, insolvency, including corporate insolvency, is regarded as a disgrace. The stigma has to some extent worn off but is nevertheless still there as a reality. In the United States, business failure is very often thought of as the result of misfortune rather than wrongdoing. In England, the judicial bias towards creditors reflects a general social attitude which is inclined to punish risk takers when the risks go wrong and side with creditors who lose out. The United States is still in spirit a pioneering country where the taking of risks is thought to be good thing and creditors are perceived as being greedy”.*<sup>134</sup>

One of the important differences between England and the US is the allocation of control rights during reorganisation.<sup>135</sup> Whereas in England the managers are displaced during the proceedings, in the US they maintain their position without any kind of supervision. Hence, this leads some<sup>136</sup> to argue that the US law tends to be pro-debtor while the UK law is pro-creditor.<sup>137</sup> In this regard, a commentator reasoned such a difference by stating that:

*“In the US a variety of factors, including a deep emotional commitment to the entrepreneurial ethic, make the owners of the corporation central to a salvage proceeding. In the UK, the prevailing view seems to be that the prior owners were the ones whose venality or incompetence created the problem and their interests disappear from moral or legal consideration once a formal proceeding has begun. Americans are much more willing to believe that financial difficulty is the result of*

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<sup>134</sup> Moss G., above 131, p.17.

<sup>135</sup> Azar Z., above 1, pp. 291-292; McCormack G., above 24, p.112.

<sup>136</sup> See Porta R., Lopez F., Shleifer A. & Vishny W., ‘Law and Finance’, (1998) 106 (6) J.P.E. 1113; Franken S., ‘Creditor- and Debtor-Oriented Corporate Bankruptcy Regimes Revisited’, (2004) 4 E.B.O.R. 645, p. 650; Philippe F., ‘Theoretical Foundation for A Debtor Friendly Bankruptcy Law in Favour of Creditors’, (2007) 24 (3) E.J.L.E. 201, pp. 203-205.

<sup>137</sup> However, McCormack challenged the traditional thesis that UK law in the sphere of corporate bankruptcy is pro-creditor whereas US law is pro-debtor. He argued that this characterisation is something of an over-simplification: see McCormack G., above 24, p. 110.

*external forces and that preservation of the company, not just the business, is a crucial social concern”.*<sup>138</sup>

Since it is acknowledged that there are a number of divergences between the laws of both England and US, the aim of this section is to examine a number of issues and see how such issues are dealt with under both jurisdictions. First, this section will start by questioning whether management should be displaced in reorganisation or not. In this regard, argument against and in favour of debtor-in-possession will be highlighted. Secondly, issues with respect to the stay on creditors during bankruptcy proceedings will be examined. Thirdly, this section will examine whether it is advisable to allow post-petition financing or not and what the advantages and drawbacks of such provisions are. Finally, the voting system and the notion of ‘cram-down’ and its impact on the success of the reorganisation plan will be discussed. It is worth noting that the outcome of this section will be utilised in the following chapters in order to propose an insolvency regime to be adopted by the Omani legislator.

### **3.4.1 The Allocation of Control Right**

One of the unique features of the US rescue regime is the fact that the debtor company remains under the control of its existing management<sup>139</sup> without any kind of supervision and that management is entitled to file for Chapter 11 without the need to prove the insolvency of the company.<sup>140</sup> However, in England, once administration procedures are filed for, the management of the company will be

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<sup>138</sup> Westbrook J., above 111, p. 88.

<sup>139</sup> However, it is worth noting that management displacement in favour of an outside trustee could be one of the options available in the US but only in exceptional cases such as fraud: see McCormack G., above 104, pp. 306-307.

<sup>140</sup> Franks J., Nyborg K. & Torous W., ‘A Comparison of US, UK and German Insolvency Codes’, (1996) 25 (3) F.M.J. 86, pp. 91-93.

displaced and control will be handed over to a qualified insolvency practitioner.<sup>141</sup> Thus, the US Chapter 11 is based on Debtor-in-Possession (DIP) while administration proceedings are based on Practitioner-in-Possession (PIP).<sup>142</sup> However, the concept of DIP is a feature of both CVA and scheme of arrangement procedures in England.<sup>143</sup>

It is worth noting that countries worldwide adopted diverse approaches with respect to the fate of the management during the reorganisation process.<sup>144</sup> Azar<sup>145</sup> conducted a review of the bankruptcy policy in fifty countries worldwide. Within his review, he identified four approaches with respect to the management's fate. The first is the approach of England where management is completely displaced with a receiver who manages the company during administration proceedings.<sup>146</sup> The second is keeping management in place with an administrator appointed by the court to supervise the process.<sup>147</sup> The third approach, which is German, is that management remains in control unless the majority of creditors vote against their remaining in place.<sup>148</sup> The fourth is the US approach where management remains in place without any kind of supervision.<sup>149</sup>

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<sup>141</sup> Ibid, p. 91; see section 13 of the Insolvency Act 1986.

<sup>142</sup> Hahn D., 'Concentrated Ownership and Control of Corporate Reorganisations', (2004) 4 J.C.L.S. 117, pp. 137-138.

<sup>143</sup> See above sections 3.2.3 & 3.2.4.

<sup>144</sup> Azar Z., above 1, pp. 291-292.

<sup>145</sup> Ibid.

<sup>146</sup> Ibid, p.291.

<sup>147</sup> Ibid, pp. 291-292.

<sup>148</sup> Ibid, p. 292.

<sup>149</sup> Ibid.

Whether it is preferable to displace the management of the company or to leave them in control is controversial. In this regard, while there are a number of arguments in favour of management displacement,<sup>150</sup> there are some arguments against such displacement.<sup>151</sup> Hence, in order to propose a specific approach to be adopted by the Omani legislator, it is essential to identify these arguments.

#### **3.4.1.1 Arguments in Favour of Management Displacement**

It is argued that the insolvency of the company is usually attributed to the failure of the management in practicing their duties and it is unacceptable to keep them in control during the process.<sup>152</sup> This is the case in England in which directors are deemed responsible for the failure of the company and as a result they must be displaced.<sup>153</sup> It is, moreover, thought that the concept of debtor in possession encourages wasteful strategic behaviour from the company directors.<sup>154</sup> This is because “they have nothing to lose and possibly a lot to gain by speculative investment of the company’s resources”.<sup>155</sup> LoPucki claimed that the problem with

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<sup>150</sup> Ibid, pp. 292-296; Goode R., above 10, pp. 63-64; LoPucki L., ‘Chapter 11: An Agenda for Basic Reform’, (1995) 69 A.B.L.J. 573, p. 574; Moss G., above 131, p. 19.

<sup>151</sup> Azar Z., above 1, pp. 296-301; Westbrook J., ‘Chapter 11 Reorganisation in the United States’, in Rajak H., *Insolvency Law: Theory & Practice*, (London, Sweet & Maxwell,1993), p. 351; Posner R., *Corporate Bankruptcy: Economic and Legal Perspectives*, (Cambridge, Cambridge University Press, 1996), p. xi.

<sup>152</sup> Goode R., above 10, p. 64.

<sup>153</sup> Ibid, p. 394.

<sup>154</sup> McCormack G., above 95, p. 524.

<sup>155</sup> McCormack provides an example by stating that “concerning perverse incentives there is a famous American story involving Federal Express: Federal Express was near financial collapse within a few years of its inception. The founder, Frederick Smith, took \$20,000 of corporate funds to Las Vegas in despair. He won at the gaming tables, providing enough capital to allow the firm to survive”: *ibid*.

the US Chapter 11 is that, in small cases, it leaves the management to run the company until it runs out of cash and in large cases, it gives them the exclusive right to file a plan of reorganisation.<sup>156</sup> Hence, in order to reduce debtor control in Chapter 11, it is suggested that a trustee should be appointed or elected in every case to supervise the process.<sup>157</sup> In this regard, it is worth noting that even though the Insolvency Act 1986 adopted the concept of debtor in possession during CVA proceedings, directors' control is subject to overseeing by a qualified insolvency practitioner.<sup>158</sup> This, as this thesis believes, will assure the creditors that directors will not prejudice their interests and will act appropriately otherwise they will be liable for their misconduct. Also, it is argued that having an administrator, other than the directors, run the business of the company provides a greater assurance of independence and also "meant increased integration and harmonization of procedure if liquidation of the company was the eventual outcome".<sup>159</sup>

In criticising the US Chapter 11, Moss argued that a debtor in possession regime could be equated with "leaving an alcoholic in charge of a pub".<sup>160</sup> He is of the view that management should be punished by displacing them and the control of the company should be handed over to a professional person and not given to the persons who might be responsible for such a failure.<sup>161</sup> This is despite the fact

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<sup>156</sup> LoPucki L., above 150, p. 574.

<sup>157</sup> Ibid.

<sup>158</sup> Section 1 of Part 1 of Insolvency Act 1986 states that "a proposal under this Part is one which provides for some person (the nominee) to act in relation to the voluntary arrangement either as trustee or otherwise for the purpose of supervising its implementation; and the nominee must be a person who is qualified to act as an insolvency practitioner in relation to the company".

<sup>159</sup> McCormack G., above 95, p. 523.

<sup>160</sup> Moss G., above 131, p. 19.

<sup>161</sup> Ibid.

that a number of external factors might have led to the failure of the company, including financial recession, or internal factors, such as poor management.<sup>162</sup> Hence, it might be argued that it is against the interests of both creditors and stakeholders to maintain a poor management.<sup>163</sup> Nonetheless, it is argued that such an argument can be exaggerated since creditors pressure in the US can result in the replacement of the old managers and the introduction of new managers at an early stage of the reorganisation process.<sup>164</sup> In addition, it is stated that in the US while management usually remains in control, in most cases management is changed during the process of Chapter 11 because the directors may have acted unwisely or because of creditors' pressure.<sup>165</sup> In this regard, an empirical study conducted by Gilson found that mostly half of Chief Executive Officers and incumbent directors lose their positions during the restructuring period.<sup>166</sup> Thus, it can be argued that adopting the concept of debtor in possession does not, in reality, mean that poor directors will preserve their position since there are a number of factors which might lead to their displacement.

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<sup>162</sup> In this regard, Finch described a number of internal and external factors that lead to the failure of the company: Finch V., above 25, pp. 152- 165; Goode also stated that "Companies become insolvent for a variety of reasons. Some of the most common causes are over-trading, expensive and ill-judged acquisitions, loss of market share, lack of cash flow and the failure of management to respond to changed circumstances": Goode R., above 10, p. 379.

<sup>163</sup> Azar Z., above 1, pp. 292-293.

<sup>164</sup> Finch V., above 25, p. 287.

<sup>165</sup> Moss G., above 131, p. 19.

<sup>166</sup> Gilson stated that "on average, only 46% of incumbent management and 43% of CEO's remain with their firms at the conclusion of the bankruptcy or debt restructuring"; Gilson S, 'Bankruptcy, Boards, Banks and Block Holders: Evidence on Changes in Corporate Ownership and Control When Firms Default', (1990) 27 (2) J.FE. 355, p. 386; Also, E. Warren in her article in the Y.L.J. (1992, v.102) entitled 'The Untenable Case for Repeal of Chapter 11' cited a number of studies showing that the vast majority of managers of companies who have filed for chapter 11 lose their jobs by the time a plan of reorganisation is confirmed.

Further, Finch claimed that leaving managers in control may create a “lack of trust between creditors and management” and as a consequence the level of litigation will rise and the expenses of such litigations will be paid from the company’s resources.<sup>167</sup> In addition, it is claimed that if management knows in advance that they will be displaced during bankruptcy proceedings, they might engage in “morally hazardous activities”<sup>168</sup> and this might result in preventing the liquidation of non-viable companies at an early stage. For example, they might gamble with other people’s money without having to worry about their jobs.<sup>169</sup> In this regard, McCormack stated that in Germany, for instance, “it was feared that adopting the concept of DIP could lead companies to seek insolvency protection with a view to making creditors wait for years for payment” which is the perceived flaw of the US Chapter 11.<sup>170</sup>

#### **3.4.1.2 Arguments against Management Displacement**

While there are a number of arguments in favour of management displacement, there are a number of arguments against such a displacement. It is argued that adopting the DIP concept could lead to the displacement of talented directors who are not to blame for the company’s financial difficulties.<sup>171</sup> In this regard, it is argued<sup>172</sup> that external factors, such as financial recession might be one of the reasons for business failure, thus it is not always a management fault. Further,

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<sup>167</sup> Finch V., above 25, p. 284.

<sup>168</sup> Azar Z., above 1, p. 293.

<sup>169</sup> Ibid, p. 294.

<sup>170</sup> McCormack G., above 95, p. 523.

<sup>171</sup> As stated above external factor may play a role in the failure of the debtor: Azar Z., above 1, p. 285.

<sup>172</sup> Finch V., above 25, pp. 152- 165.

allowing the management to stay in office would encourage them to apply for court protection at an early stage and before it becomes too late to save the company and its business.<sup>173</sup> Since directors are the first to notice the financial problem of the company, this will give them an incentive to seek reorganisation of the business at an early stage.<sup>174</sup> Thus, it can be argued that the timing of seeking court protection is a key factor of a successful reorganisation.<sup>175</sup> In this regard, the management of companies in the US knows that filing for Chapter 11 protection will safeguard their position and, as a result, they have an incentive to file for it.

However, it is argued that even though in the US early filing is encouraged by securing DIP status, there is no single statutory analogy in England law on wrongful trading and company director disqualification.<sup>176</sup> Thus, in the US there is no statutory provision to punish the company's directors who fail to apply, at an early stage, for Chapter 11.<sup>177</sup> Unlike the US Bankruptcy Law, Armour and Mokal

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<sup>173</sup> Moss G., above 131, p. 19.

<sup>174</sup> Azar Z., above 1, p. 300.

<sup>175</sup> It is stated that "total displacement of the debtor from the management of the enterprise will eliminate the incentive for debtors to avail themselves of rehabilitation procedures at an early stage and may undermine the chances of successful rehabilitation.": see International Monetary Fund, 'Orderly & Effective Insolvency Procedures', Key Issues 54 (1999), available at: <http://www.imf.org/external/pubs/ft/orderly/>. accessed on 24/03/2014; In his Article, Azar noted that whereas in the UK, only 9 % of all 'reorganisations' from 1987 to 2001 represented a voluntary administration petition, in the US, most if not all reorganisation filings are voluntary. In this regard, the difference in management treatment might help to explain the different trends that exist in the two countries: Azar Z., above 1, p. 300.

<sup>176</sup> McCormack G., above 95, p. 526; the provisions of the wrongful trading contained in section 214 of the Insolvency Act 1986 in relation to the rescue of companies in financial difficulties has been examined in detail by Andrew Campbell in his article 'Wrongful Trading and Company Rescue', (1994) 25 C.L.J. 69; see also Mithani A. & Wheeler S., *The Disqualification of Company Directors*, (Butterworths, 1996).

<sup>177</sup> Ibid.

argued that England insolvency law provides company's directors with incentives – 'sticks and carrots' in order for them to take action once they sense a future crisis.<sup>178</sup> On the one hand, the so called 'wrongful trading' and 'director disqualification' provisions contain statutory sticks to encourage directors to file for administration proceedings as soon as they notice the problem.<sup>179</sup> On the other hand, if directors acted at the "earliest appropriate moment", they "would have some hope of regaining control" since the administrator may opt for them to stay.<sup>180</sup> In criticising Chapter 11, Moss stated that "whereas in the US early filing is encouraged by the carrot of becoming a Debtor-In-Possession, in England we do at least have the stick of wrongful trading and disqualification proceedings if the management leaves it too late".<sup>181</sup> However, in reality, as stated above, in the US directors might lose their position during the Chapter 11 process.<sup>182</sup>

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<sup>178</sup> For further details: see Armour J. & Mokal R., above 6, p. 32.

<sup>179</sup> Ibid; However, it is worth noting that it is not an easy task to prove wrongful trading and fraudulent trading: see Finch V., 'Disqualification of Directors: A Plea for Competence', (1991), 53 M.L.R. 385 (in this article, Finch showed the struggle of the courts in attempting to develop a coherent rationale for the qualification of directors for unfitness. In this regard, she examined three cases, namely: *Re Ipcon Fashions Ltd* (1989) 5 BCC 773, *Re C U Fittings Ltd* (1989) 5 BCC 201 and *Re Cladrose Ltd* (1990) 6 BCC 11; Dine J., 'Wrongful Trading- Quasi Criminal Law', in Rajak H., above 151, (in this article, Dine discussed the attitude of the courts in approaching the issues of wrongful trading and fraudulent trading and disqualification of directors); see also Jones B., 'The Difficulty of Proving Fraudulent Trading', (2003), 16 (9) *Insolvency Intelligence* 69.

<sup>180</sup> Ibid

<sup>181</sup> Moss G., above 131, p. 19.

<sup>182</sup> Ibid; Gilson S., above 166, p. 386.

In addition, it is claimed that new managers do not have the necessary knowledge to run the company and as a consequence they are not familiar with the debtor's business.<sup>183</sup> In this regard, a commentator stated that:

*“The reason for giving the right to continue operation of the firm to management is that only management, and not a committee of creditors or a trustee, auctioneer, or venture capitalist or other acquirer has the knowledge to continue the firm in operation, as distinct from reviving it after an interruption for a change in control”.*<sup>184</sup>

Thus, it is argued that the existing management, although they are weak, will run the company and preserve its value better than a court-appointed trustee who knows nothing about it.<sup>185</sup> The reason behind such argument is that the concern of the trustee will be to investigate past wrongdoing, such as questionable transactions with lenders and other creditors, while the focus of the management will be on “practical steps and practical negotiations”.<sup>186</sup>

### **3.4.2 Stay on Creditors (Moratorium)**

As discussed in the previous chapter,<sup>187</sup> according to Jackson bankruptcy creates a ‘common pool problem’ which bankruptcy law addresses by replacing a mandatory mechanism of debt collection instead of the individual debt collection scheme that is in place outside bankruptcy law.<sup>188</sup> However, the concept of ‘collectivity’ cannot achieve its purpose unless creditors are prevented from

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<sup>183</sup> Azar Z., above 1, p. 297.

<sup>184</sup> Posner R., above 151, p. xi.

<sup>185</sup> Westbrook J., above 151, p. 351.

<sup>186</sup> Ibid.

<sup>187</sup> See above section 2.2.1.

<sup>188</sup> Jackson T., above 20, p. 862.

pursuing their claims.<sup>189</sup> In this regard, the notion of ‘moratorium’ (as it is called in the US) or ‘automatic stay’ (as it is called in England), plays a vital role in achieving the aim of such a concept. In recognising the importance of its existence, Goode, for example, pointed out that if secured/ unsecured creditors were left free to pursue their rights against the company’s assets, the assets of the company would be destroyed and the purpose of the rescue regime would be frustrated.<sup>190</sup> Also, Tolmie mentioned a number of the main requirements for a successful rescue regime one of which is to stay creditors’ rights during the process.<sup>191</sup> Hence, it can be argued that staying creditors’ claims during the process is essential to any insolvency law since it provides a collectivity nature to the rescue process and without it, as Finch said “the creditors would take enforcement action before negotiations could be undertaken”.<sup>192</sup> It has been described as:

*“one of the fundamental debtor protections provided by the bankruptcy laws. It gives the debtor a breathing spell from his creditors. It stops all collection efforts, all harassment and all foreclosure actions. It permits the debtor to attempt a repayment or reorganisation plan or simply to be relieved of the financial pressures that drove him into bankruptcy”.*<sup>193</sup>

Thus, the moratorium is designed to protect the assets of the company for a specific period of time in which the company is enabled to sort out its financial difficulties by preparing a plan of reorganisation. It is a ‘safe burrow’ for the

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<sup>189</sup> Ibid; Goode R., above 10, pp. 64-65.

<sup>190</sup> Ibid.

<sup>191</sup> Tolmie F., above 129, p. 64.

<sup>192</sup> Finch V., ‘The Recasting of Insolvency Law’, (2005) 86 M.L.R. 713, p. 728.

<sup>193</sup> McCormack G., *Corporate Rescue Law- An Anglo- American Perspective*, (Edward Elgar Publishing Limited, 2008), p. 80.

company.<sup>194</sup> Its effect starts from the day of filing.<sup>195</sup> As a result, it prohibits, for instance, creditors from taking any step to enforce security over the company's property, no step may be taken to repossess goods in the company's possession under a hire purchase agreement and no legal process may be instituted or continued against the company or the company's property.<sup>196</sup> The lack of a moratorium will encourage secured creditors to enforce their security against the company and will lead to landlords repossessing their property.<sup>197</sup> This is considered to be one of weaknesses in the CVA procedure in England.<sup>198</sup> Even though a CVA with moratorium was introduced for small companies, medium and large businesses do not benefit from such a moratorium.

Both England and the US adopt the concept of a moratorium in their insolvency/bankruptcy laws. In this regard, both jurisdictions allow a financially troubled business a breathing space in which to review its financial affairs in order to propose, by its management or by an appointed administrator, a plan to reorganise and settle its liabilities to the creditors.<sup>199</sup> However, the scope of such moratorium differs between the two jurisdictions.<sup>200</sup> For instance, bringing criminal proceedings

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<sup>194</sup> Jeffery B., Susan S. & Bredeson D., *Business Law and the Legal Environment*, (Cengage Learning, 2012), p. 927.

<sup>195</sup> This is the case in the US. However in England there are two types of moratorium, namely: interim moratorium which starts from the day of filing and moratorium following administrator's appointment: see Keay A. & Walton P., above 47, pp. 107-108.

<sup>196</sup> See Sch. B1, Paras 42 43 & 44 of the UK Insolvency Act 1986; Section 362 of the US Bankruptcy Code.

<sup>197</sup> Goode R., above 10, pp. 64-65.

<sup>198</sup> Weisgard G., Griffiths M. & Doyle L., *Company Voluntary Arrangements and Administration*, (2<sup>nd</sup> edition, Jordan Publishing Limited, 2010), p. 13.

<sup>199</sup> McCormack G., above 24, p. 112.

<sup>200</sup> *Ibid.*

against the debtor company is within the scope of the moratorium in England whereas in the US it is not.<sup>201</sup> Also, one of the material differences between the US and England is that while the Chapter 11 moratorium prevents suppliers and customers terminating their contracts with a company on grounds of insolvency alone, the procedures in England allow suppliers and customers to exercise contractual termination rights in insolvency, so they are permitted to do so irrespective of the moratorium.<sup>202</sup> In this regard, Finch stated that “where credit is obtained contractually through hire purchase or retention of title agreement the English courts tend to approach rights issues with a high respect for the sanctity of contract, whereas US courts look more directly to the need to protect parties collectively in a rescue scenario”.<sup>203</sup>

Since some creditors might be burdened by the imposition of moratorium, they may apply to the court in order to have the stay lifted.<sup>204</sup> This is the case both in England and in the US.<sup>205</sup> However, in the US there is a particular requirement of “adequate protection” for the holder of property rights.<sup>206</sup> Even though the concept of “adequate protection” is not defined in the US Bankruptcy Code, examples of this concept are provided under this Act.<sup>207</sup> Such “adequate protection” may be provided by requiring the trustee to make a cash payment or periodic cash payment to such entity or providing to such entity an additional or replacement lien

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<sup>201</sup> Szekely A., Richardson F. & Gallagher A., ‘Chapter 11 One Size Fits All’, (2008) 23 (9) B.J.I.B.F.L. 457, p. 458.

<sup>202</sup> Ibid.

<sup>203</sup> Finch V., above 25, p. 283.

<sup>204</sup> McCormack G., above 193, p. 80-81.

<sup>205</sup> Sections 10 & 11 of the UK Insolvency Act 1986; section 362 (a) of the US Bankruptcy Code.

<sup>206</sup> Ibid, section 362 of the US Bankruptcy Code.

<sup>207</sup> Ibid, section 362 (d).

equal to the decrease in the value of the entity's interest in the property.<sup>208</sup> Westbrook indicated that the onus of proven "adequate protection" falls on the debtor whereby he has to show that the creditor is comfortably over-secured (it is called "equity cushion") or by showing that one of the criteria mentioned in the statute is met.<sup>209</sup> Sometimes the secured creditor applies to the court to lift the stay on a property which is necessary for the purposes of a reorganisation plan.<sup>210</sup> In such a case, the issue then becomes whether the creditor is "adequately protected" or not. If he is adequately protected, then the company may retain the property for the purpose of its restructuring. Where the creditor is not "adequately protected" the creditor will be granted relief from the stay whereby he is allowed to enforce his security.<sup>211</sup> In this regard, it can be argued that even though the US Bankruptcy Code imposed a stay on creditors' actions, secured creditors will not be bound by such a stay unless the court demonstrates the fact that they are adequately protected.

In England, there is no such explicit requirement of adequate protection and it is left to the discretion of the court to decide based on the facts of each case.<sup>212</sup> However, it is stated that in deciding whether to grant leave or not, "the court must balance the interests of the secured creditor against those of the other creditors, and in the light of what the administrator's proposals, and any progress made

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<sup>208</sup> Ibid, section 362 (d) (2).

<sup>209</sup> See Westbrook J., above 151, p. 351.

<sup>210</sup> Section 362 (d) (2) (B) of the US Bankruptcy Code; For some examples: see also Bailey E. & Groves H., *Corporate Insolvency: Law and Practice*, (3<sup>rd</sup> edition, Butterworths, 2008), p. 1435.

<sup>211</sup> Section 362 (d) (2) of the US Bankruptcy Code.

<sup>212</sup> The leading case on the approach of the court in exercising its discretionary power to grant permission to the lifting of the moratorium is *Re Atlantic Computer Systems plc* [1992] Ch 505; for brief facts of this case: see Keay A. & Walton P., above 47, pp. 109-110.

towards their implementation seems destined to achieve”.<sup>213</sup> In England, a number of factors play a role in determining whether a stay has to be lifted or not,<sup>214</sup> such as the length of the stay, the impact of lifting the stay on other creditors and the conduct of the parties may also be a material consideration in a particular case, as it was in *Re Paramount Airways*.<sup>215</sup> Thus, it can be argued that secured creditors in the US are given strong statutory protection whereas in England courts have wide discretion in determining the level of such protection.

During the moratorium, the debtor company may continue its business without having to pay its pre-petition debt and most creditors are not allowed to enforce their securities. Thus, in comparing the cost of operation with its industry competitors, the debtor company’s operating costs are reduced.<sup>216</sup> This leads some to argue that operating under Chapter 11 gives the debtor company a competitive advantage, e.g. attracting customers through reducing its prices, and, as a consequence, this will lead to the collapse of other industries since they will

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<sup>213</sup> Fletcher I., *The Law of Insolvency*, (Sweet & Maxwell, 2011), p. 543; in *Re Meesan Investment Ltd* [(1988) 4 B.C.C. 788], Peter Gibson J stated that “The court was given a general discretion under section 11(3) and had to have regard to all relevant circumstances”; He also stated that “the court had to balance the legitimate interests of the bank and of the other secured creditors of the company”: see Para 789.

<sup>214</sup> In *Re Atlantic Compute System Plc* [1992] Ch 505, the Court of appeal granted permission to the lifting of moratorium and the court laid down a number of factors that court would take into account in an application for permission to lift the moratorium; for a summary of these factors: see Goode R., above 10, pp. 442-444; Keay A. & Walton P., above 47, p. 112.

<sup>215</sup> [1990] Ch 744.

<sup>216</sup> Ciliberto F. & Schenone C., ‘Bankruptcy and Product-Market Competition in the Airline Industry’, (2012) 30 I.J.I.O. 564, p. 575.

have to reduce their prices as well.<sup>217</sup> However, Broude<sup>218</sup> opposed such an argument by providing examples showing how customers are usually willing to pay more to avoid entering contracts with the bankrupt firm.<sup>219</sup> In IP world, for example, software needs to be regularly updated. In this regard, he raised a number of questions, such as who would want to buy a product with a warranty from a firm that might not be around very much longer since it is in Chapter 11?<sup>220</sup> Thus, it can be argued that granting a debtor company a breathing space does not mean that its competitors will be affected.

Further, it is argued that the length of the automatic stay<sup>221</sup> often results in the company seeking protection under Chapter 11 to lengthen its business life, without there being any real prospect of the debtor company rehabilitating itself.<sup>222</sup> This protracted period creates a period of unaccountability since creditors are not allowed to pursue their claims and they also cannot propose a reorganisation plan.<sup>223</sup> This leads a commentator to argue that Chapter 11 is mainly a 'debtor

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<sup>217</sup> In this regard, using examples from the US airline market, Ciliberto and Schenone investigated the impact of a company operating under Chapter 11 protection on other non -Chapter 11 firms that are in direct competition with the distressed company. Their study concluded that there was a significant drop in the median airfare price in markets where a bankrupt carrier operates: see *ibid*, pp. 575-576

<sup>218</sup> Broude R., 'How the Rescue Culture Came to the US and the Myths That Surround Chapter 11', (2000) 16 (5) I.L.P. 194.

<sup>219</sup> *Ibid*, p. 197.

<sup>220</sup> *Ibid*.

<sup>221</sup> For the duration of the automatic stay: see section 362 (c) & section 1121 of the US Bankruptcy Code.

<sup>222</sup> Janis S., 'Debtor in Possession Financing: The Jurisdiction of Canadian Courts to Grant Super-Priority Financing in CCAA Application', (2000) 23 D.L.J. 337, p. 371.

<sup>223</sup> *Ibid*, pp. 371- 372.

relief provision rather than a creditor remedy.<sup>224</sup> However, Coleman and Kirschner disagree with this statement and they stated that even though creditors are prevented from enforcing their securities, “the Bankruptcy Code imposes strict limitations and burdens on a debtor operation in Chapter 11”.<sup>225</sup> For example, the Bankruptcy Code, Section 1113, imposes strict requirements on a debtor seeking to reject a collective bargaining agreement.<sup>226</sup>

It is obvious that achieving the aim of bankruptcy law in preserving the going concern value of the debtor will be hindered by giving secured creditors the right to block the proceedings by enforcing his rights,<sup>227</sup> particularly if his property right is necessary to achieve this aim. Hence, it can be argued that the position in England is better than the position in the US. Staying all claims and giving courts the discretion to decide whether to lift the stay or not, after balancing the interests of all creditors, have an impact on the success of the rescue process. However, this does not mean to ignore the fact that adopting the experience of both England (given discretion to courts) and the US (having statutory requirement of adequate protection) provides more protection to secured creditors.

### **3.4.3 Post-Petition Financing**

As discussed above,<sup>228</sup> in order to alleviate the impact of financial distress on companies, bankruptcy laws both in England and in the US impose a stay on creditors’ actions. The purpose of such a stay is to give the debtor company a

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<sup>224</sup> Casey K., above 102, p. 285.

<sup>225</sup> For more details: see Coleman M. & Kirschner M., above 100, p. 364.

<sup>226</sup> Ibid.

<sup>227</sup> Azar Z., above 1, p. 319.

<sup>228</sup> See above section 3.4.2.

breathing space whereby it is able to continue its operation as a going concern and to sort out its financial difficulties by preparing a plan of reorganisation.<sup>229</sup> However, during financial crisis, the distressed company would not be able to continue its operation unless sufficient liquidity is available.<sup>230</sup> If, for example, the debtor business is manufacturing, a lack of cash to pay for wages and supplies can shut down operations, “which may be the fatal blow to an already wounded” company.<sup>231</sup> Further, lack of an unencumbered asset to offer for security and the reluctance of pre-petition lenders to supply further finance render it difficult to obtain new finance unless a sufficient guarantee is in place.<sup>232</sup> Nonetheless, since funding an insolvent firm is a risky business, a number of incentives, e.g. granting a lender super priority status, should be built into the system to encourage post-petition financing.<sup>233</sup> Hence, bankruptcy laws of some countries contain a number of provisions governing the post-petition financing (it is also called DIP financing). Examples of countries that legalise post-petition financing are the US, France, Germany and Australia, although the incentives provided by each law differ.<sup>234</sup> The focus of this section will be on the position under both the US and England insolvency laws.

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<sup>229</sup> Jeffery B., Susan S. & Bredeson D., above 194, p. 927; Goode R., above 10, p. 64.

<sup>230</sup> Henschel B., ‘Post-Petition Financing: Is There Life after Debt?’, (1991) 8 B.D.J. 575, p. 576.

<sup>231</sup> *Ibid.*

<sup>232</sup> *Ibid.*

<sup>233</sup> McCormack G., ‘Super-Priority New Financing and Corporate Rescue’, (2007) J.B.L. 701, p. 714.

<sup>234</sup> In this regard, for example, while in Australia priority over existing secured claims is forbidden by law, in the US a new lender is given a super priority status: see O’kane D. & Bawlf P., above 3, p. 242.

One of the key elements of Chapter 11 is the presence of provisions permitting the financing of the DIP's operation.<sup>235</sup> It is a court-approved funding for a bankrupt firm under the protection of Chapter 11.<sup>236</sup> It is argued that the purpose of allowing post-petition financing in the US Bankruptcy Code is to make sure that the debtor has a fighting chance to survive.<sup>237</sup> The survival of the company is beneficial not only to the distressed company, but to its creditors as well, because the value of the going concern of a corporation may exceed the liquidation value by a large margin.<sup>238</sup> Further, it is stated that even though offering funding to a firm that has just filed for bankruptcy protection may seem to be risky, with a proper court protection, it can be an excellent deal for a lender.<sup>239</sup> This is due to the fact that the lender is expected to enjoy further safeguards that it cannot be obtained outside a bankruptcy context.<sup>240</sup> For example, subject to a number of conditions being met,<sup>241</sup> lenders who provide funds to the company during the restructuring process might be paid before existing secured creditors (super priority status) if the company eventually goes into liquidation.

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<sup>235</sup> Section 364 of the US Bankruptcy Code.

<sup>236</sup> Ibid, section 364 (b).

<sup>237</sup> Henschel B., above 230, p. 577.

<sup>238</sup> Ibid.

<sup>239</sup> Smiley E. & Ekvall L., *Bankruptcy for Businesses: Benefits, Pitfalls and Alternatives*, (Entrepreneur Press, 2007), p. 101.

<sup>240</sup> Ibid.

<sup>241</sup> Section 364 (d) (1) of the US Bankruptcy Code imposes three requirements for authorising post-petition financing; e.g. pre-petition securities adequately protected and getting the approval of the court.

The potential lenders to a DIP can be divided into three categories: fully secured prepetition lenders, unsecured prepetition lenders, and new lenders.<sup>242</sup> Each of them has its own reasons for wanting to provide financing to the debtor.<sup>243</sup> However, if the DIP lender is not prepetition secured creditors, a number of safeguards for affected pre-petition secured creditors should be in place. Sometimes a DIP lender can obtain a lien, commonly known as a “priming” lien, on property of the company that is senior in priority to existing liens on such property.<sup>244</sup> However, in such a case, the debtor must, first of all, prove that it cannot obtain the loan without granting such a security and showing that a prepetition secured creditor is adequately protected against loss.<sup>245</sup> In this regard, the US Senate Judiciary Committee stated that:<sup>246</sup>

*“Secured creditors should not be deprived of the benefit of their bargain. There may be situations in bankruptcy where giving a secured creditor an absolute right to his bargain may be impossible or seriously detrimental to the policy of the bankruptcy laws. Thus, this section recognises the availability of alternative means of protecting a secured creditor's interest where such steps are a necessary part of the rehabilitative process. Though the creditor might not be able to retain his lien upon the specific collateral held at the time of filing, the purpose of the section is to insure that the secured creditor receives the value for which he bargained.”*

This means that the financial position of the pre-petition secured creditor at the time of bankruptcy filing, its prospect of being paid, will not be affected or harmed

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<sup>242</sup> For more details: see Henoch B., above 230; Qi L., ‘Availability of Continuing Financing in Corporate Reorganisation: The UK and US Perspective’, (2007) 20 (9) I.I.R. 129, pp. 164-165.

<sup>243</sup> Ibid.

<sup>244</sup> See Triantis G., ‘A Theory of the Regulation of Debtor-in-Possession Financing’, (1993) 46 V.L.R. 901, p. 902.

<sup>245</sup> Ibid; See section 363 (c) (2) & 363 (e) of the US Bankruptcy Code.

<sup>246</sup> Senate Report No. 95-989 Cong 2d Sess 53 (1978); see McCormack G., above 94, p. 715.

by granting a super priority to the new lender.<sup>247</sup> Thus, generally, the status of super priority will not be granted unless the court establishes that there is an adequate value in the collateral to protect fully both old and new lender.<sup>248</sup> Also, since the onus of proving the necessity of such a new fund and the test of 'adequate protection' is on the debtor company, it is stated that many proposed debtor-in -possession lien-priming loans are rejected by the bankruptcy courts than are authorised.<sup>249</sup>

In England, the Insolvency Law contains no specific provisions for super priority new financing, although in the Department of Trade and Industry report on the business rescue mechanism, it was proposed that the provision of additional finance to distressed companies could be value enhancing for the business provided that it was necessary to rescue the business.<sup>250</sup> It is worth noting that under the administration procedure, the administrator may exercise his powers in borrowing money and granting security on behalf of the company.<sup>251</sup> However, any new security will not take priority over pre-existing secured debt, unless expressly permitted under the terms of that indebtedness.<sup>252</sup> In acknowledging the

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<sup>247</sup> Broude R., above 218, p. 197.

<sup>248</sup> Ekvall E. & Smiley L., above 239, pp. 101-102.

<sup>249</sup> Broude R., above 218, p. 197.

<sup>250</sup> The Insolvency Service, 'A Review of Company Rescue and Business Reconstruction Mechanisms', reported by the Review Group, Department of Trade and Industry and HM Treasury, May 2000, p. 33, available at:

[http://www.insolvencydirect.bis.gov.uk/insolvencyprofessionandlegislation/con\\_doc\\_register/con\\_doc\\_archive/consultation/condoc/condocreview.pdf](http://www.insolvencydirect.bis.gov.uk/insolvencyprofessionandlegislation/con_doc_register/con_doc_archive/consultation/condoc/condocreview.pdf). accessed on 25/03/2014.

<sup>251</sup> Sch.1 Para 3 of the Insolvency Act 1986.

<sup>252</sup> Szekely A., Richardson F. & Gallagher A., above 201, p. 458.

importance of such finance, in David Cameron's proposals<sup>253</sup> for reform in July 2008, it was declared that the Conservative Party would provide a priority status for a financier willing to provide ongoing funding post-petition.<sup>254</sup> However, at present granting a super priority status for a new lender is not within the existing England legal framework.

Even though DIP financing increases the chance of the debtor's survival, it has a number of undesirable side features.<sup>255</sup> First, it is argued that in the US access to super priority financing increases the possibility of overinvestment.<sup>256</sup> For instance, Eastern Airlines<sup>257</sup> was able to raise large amounts of cash to finance the continued operation of the airline. It declared, in public, that it had sufficient funds (\$3.7 billion) to fully repay its liabilities (\$3.4 billion). A year later, Eastern proposed to repay its creditors \$1.6 billion, while Eastern's final plan of reorganisation, rejected by creditors, proposed a repayment of only \$0.85 billion. When the firm was eventually liquidated, the creditors received only about \$0.34 billion.<sup>258</sup> Hence, it is argued that such financing provides strong incentives for the debtor company to overinvest and a new lender will be happy to finance any venture, even a losing

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<sup>253</sup> David Cameron in 2008 was the leader of the Opposition Conservative Party and the Prime Minister was Gordon Brown with a Labour Government.

<sup>254</sup> Available at [http://www.conservatives.com/News/Speeches/2008/07/David\\_Cameron\\_Speech\\_to\\_the\\_CBI.aspx](http://www.conservatives.com/News/Speeches/2008/07/David_Cameron_Speech_to_the_CBI.aspx).

<sup>255</sup> Franks J., Nyborg K. & Torous W., above 140, p. 94; Triantis G., above 244, p. 903; Skeel D., 'The Past Present and Future of Debtor-in-Possession Financing', (2003-2004) 25 C.L.R. 1905, p. 1921.

<sup>256</sup> Franks J., Nyborg K. & Torous W., above 140, p. 94; Triantis G., above 244.

<sup>257</sup> This example stated in Franks, Nyborg & Torous's article, above 140, p. 97.

<sup>258</sup> Ibid.

one, since he/she will be granted a super priority status.<sup>259</sup> However, a study of more than five hundred firms that filed for Chapter 11 showed that there is little evidence of systematic overinvestment.<sup>260</sup> Researchers of this study reached the conclusion that companies obtaining DIP financing are more likely to emerge from Chapter 11 than non-DIP financed firms, they have a shorter reorganisation period, they are quicker to emerge and also quicker to liquidate.<sup>261</sup> Further, since providing new finance may incur prejudice to the prepetition secured creditors, Triantis<sup>262</sup> stated that a distinction should be made between desirable and undesirable financing arrangements. According to him, desirable financing is one in which the lender's expected return comes from the profitable use of the moneys;<sup>263</sup> while undesirable financing simply effects a transfer from existing debt holders to the DIP lender and the shareholders.<sup>264</sup> He suggested that in order to promote optimal investment and asset deployment decisions, the regulation of DIP lending should aim to permit only desirable financing arrangements.<sup>265</sup>

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<sup>259</sup> McCormack G., above 233, p. 718; Franks J., Nyborg K. & Torous W., above 140, p. 97.

<sup>260</sup> Dahiya S., John K., Puri M. & Ramirez G., 'Debtor-in-Possession Financing and Bankruptcy Resolution: Empirical Evidence', (2003) 69 J.F.E. 259, p. 259; see also Dahiya S., 'Debtor-in-Possession Financing', (2003) 69 J.F.E. 259.

<sup>261</sup> Dahiya S., John K., Puri M. & Ramirez G., above 260, p. 261.

<sup>262</sup> Triantis G., above 244, p. 903.

<sup>263</sup> Ibid.

<sup>264</sup> Ibid.

<sup>265</sup> Ibid.

Secondly, it is argued that the DIP financing is doing more than simply providing finance since, at present, it is, also, used as a mechanism to transfer control to the DIP lender itself.<sup>266</sup> In this regard, Skeel claimed that:

*“Creditors have converted two existing contractual tools into important governance levers. The first is debtor-in-possession (DIP) financing. Before they even file for bankruptcy, corporate debtors must arrange an infusion of cash to finance their operations in Chapter 11. To an increasing extent, lenders are using these loan contracts to influence corporate governance in bankruptcy ... The second is that key executives are increasingly given performance-based compensation packages in Chapter 11. The most common strategy is to promise the executives a large bonus if they complete the reorganisation quickly; likewise, executives face ever-smaller bonuses if the case takes longer”.*<sup>267</sup>

Despite this criticism, it is maintained that such shift of control through a DIP loan might be useful because the DIP lender usually has knowledge of the company's operation and restructuring procedure.<sup>268</sup>

#### **3.4.4 Creditors Voting and the Notion of Cram-Down**

A debtor company is given a breathing space in order to restructure its affairs and prepare a plan of reorganisation to be accepted by its creditors and approved by the court. Under both England and the US insolvency proceedings, creditors, whether secured or unsecured, are entitled to vote “for” or “against” the plan and

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<sup>266</sup> Skeel D., above 255, p. 1921.

<sup>267</sup> Skeel A., ‘Creditors’ Ball: The ‘New’ New Corporate Governance in Chapter 11’, (2003) 152 U.P.L.R. 917, pp. 918-919.

<sup>268</sup> Marinc M. & Vlahu R., *The Economics of Bank Bankruptcy Law*, (Springer, 2011), p. 154.

give the reasons for their objections to the court.<sup>269</sup> However, if each creditor sticks to his pre-bankruptcy bargain, it would be impossible for any rescue attempt to be achieved, particularly if substantial parts of the company's assets are encumbered. Therefore, there should be a legal mechanism in place to govern the process of such voting and to deal with such objection. In this regard, the laws of both England and the US give bankruptcy courts the authority to approve such a rescue plan despite its rejection by few creditors.<sup>270</sup> This legal mechanism is referred to as "cram-down" whereby a bankruptcy court, in certain circumstances, can impose the plan over the wishes of a particular class of creditors who object to it.

A plan of reorganisation divides creditors into classes, usually based on the ranking of claims.<sup>271</sup> In the US, for instance, equity is always placed in a separate class, and each secured creditor usually placed in a single class.<sup>272</sup> In contrast, under a scheme of arrangement in England, for instance, the test of determining the number of classes is that a class must be limited to individuals whose rights are not so different as to make it impossible for them to consult together with a view to their common interests.<sup>273</sup> Since it is impossible for creditors to agree on a specific

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<sup>269</sup> Section 1129 (a) of the US Bankruptcy Code; Sections 1.9 & 1.17 of the UK Insolvency Rules 1986.

<sup>270</sup> See section 1129 (b) of the US Bankruptcy Code; Section (4) of the UK Insolvency Law 1986; Section 899 of UK the Companies Act 2006.

<sup>271</sup> Franks J. & Torous W., above 113, p. 76.

<sup>272</sup> Ibid; In general, the classes of claim holders will be secured creditors, unsecured creditors entitled to priority, general unsecured creditors and equity secured creditors: see Walton P., 'Pre-Pack Administration- Trick or Treat?', above 11, p. 114.

<sup>273</sup> O'Dea G., 'Craving a Cram-Down: Why English Insolvency Law needs reforming', (2009) B.J.I.B.F.L 583, p. 585, available at:

rescue plan, the laws of both England and the US have a process in which a vote in favour of the plan by a specific majority of creditors within a class is treated as binding on the dissenting voters in the class.<sup>274</sup> However, the required majority and the classification of classes differ between the two jurisdictions.<sup>275</sup> In the US Chapter 11, creditors are divided into classes and the plan must be approved by a majority of two-thirds (measured by their value of claims) in each.<sup>276</sup> However, under CVA proceedings in England, all creditors are treated as a single class for voting purposes<sup>277</sup> and the will of the majority (75%) will prevail.<sup>278</sup> However, the process under a scheme of arrangement is similar to that of the US Chapter 11 where creditors might be divided into classes<sup>279</sup> and a scheme should be approved by a majority (representing  $\frac{3}{4}$  in value) in each class.<sup>280</sup>

Further, it is worth noting that unlike the case under insolvency proceedings in England, in the US Chapter 11, shareholders are given some role in the rescue

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[http://www.weil.com/files/Publication/8db63e8a-49b6-4712-90ac0348746890a9/Presentation/PublicationAttachment/c196def8-cca3-49fd-a5ab071187e511c6/JIBFL\\_Nov\\_09.pdf](http://www.weil.com/files/Publication/8db63e8a-49b6-4712-90ac0348746890a9/Presentation/PublicationAttachment/c196def8-cca3-49fd-a5ab071187e511c6/JIBFL_Nov_09.pdf). accessed on 25/01/2014.

<sup>274</sup> Unlike the case under CVAs in England, under the Scheme of Arrangement secured creditors will be bound by the scheme, if it is adopted by the requisite majority and approved by the court, even without their express consent. In this regard, section 899 (3) of the UK Companies Act 2006 states that “A compromise or arrangement sanctioned by the court is binding on: (a) all creditors or the class of creditors or on the members or class of members (as the case may be).

<sup>275</sup> See section 1122 of the US Bankruptcy Code; section 896 of the UK Companies Act 2006; Rule 1.17 & 1.18 of the UK Insolvency Rules 1986.

<sup>276</sup> Section 1122 (a) of the US Bankruptcy Code states that “Except as provided in subsection (b) of this section, a plan may place a claim or an interest in a particular class only if such claim or interest is substantially similar to the other claims or interests of such class”.

<sup>277</sup> See Rule 1.17 & 1.18 of the UK Insolvency Rules 1986.

<sup>278</sup> Rule 1.19 (2) of the UK Insolvency Rules 1986.

<sup>279</sup> Section 896 of the UK Companies Act 2006.

<sup>280</sup> *Ibid*, section 899 (1).

process so their interests and voices are more recognised.<sup>281</sup> This has been criticised by Moss when he stated that “where in reality there is nothing properly left for shareholders this seems to enable them to use blocking tactics so as to extract value from the situation in which equitably they should receive none”.<sup>282</sup> However, in order to overcome this obstacle, Finch proposed that in the case of a Chapter 11 filing, the bankruptcy court should be allowed to diminish the role of the shareholders.<sup>283</sup> This is the case in England where courts tend, in some circumstances, to disregard the objections of shareholders. For instance, in *Re Tea Corpn Ltd* in 1904<sup>284</sup> the court held that shareholders’ dissent could be disregarded when sanctioning the scheme.<sup>285</sup> When dealing with the argument that the scheme was rendered defective by the ordinary shareholders’ dissent, Vaughan Williams LJ held that “if you have the assent to the scheme of all those classes who have an interest in the matter, you ought not to consider the votes of those classes who really have no interest at all”.<sup>286</sup>

Once the rescue plan is accepted by the majority, the dissenting minority will be bound by the plan. In general, a dissented class of creditors may be crammed down if it is demonstrated that in the approval of the reorganisation plan they would

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<sup>281</sup> Moss G., above 131, p. 18.

<sup>282</sup> Ibid.

<sup>283</sup> Finch V., above 25, p. 288.

<sup>284</sup> *Tea Corpn Ltd, Re, Sorsbie v Tea Corpn Ltd* [1904] 1 Ch 12.

<sup>285</sup> See Taylor J., Stewart N., Associate Latham & Watkins, ‘UK: Cram-Down of Junior Creditors Using Schemes of Arrangements’, available at:

[http://www.lw.com/upload/pubContent/\\_pdf/pub2861\\_1.pdf](http://www.lw.com/upload/pubContent/_pdf/pub2861_1.pdf). accessed on 21/01/2014.

<sup>286</sup> Ibid, p. 23.

receive the value of its collateral plus interest.<sup>287</sup> Thus, pre-bankruptcy creditors would not be left uncompensated. Section 1129 (b) of the US Bankruptcy Code provides details of a number of conditions in which a plan may be approved by the court despite the objections of a particular class of creditors. In this regard, dissenting creditors are protected by the 'best interest' test- in which the opposing creditor must receive at least as much under the plan as it would be if the company was sent into liquidation- and a 'feasibility test'- whereby the debtor company must be able to implement its commitments as stated in the plan.<sup>288</sup> Further, each priority claim must receive special treatment unless the claim holder accepts otherwise and at least one class of creditors must accept the plan.<sup>289</sup> It is worth noting that it is not easy to cram-down the dissenting class of creditors since all the above conditions must be met. This leads an American commentator to state that "the cram-down standards appear to be simple, but the appearance is deceiving".<sup>290</sup>

However, in England, there are no specific conditions for approving a reorganisation plan and the court is given the discretion to determine whether a plan should be approved or not. For instance, in approving a scheme of

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<sup>287</sup> As stated above, under US Bankruptcy Code a strong protection given to a secured creditor in which a plan may be confirmed over the dissented secured creditor as long as the creditor is given "adequate protection".

<sup>288</sup> Sections 1129 (a) (7) (A) (ii) & 1129 (a) (11) of the US Bankruptcy Code.

<sup>289</sup> Ibid, sections 1129 (a) (9) & 1129 (a) (10).

<sup>290</sup> Klee K., 'All You Ever Wanted to Know About Cram Down Under the New Bankruptcy Code', (1979) 53 A.B.L.J. 133, p. 156. In this article, Klee examined the provisions of cram down under the US Bankruptcy Code by providing fourteen examples which demonstrate the complexity of such concept in reality.

arrangement, the court normally takes into account three factors.<sup>291</sup> First, the court must establish that the procedural requirements, e.g. the composition of classes, have been met.<sup>292</sup> Secondly, the court must be satisfied that the classes were justly represented by those who attended the meeting,<sup>293</sup> e.g. the majority acted *bona fide* and that there was no harassment of minorities.<sup>294</sup> Thirdly, the court must be satisfied that the terms of the scheme itself are fair.<sup>295</sup>

### 3.5 Evaluating Remarks

From the above discussion, it is shown that the US rescue regime is mainly focused on Chapter 11 reorganisation procedures,<sup>296</sup> while in England there are a number of insolvency proceedings that can be used to rescue the distressed enterprises: namely, administration and company voluntary arrangement proceedings, with and without moratorium, under the Insolvency Act 1986 and scheme of arrangement proceedings under Sections 895-9 of the Companies Act 2006.<sup>297</sup> It is argued that Chapter 11 opted for the 'one size fits all' approach to business reorganisation since all businesses regardless of their size, small,

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<sup>291</sup> For more details about these conditions and explanation of cases: see O'Dea G., above 273, p. 587.

<sup>292</sup> *Re Alabama, New Orleans, Texas and Pacific Junction Railway Co* [1891] 1 Ch 212, 239; *Re Anglo-Continental Supply Co Ltd* [1922] 2 Ch 723, 736.

<sup>293</sup> *Re Alabama, New Orleans, Texas and Pacific Junction Railway Co* [1891] 1 Ch 213, 245.

<sup>294</sup> *Ibid*, p. 238.

<sup>295</sup> *Re Alabama, New Orleans, Texas and Pacific Junction Railway Co* [1891] 1 Ch 215, 239, 247; *Re Anglo-Continental Supply Co Ltd* [1922] 2Ch 723, 736; *Re Dorman Long & Co* [1934] Ch635; *Re National Bank* [1966] 1 WLR 819.

<sup>296</sup> See above section 3.3.

<sup>297</sup> See above section 3.2.

medium or large, are subject to Chapter 11.<sup>298</sup> However, this thesis argues that such a description is rather exaggerated particularly after the enactment of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, whereby small firms are allowed to get through Chapter 11 more quickly and less expensively. Thus, this thesis argues that even though it is a single regime, in reality, Chapter 11 offers a ‘two sizes’ reorganisation rule in which special procedures available for small businesses differ from those designed for medium and large businesses. However, this is in contrast with the situation in England where there is a separate insolvency regime designed for small businesses, namely CVA with moratorium.<sup>299</sup> Although this regime is only designed for small companies, they are free to opt for administration, CVA without moratorium or scheme of arrangement proceedings. In opting for CVA without moratorium or scheme of arrangement, both small and large companies will lose the benefit of staying creditors’ actions and, as a consequence, the door will be opened for secured creditors to enforce their securities without having regard for the interests of other creditors. Thus, in order to benefit from such a stay both small, if they opted not to use CVA with moratorium, and large businesses are advised to go through administration proceedings which might lead to either CVA or scheme of arrangement procedures.<sup>300</sup> Having stated that whereas in the US there is a single bankruptcy regime, and in England there are various insolvency proceedings, this thesis asserts that the US bankruptcy system provides more consistency and

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<sup>298</sup> McCormack G., above 104, p. 309.

<sup>299</sup> Insolvency Act 2000 introduced a new Schedule into the Insolvency Act 1986; see Tribe J., above 69, p. 468.

<sup>300</sup> Goode R., above 10, p. 409.

coherence than is the case under the English system. Having in place a single bankruptcy regime for both small and large companies, with special rules applying to small companies, is better than having in place more than three bankruptcy proceedings, even though each of them has its own characteristic, as explained above.

Further, as discussed above,<sup>301</sup> the difference between Chapter 11 and administration proceedings is that in England once the administrator is appointed the management of the company will be displaced unless the administrator thinks otherwise.<sup>302</sup> In the US, the notion of debtor-in-possession is adopted<sup>303</sup> which provides some sort of encouragement to directors to apply for Chapter 11 once they sense a financial crisis.<sup>304</sup> Such a notion is also adopted during CVA<sup>305</sup> and scheme of arrangement procedures in England,<sup>306</sup> although under CVA the management runs the company under the supervision of an insolvency practitioner. Even though leaving the previous management in control without any kind of supervision has its merits,<sup>307</sup> it might lead to a number of undesirable consequences, such as overinvestment and losing creditors' trust.<sup>308</sup> In this regard,

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<sup>301</sup> See above section 3.4.

<sup>302</sup> Franks J., Nyborg K. & Torous W., above 140, p. 91; sections 13 & 14 of the Insolvency Act 1986.

<sup>303</sup> Coleman M. & Kirschner M., above 100, p. 363.

<sup>304</sup> Azar Z., above 1, p. 300.

<sup>305</sup> See above section 3.2.3.

<sup>306</sup> See above section 3.2.4.

<sup>307</sup> Azar Z., above 1, pp. 296-301; Westbrook J., above 151, p. 351; Posner R., above 151, p. xi; see above section 3.4.1.2.

<sup>308</sup> Goode R., above 10, p. 64; McCormack G., above 95, p. 524; see above section 3.4.1.1.

it is believed<sup>309</sup> that leaving the management in place while nominating a person to oversee their conduct provides a level of credibility and assurance for creditors. This approach is suitable to be adopted by the Omani legislator.<sup>310</sup> As will be shown in the next chapter, in Oman, during bankruptcy proceedings, the management is displaced and the bankruptcy trustee will run the business of the debtor.<sup>311</sup> However, one of the main issues with the current Omani bankruptcy regime is that the bankruptcy trustee need not be qualified to run the business of the debtor since he/she is not required to hold any certain qualifications.<sup>312</sup> Thus, combining the experience of both England and the US in this particular area is desired, that is to say, keeping the management in place to run the business during bankruptcy processes while appointing a bankruptcy trustee to oversee their conduct and raise any concerns to a bankruptcy judge.<sup>313</sup>

In addition, imposing a stay on creditors' actions is a feature of both the US Chapter 11 and administration proceedings in England.<sup>314</sup> Such a stay results in easing the process of rescuing the company since the company's assets are protected. Some of the theories discussed above, such as the creditors' bargain,<sup>315</sup>

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<sup>309</sup> It is stated that "it is therefore preferable for the law to provide for an arrangement whereby the debtor continues to operate the enterprise on a day-to-day basis, but under the close supervision of an independent, court-appointed administrator": see International Monetary Fund, 'Orderly & Effective Insolvency Procedures', above 175.

<sup>310</sup> For in-depth discussion: see below pp. 348-350.

<sup>311</sup> See below section 4.5.4 (A).

<sup>312</sup> See below section 4.4 (E).

<sup>313</sup> See below pp. 348-350.

<sup>314</sup> See above section 3.4.2.

<sup>315</sup> See above section 2.2.1.

the multiple values<sup>316</sup> and the explicit value theories,<sup>317</sup> highlighted the importance of moratorium. For instance, Jackson views bankruptcy law as a response to a 'common pool problem' which bankruptcy law addresses by replacing a mandatory mechanism of debt collection instead of the individual debt collection scheme that is in place outside the bankruptcy system.<sup>318</sup> However, staying creditors' claims is a prerequisite of any compulsory debt collection scheme.<sup>319</sup> It is worth noting that one of the deficiencies of CVA and scheme of arrangement proceedings in England is lack of a moratorium.<sup>320</sup> In order to overcome this deficiency, companies are encouraged to have recourse to the administration procedure which can be used as a bridge to conclude a CVA or scheme of arrangement. Hence, this thesis argues that it is crucial for any bankruptcy law worldwide to embody such a notion, otherwise the process of rehabilitating the debtor company will be frustrated. As will be shown in the next chapter,<sup>321</sup> under the current bankruptcy regimes in Oman, secured creditors are able to pursue their claims during bankruptcy proceedings which hinders any attempt to rescue the business of the debtor and which results in wasting the assets of the debtor.

Furthermore, it is necessary for any distressed company to have sufficient funding to continue its operation; otherwise liquidating its affairs is inevitable.<sup>322</sup> However, companies in financial crisis are normally short of money, and as a

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<sup>316</sup> See above section 2.6.1

<sup>317</sup> See above section 2.7.1.

<sup>318</sup> Jackson T., above 20, pp. 861-864; see also Baird D., 'World without Bankruptcy', (1987) L.C.P. 173, p. 184.

<sup>319</sup> Ibid.

<sup>320</sup> Weisgard G., Griffiths M. & Doyle L., above 194, p. 13; Keay A. & Walton P., above 47, p. 142.

<sup>321</sup> See below sections 4.4 (D) & 4.8.

<sup>322</sup> Henschel B., above 230, p. 576.

consequence, access to new financing is required.<sup>323</sup> Granting a loan for a distressed firm is a risky business, and as a result, any lender needs to be assured that he/she is sufficiently protected.<sup>324</sup> In this regard, the US Chapter 11 is perceived to be an example of this sort where a new lender is assured by granting him/her a super priority status.<sup>325</sup> Nonetheless, granting a super priority status to the new lender means that the pre-bankruptcy entitlement will be affected. This is, as explained in the previous chapter,<sup>326</sup> against the view of the supporters of the creditors' bargain theory.<sup>327</sup> Even though they accept the ideas of having a compulsory debt collection scheme and imposing a stay on creditors' action, they state that bankruptcy law must respect the pre-bankruptcy ordering of entitlements by translating pre-bankruptcy assets and liabilities into the bankruptcy pool.<sup>328</sup> However, since the supporters of the communitarian and the multiple values theories view bankruptcy law as having a wider goal other than maximising the return of the creditors, altering pre-bankruptcy entitlements is acceptable.<sup>329</sup> This is the case under the US Chapter 11 where a secured creditor is taken over by the new lender. In England, a secured creditor will not be taken over and the new lender is not granted a super priority status, but rather his/her loan is considered as

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<sup>323</sup> Ibid.

<sup>324</sup> McCormack G., above 233, p. 714.

<sup>325</sup> Section 364 of the US Bankruptcy Code.

<sup>326</sup> See above section 2.2.1.

<sup>327</sup> Jackson T., 'Translating Assets and Liabilities to the Bankruptcy Forum', (1985) 14 J.L.S. 73; Baird D. & Jackson T., 'Bargaining After the Fall and the Contours of the Absolute Priority Rule', (1988) 55 U.C.L.R. 738.

<sup>328</sup> Ibid.

<sup>329</sup> See above sections 2.4.1 & 2.7.1.

administrator expenses.<sup>330</sup> It is worth noting that even though in the US a new lender is granted super priority status, pre-bankruptcy creditors are not left unprotected.<sup>331</sup> Hence, this thesis strongly supports the idea that it is necessary for any bankruptcy law to embody within its articles some provisions that regulate access to new financing.<sup>332</sup> However, such access needs to be restricted, otherwise a window for abuse will be opened. While allowing access to new financing, pre-bankruptcy creditors need to be assured that their securities are protected. On the other hand, secured creditors are required not to be greedy, but rather to provide a sense of flexibility to facilitate a rescue process which might have an impact on all creditors, secured and unsecured. Nevertheless, it is of great importance to stress the fact that it is not sufficient to allow access to new funding. Instead there should also be a mechanism in place whereby the rights of secured creditors are not prejudiced. Hence, a balance should be struck and, in this regard, lessons can be learned from the experience of the US where new financing cannot be authorised unless it is proven that a pre-petition secured creditor is adequately protected against loss.<sup>333</sup>

Moreover, cramming-down dissenting creditors or a class of creditors is a feature of both the American and English bankruptcy regimes.<sup>334</sup> However, the status in England differs from that of the US.<sup>335</sup> While in England the court is given total discretion in determining whether dissenting creditors are crammed-down or

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<sup>330</sup> Szekely A., Richardson F. & Gallagher A., above 201, p. 458.

<sup>331</sup> See above section 3.4.3.

<sup>332</sup> For further elaboration of this view: see below pp. 355-357.

<sup>333</sup> Sections 363 (c) (2) & 363 (e) of the US Bankruptcy Code; see Triantis G., above 244, p. 902.

<sup>334</sup> See above section 3.4.4.

<sup>335</sup> Ibid.

not, in the US there are a number of statutory conditions which have to be met before enforcing a reorganisation plan over the wishes of objecting creditors.<sup>336</sup> From the above discussion, it is obvious that without such a mechanism, it is hard to rescue the company since it is impossible to unite all the creditors. As will be discussed in the next chapter,<sup>337</sup> one of the main drawbacks of the current Omani bankruptcy regime is that secured creditors are not allowed to participate in voting unless they relinquish their rights. Also, once the plan is approved by the required majority, secured creditors will not be bound by such a plan and they can pursue their claims. Hence, this thesis maintains that it is important for the Omani legislator to allow secured creditors to participate in voting and to adopt the notion of cramming-down dissenting creditors in order to ease the process of rescuing the business. However, it should be stressed that cramming down dissenting creditors does not mean prejudicing their interests, but rather their interests should be protected. In this regard, this thesis argues that combining the experience of both England and US is advisable. Granting bankruptcy courts discretion in determining their rulings based on the facts of each case, as well as providing the details in bankruptcy law of a number of conditions in which a plan may be approved by the court despite the objection of a particular class of creditors is justifiable.

### **3.6 Conclusion**

This chapter discussed the features of both English insolvency proceedings and American bankruptcy proceedings. It started by highlighting briefly the various available insolvency proceedings in England, namely administration, receivership,

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<sup>336</sup> Ibid.

<sup>337</sup> See below sections 4.6.2.5 & 4.8.3.

CVA and scheme of arrangement under the Insolvency Act 1986, with its 2000 and 2002 amendments, and the Company Act 2006.<sup>338</sup> Also, the main features of the US Chapter 11 were explained.<sup>339</sup> Then, this chapter proceeded by analysing a number of issues to see how such issues are dealt with under both England and the US system.<sup>340</sup> The issues discussed were whether management should be displaced or not during reorganisation processes, what the merits and drawbacks are of such displacement,<sup>341</sup> the notion of staying creditors' actions (moratorium),<sup>342</sup> the issue of post-petition new financing,<sup>343</sup> the voting system and the concept of cram down.<sup>344</sup> From the above discussion, it can be concluded that even though there are some similarities between the two jurisdictions, there are a number of divergences. As stated above,<sup>345</sup> such divergences are due to cultural differences and to the principles underpinning bankruptcy/ insolvency proceedings in each country.<sup>346</sup>

The outcomes of this chapter's discussion will be used in proposing a bankruptcy regime to be adopted by the Omani legislator. In this regard, the Omani legislator should take lessons from the experience of both England and US. Adopting the concept of 'rescue culture' is of great importance in any modern bankruptcy system. However, adopting such a concept without taking into account

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<sup>338</sup> See above section 3.2.

<sup>339</sup> See above section 3.3.

<sup>340</sup> See above section 3.4.

<sup>341</sup> See above section 3.4.1

<sup>342</sup> See above section 3.4.2

<sup>343</sup> See above section 3.4.3

<sup>344</sup> See above section 3.4.4.

<sup>345</sup> See above pp. 139-141.

<sup>346</sup> Goode R., above 10, p. 399.

the above-discussed issues is not enough. Hence, preventing creditors from enforcing their securities during bankruptcy proceedings, injecting new financing in order to ease a rescue process and giving courts the discretion to approve the rescue plan over the wishes of dissenting creditors are some features of a desired insolvency regime.

## Chapter Four: An Overview of the Current Bankruptcy Regime in Oman

### 4.1 Introduction

Whether having a separate bankruptcy/ insolvency law or not, each country has some rules designed to deal with the insolvency of traders.<sup>1</sup> However, the types of bankruptcy procedures available differ from country to country.<sup>2</sup> While some

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<sup>1</sup> Some countries have a separate bankruptcy/ insolvency law to regulate the insolvency and liquidation of traders. Examples of such laws are the US Bankruptcy Act of 1978, the UK Insolvency Act 1986 & the UK Enterprise Act of 2002, French Business Safeguard Act of 2006, German Company Restructuring Facilitation Act of 2012 and Enterprise Insolvency Law of the People's Republic of China of 2007. However, countries, such as Oman, UAE, Egypt and Jordan, do not have a separate bankruptcy law. Rather, their Commercial Codes and Commercial Companies Laws provide a framework for the bankruptcy of traders and liquidation of companies: see, for example, Oman's Commercial Code of 1990 (Articles 579-786), Oman's Commercial Companies Law of 1974 (Articles 14-45), UAE Commercial Transaction Law of 1993 (Articles 645-900), UAE Commercial Companies Law of 1984 (Articles 281-312), Egyptian Commercial Act of 1999 (Articles 550-772 ), Egyptian Joint Stock Companies, Partnerships Limited by Shares & Limited Liability Companies Law of 1998 (Articles 137-154), Jordanian Commercial Act of 1966 (Articles 290-477), Jordanian Companies Law of 1997 (Articles 32-40 & 252-272 & 285).

<sup>2</sup> As stated above (sections 3.2 & 3.3), in England there are five insolvency proceedings and in the US there are two bankruptcy procedures. In Germany there are two insolvency procedures: insolvency proceedings leading to liquidation and insolvency proceedings leading to an insolvency plan. The procedures currently available in France for companies in financial distress are liquidation proceedings, mandate and hoc proceedings, conciliation proceedings, safeguard proceedings and redressement judiciaire; for more description of various insolvency proceedings in these jurisdictions: see O'kane D. & Bawlf P., 'Global Guide to Corporate Bankruptcy: A Comprehensive Guide to Corporate Bankruptcy and a Survey of Global Corporate Bankruptcy Regimes', (Nomura International, July 2010), pp. 45-79, available at:

<http://www.scribd.com/doc/59845050/Bankruptcy-Guide>. accessed on 19/02/2014; in Oman, UAE, Egypt and Jordan there are three types of bankruptcy proceedings: bankruptcy proceedings, liquidation procedures for companies and preventive composition procedures; for discussion of common features of some Arab countries' bankruptcy laws: see Uttamchandani M., 'No Way Out:

countries have limited insolvency proceedings, others have various insolvency proceedings.<sup>3</sup> As discussed in the previous chapter,<sup>4</sup> for instance, in England there are five insolvency proceedings: administration, administrative receivership, CVA, scheme of arrangement and liquidation proceedings, whereas in the US there are two bankruptcy proceedings, Chapter 11 reorganisation and Chapter 7 liquidation. However, as shown in the previous chapter,<sup>5</sup> the features of each of these proceedings differ from the others. For instance, whereas under the US Chapter 11 directors retain their position,<sup>6</sup> they are displaced during administration procedures in England.<sup>7</sup> Also, whereas the purpose of the receivership proceeding in England is to protect the interests of a floating charge holder by appointing a receiver,<sup>8</sup> the purpose of both the administration regime<sup>9</sup> and the US Chapter 11<sup>10</sup> are, generally

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The Lack of Efficient Insolvency Regimes in the MENA Region', (March 2011), Policy Research Working Paper 5609, the World Bank, available at:

<http://elibrary.worldbank.org/doi/book/10.1596/1813-9450-5609>. accessed on 19/02/2014; Also, McNally R., 'Insolvency Regimes in the MENA Region', available at:

[http://www.menacitylawyers.com/uploaded/publication\\_5feb3dd1-39ef-47bc-ad7d-4716d880dce5\\_.pdf](http://www.menacitylawyers.com/uploaded/publication_5feb3dd1-39ef-47bc-ad7d-4716d880dce5_.pdf). accessed on 19/02/2014.

<sup>3</sup> Ibid.

<sup>4</sup> See above section 3.2 & 3.3.

<sup>5</sup> See above section 3.4.

<sup>6</sup> See above section 3.4.1.2.

<sup>7</sup> See above section 3.4.1.1.

<sup>8</sup> Insolvency Act 1986, section 230 (2); Goode R., *Principles of Corporate Insolvency Law*, (4<sup>th</sup> edition, Sweet & Maxwell, 2011), p. 320; see above section 3.2.2.

<sup>9</sup> Keay A. & Walton P., *Insolvency Law: Corporate and Personal*, (Longman, 2003), p. 92; Goode R., above 8, p. 394; Okoli P., 'Rescue Culture in the United Kingdom: Realities and the Need for a Delicate Balancing Act', (2012) 23 (2) I.C.C.L.R. 61-65, p. 62.

<sup>10</sup> Dahl H., 'USA: Bankruptcy under Chapter 11', (1992) 5 I.B.L.J. 555, p. 555; McCormack G., 'Control and Corporate Rescue: An Anglo- American Evaluation', (2007) 56 (3) I.C.L.Q. 505, p. 517; Coleman M. & Kirschner M., 'The Case in Favour of the US Chapter 11 Reorganisation System: Debunking the Myths and Mischaracterisations', (1993) 4 I.C.C.L.R. 363, p. 363.

speaking, to rehabilitate the business of the company in order to protect the interest of all creditors.

At present, Oman does not have a separate bankruptcy law and in dealing with the bankruptcy of traders<sup>11</sup> both the Omani Commercial Code of 1990 and Omani Commercial Companies Law of 1974 incorporate some articles.<sup>12</sup> Even though these laws regulate the bankruptcy of companies, the more modern corporate restructuring or reorganisation regimes which appear, for example, in the bankruptcy/ insolvency laws of England and US are not alternatives under current Omani Law.<sup>13</sup> As will be shown below,<sup>14</sup> although the composition (arrangement) scheme with creditors is one of the alternatives available under Omani law, a number of factors lead to its inefficiency.<sup>15</sup> As stated in the previous chapter,<sup>16</sup> in judging the efficiency of any bankruptcy regime, a number of criteria should be taken into account. The ease and speed of the proceedings, staying creditors' actions, the availability of new financing and adopting the notion of cram-down are all examples of such factors.<sup>17</sup> As will be discussed below,<sup>18</sup> most of these criteria are lacking under the current Omani bankruptcy regime.

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<sup>11</sup> Refers to individual merchants and companies: see Article 16 of the Omani Commercial Code of 1990.

<sup>12</sup> Articles 579-786 of the Commercial Code & Articles 14-45 of the Commercial Companies Law.

<sup>13</sup> See below section 4.3.

<sup>14</sup> See below section 4.5.2.2.

<sup>15</sup> See below section 4.6.2 & section 4.8.3.

<sup>16</sup> See above section 3.4.

<sup>17</sup> Tolmie F., *Corporate and Personal Insolvency Law*, (2<sup>nd</sup> edition, Cavendish Publishing Limited, 2003), p. 64.

<sup>18</sup> See below section 4.6.2. & section 4.8.3.

The aim of this chapter is to assess the efficiency of Oman's bankruptcy system by identifying the reasons for its inadequacy in order to offer a particular proposal for future bankruptcy reform. However, this chapter will start by outlining Oman's current statutory framework for bankruptcy, then highlighting the bankruptcy regimes available for distressed traders; namely, bankruptcy proceedings, composition with creditors' scheme, liquidation proceedings. The aim of this chapter is also to explore whether or not the composition with creditors' scheme provides incentives for both debtor and creditor to opt for this particular regime.<sup>19</sup> It is worth noting that in illustrating the strengths and weaknesses of Oman's bankruptcy regime, reference will be made to the experience of both England and the US as discussed in the previous chapter.

## **4.2 Statutory Framework for Bankruptcy**

As discussed in the first chapter,<sup>20</sup> at present, Oman does not have a separate bankruptcy law. However, the Commercial Code of 1990 contains one chapter on the bankruptcy of traders and the Commercial Companies Law of 1974 governs companies' liquidation procedures. Although the Omani Commercial Code has a detailed chapter on the bankruptcy of traders, a number of crucial issues are not regulated, which renders it incomplete.<sup>21</sup>

Further, although Oman is an Islamic country, Sharia law applies only in the absence of specific legislative provisions and of local or general bankruptcy

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<sup>19</sup> See below section 4.8.3.

<sup>20</sup> See above pp. 5-6.

<sup>21</sup> See below sections 4.3 & 4.4.

customs.<sup>22</sup> However, it is worth mentioning that before the issuance of the Commercial Law of 1990, reliance was on the principles of Sharia Law.<sup>23</sup> Thus, bankruptcy declaration of trader was based on the concepts of Sharia.<sup>24</sup> Under Sharia rules, once the debtor ceases paying his debts, he is normally given respite as recommended by the Holy Quran: ‘If the debtor is in difficulty grant him a time till it is easy for him to repay’.<sup>25</sup> Nonetheless, if the debtor refuses to pay, despite his solvency, the judge may order to put him in jail until he changes his attitude and the judge may order the sale of the debtor’s properties to the extent of the debts which have already fallen due.<sup>26</sup>

However, it is important to note that bankruptcy provisions in the Commercial Code may not apply to companies that are incorporated or shared by the government or other public bodies and institutions,<sup>27</sup> even though they engaged in commercial activities.<sup>28</sup> Article 19 of the Commercial Code states that “companies incorporated or shared by the government or other public bodies and institutions and which are essentially engaged in commercial activity are, apart from

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<sup>22</sup> Article 5 “If no legislative provisions exist, the rules of custom shall apply and local custom take precedence over general custom. In the absence of custom, the provisions of the noble Islamic Sharia shall apply and thereafter the rules of justice”: *ibid*.

<sup>23</sup> Nabil S., *The General Principles of Saudi Arabian and Oman Company Laws: Statutes and Sharia*, (Namara Publications, 1981), p. 108.

<sup>24</sup> *Ibid*.

<sup>25</sup> The Holy Quran: 2:280; AL-Salimi A., *Jawhar AL-Nizam*, (Qatar House Publisher, 2002), p. 399.

<sup>26</sup> AL-Salimi A., above 25, p. 399; Nabil S., above 23, p. 110.

<sup>27</sup> Article 19 of the CC.

<sup>28</sup> Also, this was the case in Egypt where public companies are excluded. However, after the issuance of Egyptian Public Companies Law in 1991 such exclusion was abolished: see Darmaki S., *Bankruptcy Procedures under Commercial Code in Oman*, (Sultan Qaboos University Press, 2013), pp. 3-5.

bankruptcy, governed by the provisions related to a trader under this Act". It is argued that the reason for such exclusion is that the bankruptcy of these companies would diminish the esteem of the public authority.<sup>29</sup> In addition, it is claimed that usually the reason for setting up government companies is not to gain profits, but rather the implementation of national development plans might lead to the establishment of such companies.<sup>30</sup> For instance, in partnership with private sectors, the involvement of the public sector in Oman is mainly in infrastructure projects, such as communications, power, transportation and water supply.<sup>31</sup> Hence, even though these companies carry out commercial activities, they are excluded from bankruptcy provisions contained in the Commercial Code since the government has shares in these companies. However, in this regard, this thesis argues that excluding such companies from bankruptcy may harm the interests of secured and unsecured creditors. In this case, creditors are unable to initiate bankruptcy proceedings if these companies do not pay their due commercial debts. This means that these companies will pursue their business, even though the financial affairs of these companies are so disturbed as to lead to a suspension of payments. Thus, it is crucial to regulate the bankruptcy of such companies or at least to establish some rules whereby these companies, subject to viability, can be reconstructed or reorganised in the event of financial distress.

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<sup>29</sup> Ibid, p. 5.

<sup>30</sup> Ali J., 'The Legal Concepts of Public Companies', (1963) E.J.P.S. 90, p. 91.

<sup>31</sup> See, *Oman Investment and Business Guide: Strategic and Practical Information*, published by (Ibpus.com, International Business Publication, USA, 2012), p. 108.

### 4.3 Available Bankruptcy Proceedings

In Oman, the formal available bankruptcy procedures for traders under financial distress are bankruptcy proceedings,<sup>32</sup> preventive composition with creditors<sup>33</sup> and liquidation procedures<sup>34</sup> which are designed merely for companies. Unless a debtor is able to propose a composition or scheme acceptable to its creditors, the debtor will be declared bankrupt and, as a result, the debtor company will be liquidated.

The aims of these bankruptcy proceedings differ. While the objective of the liquidation proceedings is the dissolution of the company, the ultimate objective of the bankruptcy proceedings is to release the bankrupt from his debts and liabilities so that the trader can begin a new business with a 'clean slate', free from the burden of the debts.<sup>35</sup> However, such a release normally begins after five years have elapsed from the day of the bankruptcy declaration or earlier if it is proven that the debtor has paid his debts.<sup>36</sup> On the other hand, the main aim of the scheme of arrangement, as it stands today, is to allow the trader to escape the consequences of an adjudication of its bankruptcy.<sup>37</sup> As will be shown below, the scheme of arrangement is far from the concept of rescue culture since the main aim of this regime is not to rescue the business of the company.<sup>38</sup> Instead, its aim is to give the trader the opportunity to escape the consequences of being bankrupt.

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<sup>32</sup> Articles 579-752 of the CC.

<sup>33</sup> Ibid, Articles 753-783.

<sup>34</sup> Articles 14-27 of the Commercial Companies Law 1974.

<sup>35</sup> For the aim of bankruptcy procedures under Omani Law see: Al-Hinai S., 'Preventive Composition Scheme', (Master Degree Dissertation, Sultan Qaboos University, 2010), pp. 7-11.

<sup>36</sup> Article 752 of the CC.

<sup>37</sup> See Al-Hinai S., above 35, pp. 13-16; Article 753 of the CC.

<sup>38</sup> See below section 4.5.3.

#### **4.4 General Features of the Current Bankruptcy Regime**

This thesis believes that before embarking on the assessment of bankruptcy procedures in Oman, it is important to highlight the main characteristics of the current Omani bankruptcy regime. Thus, the aim of this section is to explore a number of features under the current bankruptcy system in Oman. First, an identification of the bankruptcy test that is currently recognised by the Commercial Code will be dealt with. Then, the position of the bankrupt trader upon the bankruptcy declaration will be examined. Also, the issues of creditors' ranking and staying creditors' claims will be explored. In addition, this section will demonstrate that one of the main issues of the current bankruptcy regime in Oman is that officers administering bankruptcy processes are not required to be qualified bankruptcy practitioners. Finally, the treatment of small bankruptcies and the position of employees will be analysed.

##### **A- Definition of Bankruptcy**

The Commercial Code does not have an explicit definition of the word bankruptcy. However, the circumstances in which a trader might be regarded as a bankrupt are stated. Article 579 of the Commercial Code states that any merchant whose financial affairs are in difficulty and who ceases to pay due debts might be bankrupt. In this regard, it should be pointed out that the nature of the debt that the trader fails to pay must be a commercial debt.<sup>39</sup>

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<sup>39</sup> Article 579 of the CC; see 'A Set of the Supreme Court Judgments in Oman: 1999', Commercial Department, case number 44/99.

In some jurisdictions,<sup>40</sup> the notion of ‘inability to pay debt’ is examined by making reference to two principles tests of bankruptcy.<sup>41</sup> For instance, in England, the cash flow and balance sheet of insolvency are tests of inability to pay debts.<sup>42</sup> “A company is insolvent if it is unable to pay its debts as they fall due (‘cash flow’ insolvency); it is also insolvent if its liabilities exceed its assets (‘balance sheet’ insolvency).”<sup>43</sup> Both cash flow and balance sheet tests are clearly stated in Section 123 (definition of inability to pay debts) of the Insolvency Act 1986 where it is stated that:

- (1) A company is deemed unable to pay its debts... (e) if it is proved to the satisfaction of the court that the company is unable to pay its debts as they fall due.
- (2) A company is also deemed unable to pay its debts if it is proved to the satisfaction of the court that the value of the company’s assets is less than the amount of its liabilities, taking into account its contingent and prospective liabilities.

In Oman, it is unclear what sort of tests are relied on, since both the Commercial Code and the Commercial Companies Law are silent in explaining what is meant by the ‘inability to pay debt’.<sup>44</sup> Even though cessation of payment is

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<sup>40</sup> For Example, section 123 (1) (e) & 2 of the Insolvency Act 1986; Germany (Section 17 of the Insolvency Act 1999 ‘*Insolvenzordnung*’); the UK (section 123 of the Insolvency Act 1986).

<sup>41</sup> Day W., ‘Taking Balance-Sheet Insolvency Beyond the Point of No Return’, (2013) 72 (3) C.L.J. 515; Nyombi C., ‘Employees’ Rights during Insolvency’, (2013) I.J.L.M. 417, p. 418; Henderson D., ‘Inability to Pay Debts: Where Are We Now’, (2011) 24 (4) I.I. 54, pp. 54-55.

<sup>42</sup> Birds J. & Boyle A., *Boyle & Birds’ Company Law*, (Bristol, Jordans, 2004), p. 687;

<sup>43</sup> *Ibid.*

<sup>44</sup> See Al-Hinai S., above 35, p. 122.

used as a crucial element in determining the state of bankruptcy, the Commercial Code does not include an objective definition of the word cessation.<sup>45</sup> Thus, this thesis argues that this 'inability to pay due debts' test is ambiguous and gives rise to a number of crucial questions. First, is a single default of payment of a due commercial debt to a single creditor sufficient to provoke the bankruptcy of the debtor 'cash flow test' or is an assessment of the debtor's assets required for the 'balance sheet test'? Second, in the absence of such a specific definition, what factors should be taken into account by the court in determining the cessation of payment? In Oman, in one of its judgments the high court stated that "regardless of the amount of unpaid debt, the court has the right to declare the bankruptcy of any trader even though he ceases to pay a single commercial debt".<sup>46</sup> Similarly, in 2008 a Dubai Supreme Court ruled that a single unpaid commercial debt is enough to provoke the insolvency of a company.<sup>47</sup> Nonetheless, this thesis is of the opinion that the main deficiencies of these rulings are that they do not make a distinction between an honest and dishonest trader. Also, these rulings might create uncertainty in commercial life. Sometimes the company experiences a temporary financial difficulty that causes the cessation of payment. Thus, provoking the bankruptcy of the trader due to a single unpaid commercial debt without taking into account the temporary nature of the crisis could lead to uncertainty. As a result, viable businesses might be declared bankrupt due to the non-payment of a single

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<sup>45</sup> This is the case also in the UAE: see, 'Legal and Practical Issues for Restructuring and Insolvency in the UAE', Q.J.INSOL.I, (1<sup>st</sup> Quarter 2010).

<sup>46</sup> 'A Set of the Supreme Court Judgments in Oman: 1992', Commercial Department, case number 14/92.

<sup>47</sup> See Boustany M., 'UAE Insolvency Law Exists', (2010) 180 the In-House Lawyer 63, p. 63.

transaction. Further, these kinds of judgments would open the door for many bankruptcy applications to be filed and this, as a result, would over-load the courts.

Further, the Commercial Code states that “the company may be declared bankrupt even if it does not cease payment of its commercial debts”.<sup>48</sup> Thus, if the court senses instability in the business of the company, it has the discretion to declare the company bankrupt. However, a state of bankruptcy exists only on a court judgment declaring the bankruptcy of the trader, and failure to pay debts before the issue of such decision shall have no legal effect on the trader unless the law provides otherwise.<sup>49</sup>

It should be noted that the onus of proving the debtor’s failure to pay a due commercial debt lies on the creditor who submits a bankruptcy application.<sup>50</sup> Article 582 of the Commercial Code states that “any creditor may apply for his trading debtor to be declared bankrupt if the debtor fails to pay a due commercial debt... provided that the creditor proves that the debtor has failed to pay a due commercial debt”. Nonetheless, it is not easy to prove such a failure, unless the creditor has knowledge of the debtor’s overall financial situation. In this regard, it can be asserted that such a requirement has the effect of closing the door on any aggressive creditor who submits a bankruptcy application of his debtor without having clear evidence. However, the court has full discretion in determining whether the state of bankruptcy of the trader is declared or not. In affirming this

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<sup>48</sup> Article 682 of the CC.

<sup>49</sup> Ibid, Article 580.

<sup>50</sup> Ibid, Article 582.

discretion, the court<sup>51</sup> has stated that even though the trader fails to pay a due commercial debt to the appealing bank, the court has freedom of choice in determining the state of bankruptcy. The facts of each case play a central role in guiding the court to the appropriate decision.<sup>52</sup> In this regard, this thesis argues that giving the court such discretion is important since it is not satisfactory to declare the bankruptcy of an honest trader who fails to pay a single cheque.

### **B- Handcuffing of the Debtor in Bankruptcy**

Oman's bankruptcy system puts pressure on debtors to prevent them from harming the rights of their creditors.<sup>53</sup> The handcuffing of a bankrupt is immediately effective from the day in which the judgment of declaration of bankruptcy is issued.<sup>54</sup> In this regard, the debtor may not leave Oman until court permission is sought and the court is given the power to place him under supervision and bar him from leaving Oman.<sup>55</sup> However, courts in Oman are not allowed to seize the bankrupt debtor.<sup>56</sup> This is a departure from Sharia principles where the Sharia judge is given the right to send the debtor to prison if certain conditions have been met.<sup>57</sup>

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<sup>51</sup> 'A Set of the Supreme Court Judgments in Oman: 1997', Commercial Department, case number 173/97.

<sup>52</sup> Ibid.

<sup>53</sup> Darmaki S., above 28, p. 93.

<sup>54</sup> Article 604 of the CC.

<sup>55</sup> Ibid, Article 603.

<sup>56</sup> This is the case also under Bahraini and Kuwaiti law. However, this is in contrast to the case in Egypt, UAE and Jordan where the court has the right to seize the bankrupt: see Ghanayem H., 'Handcuffing of a Bankrupt', (1993) 7 J.S.L. 375.

<sup>57</sup> Ibid.

Moreover, the Commercial Code imposes upon the bankrupt various civil disabilities<sup>58</sup> including prohibition, for not less than a year, from becoming a director or a member of the management board of any company. Also, the bankrupt is forbidden from applying for a public job or position; however, seeking a private job is allowed.<sup>59</sup> It is worth noting that, unlike the case in Egypt<sup>60</sup> and UAE,<sup>61</sup> in Oman the bankrupt is not deprived from practising his/her political rights.<sup>62</sup> Thus, he/she can vote and elect him/herself in the consultancy councils and municipal councils.<sup>63</sup> The bankrupt is also banned from administering, litigating or disposing of property and assigning it to a trustee (administrator of bankruptcy).<sup>64</sup>

This thesis takes the view that the rationale for this restriction is that the debtor is considered as a wrongdoer who deserves to be punished. The debtor is not viewed as an economic actor that might be affected by any financial crisis. Whether the failure of the debtor's business is attributed to external or internal factors, deliberately or unintentionally, the above-mentioned restrictions will take place.

The bankrupt, except in cases of fraudulent or negligent bankruptcy, will retain the freedom to practise the above-mentioned restrictions after five years have elapsed from the termination of the bankruptcy.<sup>65</sup> Furthermore, according to Article

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<sup>58</sup> Article 602 of the CC.

<sup>59</sup> Ibid.

<sup>60</sup> Article 588 of the Egyptian Commercial Code of 1999.

<sup>61</sup> Article 683 of the UAE Commercial Transaction Law of 1993.

<sup>62</sup> Article 602 of the CC.

<sup>63</sup> Darmaki S., above 28, p. 94.

<sup>64</sup> Article 604 of the CC.

<sup>65</sup> Ibid, Article 752.

743 of the Commercial Code, the bankrupt may retain his rights before the elapse of this period if one of the following circumstances applies: (i) where the bankrupt secures a composition with the creditors and implements the conditions thereof. Such provision also applies to a general liability partner in a company that is declared bankrupt where the said partner obtains composition with the company's creditors and implements the conditions thereof; and (ii) where the debtor proves that the creditors have fully released him/ her from all debts.<sup>66</sup>

### **C- Ranking of Creditors**

The notion of 'absolute priority'- whereby secured creditors are paid first, followed by general creditors and then shareholders if any residuals remain- is not preserved in the current Oman's bankruptcy regime. In distributing the assets of a bankrupt company, all expenses of the trustee or liquidator, including remuneration, must be paid from the assets of the bankrupt company before any distribution is made to creditors.<sup>67</sup> Then, according to the Law on Recovery of Government Debts of 1994, any debt owed to the government, even if it is not secured and arises late, has top priority and must be paid before the secured creditors are compensated.<sup>68</sup> Also, employees' salaries or wages enjoy a priority and have to be settled before paying the debt of secured creditors.<sup>69</sup> Article 628 of the CC states that:

*“Having asked permission from the judge in bankruptcy, the receiver is, within the ten days following issue of the adjudication of bankruptcy, to pay out of such*

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<sup>66</sup> Ibid, Article 743.

<sup>67</sup> Ibid, Article 678 and article 734; Article 24 of the Commercial Companies Law 1974.

<sup>68</sup> Article 3 of Recovery of Government Debts Act 1994.

<sup>69</sup> Article 628 of the CC.

*monies available to him and irrespective of there being any other debt the wages and salaries for fifteen days for workers, thirty days for staff and servants, and ninety days for seamen due prior to the issue of the adjudication of bankruptcy... if the receiver does not hold the necessary monies therefore, payment must be made from the first monies incoming, even if there are other debts that have precedence since they amount to a lien.”*

As discussed in the previous chapter,<sup>70</sup> in the US in order to facilitate the continuing operation of the business, the court is given discretion to sanction post-petition debt financing, usually with super priority status over existing claims.<sup>71</sup> However, this kind of discretion is not given to courts in Oman. The judges are not allowed to grant a super priority status to any lender after the commencement of bankruptcy proceedings. Pre-bankruptcy secured creditors will have precedence over any creditors, except the debt owed to the government and the salaries or wages of employees. Hence, as will be discussed further,<sup>72</sup> this thesis argues that pre-bankruptcy rights of secured creditors are not well protected in Oman since priority is given to government debts<sup>73</sup> and to employees' and servants' salaries/wages.<sup>74</sup>

#### **D- Stay on Creditors' Claims (Moratorium)**

Easing the process of rescuing/ liquidating the assets of the company requires a legal mechanism whereby secured and unsecured creditors are prevented from commencing or continuing legal claims against the company and secured creditors

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<sup>70</sup> See above section 3.4.3.

<sup>71</sup> Henoeh B., 'Post-Petition Financing: Is There Life After Debt?', (1991) 8 B.D.J. 575, p. 577.

<sup>72</sup> See below section 5.5.2.2.

<sup>73</sup> Article 3 of Recovery of Government Debts Act 1994.

<sup>74</sup> Article 628 of the CC; Article 54 of Omani Labour Law of 2003.

are prevented from seizing assets of the company and enforcing their rights for a limited period of time.<sup>75</sup> Therefore, in order to protect the assets of the company and to facilitate insolvency proceedings, both England and the US insolvency laws impose a stay on creditors' claims.<sup>76</sup>

In Oman, upon the issuance of an adjudication of bankruptcy, actions brought by ordinary creditors are stayed and these creditors may not take individual enforcement proceedings against the assets of the bankrupt, nor may they finalise proceedings begun before the issuance of the adjudication of bankruptcy.<sup>77</sup> However, secured creditors may bring and continue actions against the bankrupt company and may enforce or continue the enforcement against the assets that guarantees their rights.<sup>78</sup>

In addition, if the company wishes to avoid the consequences of the adjudication of bankruptcy, it is able to negotiate a composition or settlement with its creditors.<sup>79</sup> In this case and upon the court issuing a decision to commence composition procedures, all bankruptcy proceedings, other claims and enforcement actions relating to the trader are automatically stayed.<sup>80</sup> However, before the issuance of such a decision, the court may make protective orders in order to

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<sup>75</sup> Jackson T., 'Bankruptcy, Non-Bankruptcy Entitlement, and the Creditors' Bargain', (1982) 91 Y.L.J. 857, p. 862; Goode R., above 8, pp. 64-65.

<sup>76</sup> See above section 3.4.2.

<sup>77</sup> Article 620 of the CC.

<sup>78</sup> Ibid.

<sup>79</sup> However, this is subject to a number of conditions that must be met: see below section 4.5.2.2.1.

<sup>80</sup> Article 776 of the CC.

preserve the trader's assets until the application for settlement is determined.<sup>81</sup>

This is similar to the interim moratorium that is found in England.<sup>82</sup>

### **E- Persons Administering Bankruptcy**

Finch stated that “corporate insolvency processes are not mere bodies of rules: they are elaborate procedures in which legal and administrative, formal and informal rules, policies and practices are put into effect by different actors”.<sup>83</sup> Thus, it is important that those players should have cultural, institutional, disciplinary and professional backgrounds which influence their work.<sup>84</sup> In England, for instance, insolvency practitioners are required to have a professional qualification from a recognised professional body, the Secretary of State or a competent authority designated by the Secretary of State.<sup>85</sup> In the US, ‘The United States Trustee Program’,<sup>86</sup> established in 1979, consists of 21 trustee regions covering almost all of the United States. It is a competent division within the Department of Justice responsible for overseeing the administration of bankruptcy cases and private trustees, as well as appointing bankruptcy professionals (lawyers, trustees) and investigating bankruptcy fraud.<sup>87</sup>

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<sup>81</sup> Ibid, Article 762.

<sup>82</sup> Sch. B1 para. 44 of the Insolvency Act 1986; see Goode R., above 8, pp. 424 & 425; Keay A. & Walton P., above 9, pp. 107-108.

<sup>83</sup> Finch V., *Corporate Insolvency Law: Perspectives and Principles*, (2<sup>nd</sup> edition, Cambridge University Press, 2009), p. 178.

<sup>84</sup> Ibid.

<sup>85</sup> Insolvency Practitioners (Recognised Professional Bodies) Order 1986/1764; see, Goode R., above 8, p. 67.

<sup>86</sup> For further details see: [www.justice.gov/ust](http://www.justice.gov/ust).

<sup>87</sup> Ibid.

In Oman, the Commercial Code creates three types of bankruptcy officials who are authorised to control bankruptcy proceedings.<sup>88</sup> These officials are the 'bankruptcy judge', the 'trustee/ trustees' and the 'supervisor/ supervisors' appointed by the court from amongst creditors. A 'bankruptcy judge' is a court appointed official who is empowered to oversee the whole bankruptcy process and make all the necessary arrangements for its completion.<sup>89</sup> During bankruptcy processes, the bankruptcy judge appoints one or more trustees, provided that their number does not exceed three.<sup>90</sup> The roles of the trustee, called liquidator of a company in the case of liquidation,<sup>91</sup> are to administer, safeguard, realise and distribute the assets of the bankrupt.<sup>92</sup> In order to ensure the neutrality of the trustee, it is stated that neither the spouse of the bankrupt nor relative or relative by marriage to the fourth generation may be appointed as a trustee.<sup>93</sup> Also, the trustee must not be a person who was a partner, employee, accountant or agent of the bankrupt during the three years preceding the adjudication of bankruptcy.<sup>94</sup> In addition, the powers vested in the supervisors include inspecting the balance sheet and report submitted by the trustee and assisting the adjudicator in supervising the work of the bankruptcy trustee.<sup>95</sup> Further, it is worth noting that the bankruptcy adjudicator may at his own discretion, or at the request of the bankrupt or the

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<sup>88</sup> Articles 645-654 of the CC.

<sup>89</sup> Ibid, Article 653.

<sup>90</sup> Ibid, Article 645.

<sup>91</sup> It is worth noting that even though the word 'trader' under the Commercial Code includes a sole merchant and a corporate, the procedures of winding up and liquidation apply only to companies.

<sup>92</sup> Articles 648-649 of the CC.

<sup>93</sup> Ibid, Article 645.

<sup>94</sup> Ibid, Article 645.

<sup>95</sup> Ibid, Article 651.

supervisor, order the dismissal or replacement of the trustee or a reduction in the number of trustees.<sup>96</sup> In addition, the public prosecutor may also have a role in bankruptcy proceedings if any element of fraud is detected.<sup>97</sup>

Hence, under the current Omani bankruptcy regime, a number of bankruptcy officials play a central role in any bankruptcy case, starting with the judges who administer the whole bankruptcy law and ending with trustees who realise and distribute the assets of the bankrupt. These tasks which are performed by bankruptcy officials require expertise, skill and sufficient knowledge of various bankruptcy issues. However, one of the main issues with the current bankruptcy regime in Oman is that judges revolve between different courts, dealing with different subject matters and there are no specialised bankruptcy judges who deal only with bankruptcy cases. In addition, Oman does not have in place a regulation for bankruptcy trustees/ administrators nor there is a program whereby sufficient training for a number of professionals is provided. As a result, the trustee is not required to have a particular qualification nor he is required to obtain specific training.

#### **F- The Treatment of Small Bankruptcies**

In order to ease the bankruptcy process, the Commercial Code provides special treatment to small bankruptcy cases.<sup>98</sup> Small bankruptcies are defined by Article 679 as bankruptcies where, after taking the inventory, the value of the bankrupt's assets is less than ten thousand Omani Rials (approx. £15,800). In such cases, the

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<sup>96</sup> Ibid, Article 646

<sup>97</sup> Ibid, Articles 597-601.

<sup>98</sup> Ibid, Articles 679 & 680.

court may, at its own discretion or at the request of the trustee or a creditor, reduce the period of bankruptcy proceedings as it deems fit.<sup>99</sup> Thus, the Commercial Code does not provide a specific time limit to finalise bankruptcy processes of small bankruptcy cases and full discretion is given to the court to determine the time based on the circumstances of each case.

It is worth noting that the above-mentioned treatment applies to all traders, whether a sole merchant, or a small, medium or large company<sup>100</sup>, as long as the value of the assets is less than the amount stipulated. Also, even if the value of the bankrupt's assets is less than ten thousand Omani Rials, the court may decide that this special treatment will not be given.<sup>101</sup> Thus, applying the normal procedures to small bankruptcy cases is one of the options that the court may use. This can be considered to be one of the issues with the current bankruptcy regime in Oman. Having in place detailed procedures to regulate these kinds of small bankruptcies is desirable.

### **G- The Position of the Employees**

As discussed in the previous chapter,<sup>102</sup> both in England and the US insolvency regimes promote the concept of rescue culture. The aim of such a concept is to reorganise the distressed company instead of liquidating its affairs.<sup>103</sup> Reorganising the business of the distressed company would have the effect of maximising the

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<sup>99</sup> Ibid, Article 680.

<sup>100</sup> Although it is hard to believe that the asset's value of medium or large companies is less than this amount.

<sup>101</sup> Article 679 of the CC.

<sup>102</sup> See above sections 3.2 & 3.3.

<sup>103</sup> Hunter M., 'The Nature and Function of A Rescue Culture', (1999) J.B.L. 491, p. 500.

welfare of all creditors.<sup>104</sup> Saving the jobs of the company's employees is one of the main benefits of rescue culture.<sup>105</sup> However, if rescuing the company's business is not economically viable, then liquidating its affairs is inevitable. Following bankruptcy, the employees are normally given special protection in regard to some of their entitlements.<sup>106</sup> They are given priority over the secured and unsecured creditors. However, the amount that employees are able to claim as priority is limited and differs from one jurisdiction to another.<sup>107</sup> For instance, in England, employees' entitlements have preference and are ranked ahead of floating charge claims and general unsecured creditors.<sup>108</sup> By statute they have a preference for four months of unpaid wages (up to a prescribed maximum limit per

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<sup>104</sup> In this regard, an empirical study conducted by Frisby demonstrated that post-Enterprise Act administrations deliver more returns to secured creditors than pre-Enterprise Act administrations: see Frisby S., 'Interim Report to the Insolvency Service on Returns to Creditors from Pre-and-Post Enterprise Act Insolvency Procedures', p. 14, Baker & Mckenzie Lecturers in Company and Commercial Law, (24 July 2007), available at:

<http://webarchive.nationalarchives.gov.uk/+http://www.insolvency.gov.uk/insolvencyprofessionandlegislation/research/returntocreditors.pdf>. accessed on 29/03/2014; however, Goode stated that "the general experience has been that the Enterprise Act 2002 has had little effect in restoring insolvent businesses to profitable trading. The most common outcome of insolvency proceedings, of whatever kind, is cessation or disposal of the company's business and the winding up of the company": Goode R., above 8, p. 60.

<sup>105</sup> McCormack G., above 10, p. 517; Coleman M. & Kirschner M., above 10, p. 363.

<sup>106</sup> Finch V., above 83, pp. 604-606; Cleig B., 'Unpaid Wages in Bankruptcy', (1987) 21 U.B.C.L.R. 61; Cantlie S., 'Preferred Priority in Bankruptcy', in Ziegel J., *Current Developments in International Corporate Insolvency Law*, (Oxford, Clarendon Press, 1994), p. 392.

<sup>107</sup> Ibid; O'kane D. & Bawlf P., above 2, pp. 45-79; see Johnson G., 'Insolvency and Social Protection: Employee Entitlements in the Event of Employers Insolvency', Forum for Asian Insolvency Reform which was held on 27-28 April 2006 in Beijing, China, available at:

<http://www.oecd.org/daf/ca/corporategovernanceprinciples/38184691.pdf>. accessed on 20/01/2014.

<sup>108</sup> O'kane D. & Bawlf P., above 2, p. 63

employee of £800),<sup>109</sup> and accrued holiday entitlements; unpaid pension contributions from the employer to a maximum of twelve months to state and occupational pension schemes; and unpaid levies on coal and steel production.<sup>110</sup> In the US, each employee is entitled to a maximum of US \$4,650 in priority ranking and only entitlements which accrued in the 90 days prior to the filing of the bankruptcy petition are claimable with priority.<sup>111</sup> However, Chapter 11 contains no protection of existing terms and conditions of employment contracts during business transfers while the law in England provides protection in this regard.<sup>112</sup> In England, employment contracts are transferred as part of a business transfer with existing employment rights remaining good against the transferor.<sup>113</sup>

In Oman, as in England and the US, in the event of an employer's bankruptcy employees are given some kind of preferential protection. First of all, preference is given to the unpaid salaries and wages due for fifteen days for workers, thirty days for staff and servants and ninety days for seamen prior to the issue of the adjudication of bankruptcy.<sup>114</sup> Oman's Labour law also affirms such a preference by stating that the wages of the worker shall have priority over all debts owed by the employer except alimony<sup>115</sup> which is adjudicated by Sharia Court.<sup>116</sup> Unlike the case in England and the US, in Oman there is no limit set for the amount to be

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<sup>109</sup> Section 386 of the UK Insolvency Act 1986 & Category 5 of Sch. 6.

<sup>110</sup> Further details: see Finch V., above 83, pp. 604-606 & pp. 756-759.

<sup>111</sup> See Johnson G., above 107.

<sup>112</sup> McCormack G., 'Apples and Oranges? Corporate Rescue and Functional Convergence in the US and UK', (2009) 18 I.I.R. 109.

<sup>113</sup> Ibid; Nyombi C., above 41, p. 420.

<sup>114</sup> Article 628 of the CC.

<sup>115</sup> A financial support to the family of the bankrupt.

<sup>116</sup> Article 54 of the Labour Law. In this case, Article 47 of the Personal Affairs Law of 1997 clearly states that "the amount of alimony has preference over all debts".

paid. However, the restriction, as stated in the Commercial Code, is on the period in which this preferential treatment applies.<sup>117</sup> Redundancy payments and accrued holiday entitlements are afforded no priority at all and, as a result, they are considered as unsecured debts. Further, according to Article 70 of the Social Insurance Law of 1991 unpaid pension contributions from the employer have preference over all debts owned by the employee and must be paid after government debts and judicial expenses have been paid.

It seems that various laws have granted priority status to a certain claimant. For example, Oman's Labour Law of 2003 grants workers' wages priority over government debts while Recovery of Government Debts of 1994 states that debt owned by the government, despite the fact that it is not secured and arose later, will have top priority and must be paid before secured creditors are compensated. Also, while the Social Insurance Law of 1991 grants preference, after paying government debts and judicial expenses, to unpaid pension contributions, the Personal Affairs Law of 1997 gives alimony top priority over all debts. In this case, and in determining the priority of each debt, the reliance is on courts. An interview with a High Court Judge<sup>118</sup> reveals the fact that courts normally grant alimony and the wages of the employees' priority over all government debts. It is believed that the reason behind this preference is that the government is viewed as a well-pocketed entity and it is inappropriate to grant the debts of the government priority over the debts of alimony and employees.<sup>119</sup>

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<sup>117</sup> Article 628 of the CC.

<sup>118</sup> A call interview with a High Court Judge in Oman AL-Brashdi Zahran Nasser on 6<sup>th</sup> October 2012.

<sup>119</sup> Ibid; for the view of this thesis see below section 5.5.2.2.

## 4.5. Bankruptcy Procedures

Under the current regime, bankruptcy procedures apply to companies with legal personality and to sole merchants.<sup>120</sup> Thus, while liquidation procedures are designed merely for companies,<sup>121</sup> bankruptcy procedures are designed for both sole merchants and companies. As will be shown below,<sup>122</sup> if a company ceases to pay its debts, it may be declared bankrupt. Thus, amongst other grounds, bankruptcy is one of the grounds set out in Article 14 of the Commercial Companies Law of 1974 upon which a company may be wound up by the court. Bankruptcy procedures under the Commercial Code are distinguished from winding up procedures under the Commercial Companies Law. Bankruptcy does not entail the extinction of the company, and its legal personality remains in existence until the liquidation of its affairs is concluded.<sup>123</sup> Retaining its legal personality means that during the course of bankruptcy proceedings, the company, as discussed below,<sup>124</sup> may propose a scheme of arrangement with its creditors in order to terminate its bankruptcy.<sup>125</sup> It is not like the case in England where a company cannot be made bankrupt,<sup>126</sup> but if it cannot pay its debts it may be dealt with under the equivalent process of winding up, laid down in the Insolvency Act of 1986.<sup>127</sup>

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<sup>120</sup> Article 581 of the CC.

<sup>121</sup> Article 14 of the Commercial Companies Law 1974.

<sup>122</sup> See below section 4.5.1.3.

<sup>123</sup> Article 15 of the Commercial Companies Law 1974.

<sup>124</sup> See below section 4.6.2.

<sup>125</sup> Article 755 of the CC.

<sup>126</sup> Reeday G., *The Law Relating to Banking*, (5<sup>th</sup> edition, Butterworths, 1985), p. 170.

<sup>127</sup> *Ibid.*

#### 4.5.1 Who can Request a Bankruptcy Declaration?

An application for bankruptcy can be made by the trader itself,<sup>128</sup> a court, and creditors.<sup>129</sup> Article 581 of the Commercial Code states that “A merchant may be declared bankrupt at the request of one of his creditors or at his own request. The court may declare a merchant bankrupt of its own accord.” Unlike the case in UAE, Bahrain and Egypt,<sup>130</sup> in Oman the public prosecutor is not given the authority to initiate bankruptcy proceedings unless it is shown that the debtor has committed a criminal act e.g. fraudulent bankruptcy.<sup>131</sup> In this case, the debtor will be prosecuted according to the applicable provisions of both the Commercial Code and Penal Law.

##### **A- Debtors**

The sole merchant may voluntarily file for a declaration of bankruptcy if he is not able to pay his commercial debts.<sup>132</sup> However, it is not obligatory for a debtor to apply to a competent court for a declaration of bankruptcy once the cessation of payment takes place, but it is optional.<sup>133</sup> This is contrary to the case under the laws of UAE,<sup>134</sup> Bahrain<sup>135</sup> and Egypt,<sup>136</sup> whereby if a period of time (30 days in

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<sup>128</sup> Article 579 of the CC.

<sup>129</sup> Ibid, Article 581; see Darmaki S., above 28, pp. 62-72.

<sup>130</sup> See Darmaki S., above 28, pp. 67-68; Article 2 of 1987 Bankruptcy and Preventive Compositions scheme Act in Bahrain; Article 552 of the Egyptian Commercial Code of 1999; Article 647 of UAE Commercial Transactions Law of 1993.

<sup>131</sup> Article 300 of Omani Penal Law 1974; Article 598 of the CC; Darmaki S., above 28, p. 68.

<sup>132</sup> Article 579 of the CC.

<sup>133</sup> Darmaki S., above 28, pp. 62-63.

<sup>134</sup> Article 649 of UAE Commercial Transactions Law of 1993.

<sup>135</sup> Article 3 of Bankruptcy and Preventive Composition Scheme Act 1987.

<sup>136</sup> Article 553 of the Egyptian Commercial Code of 1999.

UAE, 15 days in Egypt) lapses from the date of cessation of payment, the debtor is obliged to apply for a declaration of bankruptcy; indeed, failure to do so would result in a criminal offence being committed.<sup>137</sup>

In the case of a company,<sup>138</sup> power to apply for adjudication of bankruptcy on behalf of a company is generally vested in directors.<sup>139</sup> Thus, directors of the company may apply for a declaration of bankruptcy when the company is unable to pay its due commercial debts.<sup>140</sup> However, before submitting such an application, directors should obtain the consent of a majority of partners in the case of general partnerships and limited partnerships; the consent of the ordinary general assembly in the case of joint stock companies; and the consent of partners' committee in the case of limited liability companies.<sup>141</sup> As in the case of the sole merchant, the debtor company is not obliged to apply for a declaration of bankruptcy if it ceases paying its due commercial debts.<sup>142</sup>

The debtor's request must be submitted by way of a report explaining the reasons for the cessation of payment,<sup>143</sup> to which several documents shall be attached, such as the accounting books, a copy of the latest balance sheet, the profit and loss account, a detailed statement of movable and immovable assets

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<sup>137</sup> Ibid.

<sup>138</sup> According to Article 2 of the Commercial Companies Law 1974: companies incorporated in Oman have to take the form of one of these types: (1) General Partnerships; (2) Limited Partnerships; (3) Joint ventures; (4) Joint Stock Companies; (5) Limited Liabilities Companies; (6) Holding Companies.

<sup>139</sup> Article 684 of the CC.

<sup>140</sup> Ibid.

<sup>141</sup> Ibid, Article 685.

<sup>142</sup> Ibid, Articles 579 & 684.

<sup>143</sup> Ibid, Article 584.

and their approximate value on the date of the failure to pay, a statement of the names of the creditors, their addresses, their rights and their obligations and security.<sup>144</sup> In this regard, this thesis argues that the rationales behind presenting such documents are to assist the court in determining the bankruptcy of the debtor and to examine the grounds for the failure and whether they should be attributed to the debtor or to external factors.

## **B- Creditors**

An application for adjudication in bankruptcy made by creditors takes the form of a petition addressed to the civil court with jurisdiction in the area where the debtor carries on business.<sup>145</sup> This application can be made by any creditor who must satisfy the court that the trader has not paid a commercial debt when it has fallen due.<sup>146</sup> In this regard, the Commercial Code does not prescribe a *de minimis* amount of the commercial debt. Thus, principally, whatever the amount of the debt is, the creditor is eligible to initiate bankruptcy proceedings against the debtor if cessation of payment of a due commercial debt occurs. It is worth noting that, in one of its judgments, the high court asserted that although the unpaid debt is commercial, due and undisputed, because of the amount of the unpaid commercial debt, the court has the discretion to reject the request for a bankruptcy declaration.<sup>147</sup> Further, even though the debt is not yet due and payable, in some

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<sup>144</sup> Ibid.

<sup>145</sup> Darmaki S., above 28, p. 65.

<sup>146</sup> Article 582 of the CC.

<sup>147</sup> 'A Set of the Supreme Court Judgments in Oman: 1997', Commercial Department, case number 18/97, p. 531.

cases the creditor is able to commence the proceedings.<sup>148</sup> For instance, any creditor for a deferred commercial debt is entitled to apply for his trading debtor to be declared bankrupt if that merchant has no known domicile, has fled the country, closes down his premises, proceeds to liquidation or takes action harmful to his creditors.<sup>149</sup> However, it is not enough for the creditor to allege this, rather the creditor must demonstrate that the debtor has already failed to pay a due commercial debt.<sup>150</sup> In this regard, it can be asserted that such restriction provides some sort of protection to the debtor.

If a bankruptcy application is submitted by a creditor, according to Article 671 of the Commercial Code the debtor is able to appear before the court to defend himself and prove that he is able to pay his debts. Further, it should be noted that the Commercial Code puts some measures in place aiming to prevent any creditor from seeking a court judgment against the debtor without having legitimate grounds.<sup>151</sup> In this regard, Article 596 of the Commercial Code states that “if one of the creditors applies for the debtor to be declared bankrupt and the court rules to refuse the application, the court may impose a fine not exceeding three hundred Omani Rials (approx. £475) on the creditor and the ruling shall be published in the Official Gazette at his expense if it appears to the court that the creditor intended to harm the commercial reputation of the debtor, without prejudice to the debtor’s entitlement to demand compensation”.

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<sup>148</sup> Article 582 of the CC.

<sup>149</sup> Ibid.

<sup>150</sup> Ibid, Article 582.

<sup>151</sup> Ibid, Article 596.

In addition, one of the preconditions for submitting a bankruptcy application is that the petitioning creditor should have an interest in such petition.<sup>152</sup> Even though all creditors have the right to submit a bankruptcy application, generally the court tends to reject the request of secured creditors if it is satisfied that their securities can be met without affecting the business of the debtor.<sup>153</sup> In one instance, the high court stated that the secured creditor had no interest in submitting an application of bankruptcy since their debts were secured and they were able to enforce their securities to recover their money.<sup>154</sup> However, after enforcing the security, if one of the secured creditors did not recover the whole secured debt, the remaining amount was considered to be an unsecured debt.<sup>155</sup> Having considered it as an unsecured debt, the secured creditor had an interest in approaching the court and, as a result, could apply for the bankruptcy of the debtor.<sup>156</sup>

### **C- The Court**

Unlike the case in both England<sup>157</sup> and the US,<sup>158</sup> in Oman the court acting under its own initiative can apply for the bankruptcy of a trader.<sup>159</sup> As a general

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<sup>152</sup> 'A Set of the Supreme Court Judgments in Oman: 1997', Commercial Department, case number 18/97, p. 531.

<sup>153</sup> Ibid.

<sup>154</sup> Ibid.

<sup>155</sup> Ibid, p. 532.

<sup>156</sup> Ibid, p. 533.

<sup>157</sup> Part I (sections 1 & 2) & Part II (section 9) of the UK Insolvency Act 1986.

<sup>158</sup> Sections 301 & 303 of the US Bankruptcy Code.

<sup>159</sup> Article 581 of the CC; this is the case also in UAE (Article 647 of UAE Commercial Transactions Law of 1993); Bahrain (Article 2 of 1987 Bankruptcy and Preventive Composition scheme Act); and Egypt (Article 552 of 1999 Commercial Act).

rule, the court should be a neutral entity and cannot be one of the petitioners.<sup>160</sup> Thus, giving such power to the court can be considered as a departure from this general rule. However, due to such a departure and lack of any court precedent, it is unclear how, in practice, an application of bankruptcy is submitted by the court. Nonetheless, Article 763 of the Commercial Code provides an example in which the court may initiate bankruptcy proceedings against the debtor. It is provided that if the debtor applies for a preventive composition scheme and the court rejects the application, in such a case the court may at its own discretion initiate bankruptcy proceedings.<sup>161</sup>

#### **4.5.2 The Nature of the Debt**

Even though all the above-mentioned players have the right to submit a bankruptcy application, failure to pay a single debt is not sufficient ground to accept such a request.<sup>162</sup> Thus, a number of conditions should be met in order for a bankruptcy petition to proceed.<sup>163</sup> First, the unpaid debt must be a commercial debt; ceasing to pay a civil debt is not sufficient to apply for a bankruptcy application.<sup>164</sup> Nevertheless, a creditor of a civil debt can apply for the bankruptcy of the debtor if it is demonstrated that the debtor has failed to pay a commercial debt.<sup>165</sup> Secondly, the debt must be due, unless one of the exceptional cases stated above is proven, e.g. the debtor has no known domicile, proceeds to

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<sup>160</sup> Naseef A., *Comprehensive Commercial Encyclopedia*, (4<sup>th</sup> edition, Beirut, Ewidat Press, 1999), p. 120.

<sup>161</sup> See Article 763 of the CC.

<sup>162</sup> *Ibid*, Articles 579 & 582.

<sup>163</sup> *Ibid*.

<sup>164</sup> *Ibid*, Article 579.

<sup>165</sup> *Ibid*.

liquidation or takes action harmful to his creditors.<sup>166</sup> Further, the petition should be based on an undisputed due commercial debt.<sup>167</sup> A bankruptcy petition that is based on a disputed commercial debt will usually be rejected and the petitioner is asked to establish the debt in separate proceedings.<sup>168</sup> Finally, as mentioned above, the Commercial Code does not prescribe a *de minimis* amount of the commercial debt.<sup>169</sup> However, in one of its judgments the high court stated that even though the unpaid debt was commercial, due and undisputed, in this case the amount of the debt did not justify the declaration of the debtor's bankruptcy.<sup>170</sup> It went further by saying that although the appealing bank demonstrated the debt, the declaration of bankruptcy was governed by judicial discretion.<sup>171</sup> However, it is difficult to take this ruling as a base to rely on since in one of its judgments the high court stated that "regardless of the amount of unpaid debt, the court has the right to declare the bankruptcy of any trader even though he ceases to pay a single commercial debt".<sup>172</sup> Even though in the former decision the court refused to declare the bankruptcy of the trader since the amount of the commercial debt, in the view of the court, did not justify the bankruptcy declaration, in the later decision it is clearly stated that it is possible to declare the bankruptcy of the trader without taking into consideration the amount of the unpaid debt. Thus, it can be concluded

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<sup>166</sup> Ibid, Article 582.

<sup>167</sup> Ibid.

<sup>168</sup> 'A Set of the Supreme Court Judgments in Oman: 1997', Commercial Department, case number 179/97, p. 405.

<sup>169</sup> Darmaki S., above 28, p. 11.

<sup>170</sup> 'A Set of the Supreme Court Judgments in Oman: 1997', Commercial Department, case number 179/97, pp. 406-407.

<sup>171</sup> Ibid.

<sup>172</sup> 'A Set of the Supreme Court Judgments in Oman: 1992', Commercial Department, case number 14/92.

that at the end of the day, the facts of each case determine the outcome of the bankruptcy application.

#### **4.5.3 Declaration of Bankruptcy**

After the bankruptcy application is submitted, the court may order the necessary actions to be taken to maintain or manage the assets of the debtor until the bankruptcy petition is determined.<sup>173</sup> Also, the court may appoint whomsoever it chooses to investigate the financial affairs of the debtor and the reasons behind the failure to pay and submit a report accordingly.<sup>174</sup> Principally, at this stage, the management of the company will remain in place and it is entitled to run the business unless the court opts to displace them.<sup>175</sup>

Having ensured that the conditions for adjudication exist,<sup>176</sup> the court makes an order declaring the debtor bankrupt.<sup>177</sup> In case of a company, if a firm is declared bankrupt, all the general liability partners must be declared bankrupt.<sup>178</sup> This includes general liability partners who have left the company after the suspension of payment, provided that no more than two years have elapsed since the date on which notice of their departure from the company was entered in the commercial register.<sup>179</sup> It is worth mentioning that, under Omani law, the bankruptcy of one of

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<sup>173</sup> Article 588 of the CC.

<sup>174</sup> Ibid.

<sup>175</sup> Article 661 of the CC.

<sup>176</sup> As stated above, an application is submitted by the debtor itself, the creditor or the court; the debtor ceases to pay a due commercial debt.

<sup>177</sup> Article 580 of the CC.

<sup>178</sup> Ibid, Article 690.

<sup>179</sup> Article 690 of the CC, states that "Where a company is declared bankrupt, all general liability partners therein shall likewise be declared bankrupt. The bankruptcy shall include a general liability

the general liability partners may not lead to the bankruptcy of the company,<sup>180</sup> although it is one of the grounds for winding up a general partnership and a limited partnership.<sup>181</sup> Article 41 of the Commercial Companies Law of 1974 states that “unless the partnership’s Memorandum of Association provides otherwise, the partnership shall be deemed dissolved upon the death, declaration of ineligibility or bankruptcy or withdrawal of one of its partners. The remaining partners, however, may decide unanimously to continue the partnership between them provided such a decision is registered in the Commercial Register”.

Furthermore, it should be pointed out that in its bankruptcy judgment the court should determine a provisional date for the cessation of payment.<sup>182</sup> However, if it does not, the date on which the judgment was pronounced is deemed to be the date for the suspension of payment.<sup>183</sup> If it does, the date of cessation may not be referred back to more than two years from the date the bankruptcy judgment is pronounced.<sup>184</sup>

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partner who leaves the company after it ceases making payments where the company is declared bankrupt before two years lapse as from the date when the departure of such partner is declared in the Commercial Register”: *ibid.*

<sup>180</sup> Article 50 of the Omani Commercial Companies Law 1974.

<sup>181</sup> *Ibid.*, Articles 41 & 50.

<sup>182</sup> *Ibid.*, Article 590.

<sup>183</sup> Article 590 of the CC.

<sup>184</sup> *Ibid.*, Article 591.

## 4.5.4 Effects of the Bankruptcy

### A- Effect on the Debtor

As stated above,<sup>185</sup> from the day on which the judgment of bankruptcy is issued, a bankrupt will be prohibited from practising a number of civil rights, e.g. becoming a director or a member of the management board of any company for a period not less than a year and from applying for a public job or position.<sup>186</sup> Such restrictions apply to both sole merchants and the general liability partners in a bankrupt company.<sup>187</sup> Thus, since the bankruptcy of a company leads to the bankruptcy of all general liability partners, all general liability partners are prohibited from practising these civil rights.

Furthermore, upon the issuance of bankruptcy adjudication, the debtor will be prohibited from managing his assets or disposing of them.<sup>188</sup> The prohibition on administration and disposal by the bankrupt debtor covers all assets owned by the bankrupt, including those that accrue to him after the declaration of bankruptcy.<sup>189</sup> In this case, the management of the business will be handed over to the trustee who is responsible for administering the assets<sup>190</sup> on behalf of the bankrupt under the supervision of a bankruptcy judge.<sup>191</sup> Thus, after declaring the bankruptcy of the company, the management of the company will be displaced and the bankruptcy trustee will administer the assets of the bankrupt company. In this

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<sup>185</sup> See above section 4.4 (B).

<sup>186</sup> Article 602 of the CC.

<sup>187</sup> Ibid, Article 681.

<sup>188</sup> Ibid, Article 604.

<sup>189</sup> Ibid; however, Article 605 contains some exemptions to this rule.

<sup>190</sup> Ibid, Article 660.

<sup>191</sup> Ibid, Articles 659 & 660.

regard, Omani law does not distinguish between an honest, negligent, or fraudulent debtor.

It is worth noting that the trustee in bankruptcy might be considered as a representative of the bankrupt, the bankrupt's creditors and the public. Since the trustee administers the property on behalf of the bankrupt debtor, it can be said that the trustee is a representative of the bankrupt. The trustee may, also, be considered as the representative of creditors of the bankrupt in that one of his duties is to realise the greatest amount of assets for the benefit of creditors.<sup>192</sup> In addition, safeguarding the public interest is one of the duties of the trustee.<sup>193</sup> In affirming such contention, it is stated that "the trustee shall assume responsibility for all actions necessary to safeguard the rights of the bankrupt";<sup>194</sup> and that "at the request of the trustee, the bankruptcy judge may authorise the continued operation of the business where the public interest, the interest of the debtor, or the interest of creditors so requires".<sup>195</sup> Having been authorised, the trustee shall appoint an external person to run the business of the bankrupt or the bankrupt himself may be appointed to run the business.<sup>196</sup> In this regard, the trustee has discretion in determining whether to appoint a new management to run the business or allow the old management to do this task.<sup>197</sup> Hence, even though in principle directors will be displaced upon the initiation of the bankruptcy process, the bankruptcy trustee may order that they retain their position during bankruptcy processes.

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<sup>192</sup> Ibid, Article 648.

<sup>193</sup> Ibid, Article 661.

<sup>194</sup> Ibid, Article 660.

<sup>195</sup> Ibid, Article 661.

<sup>196</sup> Ibid.

<sup>197</sup> Ibid.

## **B- Effect on Creditors**

By statute, once a bankruptcy adjudication is declared, a 'group of creditors' is established.<sup>198</sup> Such a group consists of ordinary creditors having valid claims against the bankrupt arising prior to the issue of the adjudication of bankruptcy.<sup>199</sup> This group enjoys a legal personality and is represented by the bankruptcy trustee.<sup>200</sup> It is believed that the purpose of organising the ordinary creditors into a body is that of protecting their collective interests and being represented by the bankruptcy trustee.<sup>201</sup> However, secured creditors are not considered part of this group unless they waive their rights.<sup>202</sup> It can be said that their ability to enforce their securities despite the commencement of bankruptcy proceedings justifies the exclusion of secured creditors from becoming a part of a 'group of creditors'.<sup>203</sup>

In addition, as stated above,<sup>204</sup> upon the issuance of an adjudication of bankruptcy, ordinary creditors' actions are stayed and these creditors are unable to take individual enforcement proceedings against the assets of the bankrupt, nor may they finalise proceedings begun before the issuance of the adjudication of bankruptcy.<sup>205</sup> It is believed that the reasons for such a stay are that the claims of the ordinary creditors will be satisfied proportionately out of the assets of the bankrupt debtor; and that the bankruptcy trustee normally takes action on their

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<sup>198</sup> Ibid, Article 615.

<sup>199</sup> Ibid.

<sup>200</sup> Ibid.

<sup>201</sup> Darmaki S., above 28, pp. 97-98.

<sup>202</sup> Article 615 of the CC.

<sup>203</sup> See Darmaki S., above 28, p. 101.

<sup>204</sup> See above section 4.4 (D).

<sup>205</sup> Article 620 of the CC.

behalf since he is responsible for safeguarding their interests.<sup>206</sup> Nonetheless, this restriction does not apply to secured creditors since they are not prevented from bringing or continuing actions against the bankrupt company.<sup>207</sup> In this case, this thesis argues that granting a secured creditor the right to enforce his securities might result in preventing any effort from the trustee to authorise the continued operation of the business.

Furthermore, upon bankruptcy, the terms of all monetary debts will be eliminated and all the bankrupt's debts are deemed to have become due at the date of the bankruptcy declaration.<sup>208</sup> Also, an adjudication of bankruptcy halts the interest on debts only with respect to the group of creditors.<sup>209</sup> However, "interest on debts guaranteed by mortgage or lien may be claimed only from sums produced by the sale of assets guaranteeing those debts".<sup>210</sup> The distinction made between secured and unsecured creditors during bankruptcy proceedings clearly demonstrates that under the current bankruptcy regime the interests of secured creditors, usually banks, are well protected and their *ex ante* bargains are respected even though a debtor enters into bankruptcy proceedings.

### **C- Effect on Contracts Concluded before the Declaration of Bankruptcy**

In general, the adjudication of debtor bankruptcy does not result in the automatic rescission of a contract to which a bankrupt is a party,<sup>211</sup> unless such a

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<sup>206</sup> Ibid, Article 660; see Darmaki S., above 28, pp. 101-102.

<sup>207</sup> Article 620 of the CC.

<sup>208</sup> Ibid, Article 616.

<sup>209</sup> Ibid.

<sup>210</sup> Ibid.

<sup>211</sup> Ibid, Article 633.

contract is based on 'personal consideration' in which a contract cannot be performed except by the bankrupt himself.<sup>212</sup> Since one of the responsibilities of the trustee is to administer the business of the bankrupt,<sup>213</sup> the trustee is required to perform the contract on behalf of the bankrupt. However, if the bankruptcy trustee decides not to perform the contract or will no longer continue to do so, the other party is given the right to seek the rescission of the contract.<sup>214</sup> Having sought the rescission of the contract, the contracting party is not given priority in respect of compensation arising from the termination of the contract, but rather he is entitled to share in the bankrupt's estate as an ordinary creditor.<sup>215</sup> It is, thus, apparent that in Oman the bankruptcy of the trader alone cannot be used as a ground to terminate the contract. This is the case in England, as well, where the mere fact of insolvency does not in itself put an end to contracts.<sup>216</sup> In affirming this, in *Chalmers, re Edwards*,<sup>217</sup> Sir G Mellish, L. J, stated that "I agree with what was said by Crompton, J. in *Griffiths v. Perry*, that the mere fact of the insolvency of the purchaser did not put an end to the contract. It certainly would be very unfair if it had that effect; for if the insolvent had any beneficial contracts remaining, it

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<sup>212</sup> Ibid, Article 633.

<sup>213</sup> Ibid, Article 660.

<sup>214</sup> Ibid, Article 633.

<sup>215</sup> Ibid.

<sup>216</sup> In this regard, Goode states that "the entry of the company into administration does not automatically terminate contracts entered into by the company except where the contract in question so provides, which is often the case": Goode R., above 8, p. 463; Wood P., *Principles of International Insolvency*, (Sweet & Maxwell, 2007), p. 398.

<sup>217</sup> *Ex P. Chalmers, Re Edwards* (1872-73) L.R. 8 Ch. A, p. 289

would be hard on him as well as on his creditors if they could not have the benefit of those contracts” .<sup>218</sup>

Article 630 of the Commercial Code goes further by annulling any contract clause to terminate or modify the contract based on the debtor’s bankruptcy or based on the initiation of bankruptcy proceedings. This is similar to the case under the US Bankruptcy Code where any contract clause that terminates or modifies the contract based on the debtor’s financial condition or insolvency is invalidated.<sup>219</sup> Thus, in both Oman and the US, clauses which allow a counterparty to cancel a contract by reason of the commencement of bankruptcy proceedings are void. Article 633 of the Commercial Code gives the bankruptcy trustee the choice of determining whether to accept or to reject the performance of such a contract. If the bankruptcy trustee rejects the performance of the contract, the other contracting party has the right to seek court judgment to terminate the contract.<sup>220</sup>

The case in England differs in that great respect is given to the sanctity of a contract<sup>221</sup> and the contracting parties are allowed to insert such a clause. Such a clause is known as an ‘*ipso facto clause*’, in which a contract contains a provision permitting the counterparty to cancel on the insolvency of the other.<sup>222</sup> In addressing this issue, Goode stated that the *ipso factor clause* “caused concern among insolvency practitioners, who consider that such clauses are detrimental to

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<sup>218</sup> Ibid, pp. 293-294.

<sup>219</sup> McEowen R., ‘The Assumption or Rejection of Executory Contracts in Bankruptcy- Are Commodity Contracts within a Safe Harbor?’, (March 18<sup>th</sup>, 2009), Iowa State University, available at: [www.calt.iastate.edu](http://www.calt.iastate.edu); Section 365 (c) (e) (1) of the US Bankruptcy Code.

<sup>220</sup> Article 633 of the CC.

<sup>221</sup> Finch V., above 83, p. 283.

<sup>222</sup> Wood P., above 216, p. 429.

the administration procedure” and, as a result, they should be annulled as contrary to public interest.<sup>223</sup> Further, in liquidation for instance, the effect of a termination clause is that a contract right that constitutes an asset of the firm prior to the commencement of proceedings is removed from the reach of the general body of creditors.<sup>224</sup> Also, it is claimed that allowing a supplier to cut off the lifeblood of a manufacturing company could obstruct any attempt to rescue the business of the company.<sup>225</sup> Therefore, it is argued that *ipso facto clauses* can give suppliers considerable leverage against administrators to get paid ahead of other creditors, thereby disrupting the administration process.<sup>226</sup> Nevertheless, Milman, rightly, argued that “it is not appropriate to require a supplier to continue to deliver goods or services to an insolvent customer’ unless “there is in place a cast iron guarantee that payment for any future deliveries will be made”.<sup>227</sup> It is worth noting that during the Standing Committee stage of the Enterprise Act 2002, an amendment was proposed to suspend *ipso facto clauses* in administration,<sup>228</sup> however the Minister rejected this by saying that “a keystone of jurisprudence north and south of the border is freedom of contract and that is the fundamental difficulty with the amendment.... if those entering into contracts knew that the terms could be

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<sup>223</sup> Goode R., above 8, p. 361.

<sup>224</sup> Ibid, p. 183.

<sup>225</sup> Milman D., ‘Moratoria in UK Insolvency Law: Policy and Practical Implication’, (2012 ) 317 C.L.N. 1, p. 3.

<sup>226</sup> In his article Suchak discusses *ipso facto* termination clause in both the US and UK and the pros and cons of statutory invalidation: see Suchak R., ‘Corporate Rescue Proceedings and the Enforcement of *Ipso Facto* Termination Clauses: A comparison of the English and US Approaches’, (2012) 8 (2) I.C.R. 131, p. 132.

<sup>227</sup> Milman D., above 225, p. 3.

<sup>228</sup> Tett R., ‘Administration Falls Short: The Need for Contractual Stability and an Executory Contract Regime’, (2012) 9 (3) I.C.R. 167, p. 169.

overridden, they might be less likely to enter into or continue a contract if they became aware that the company was in financial difficulty”.<sup>229</sup>

As shown, counterparties are prohibited from exercising their rights to terminate the contracts under both Oman’s bankruptcy regime and the US Chapter 11, while they are permitted to exercise them under administration proceedings in England. However, this thesis stands on the view that a balance should be struck between respecting the notion of freedom of contract and promoting the concept of business rescue. Giving the contracting parties the right to negotiate their own contract and to include *ipso facto* clauses and, on the other hand, stay the enforcement of such rights pending the completion of the reorganisation process or bending the approval of the court creates some sort of balance. In this regard, following the experience of the US,<sup>230</sup> where the bankruptcy trustee is given the right to assume or reject any executor contract of the debtor is advisable. Upon the rejection, other contracting parties have the right to terminate their contracts after seeking the approval of the court. However, if the bankruptcy trustee assumes the contract, the other contracting parties should be given adequate assurance of future performance.

#### **4.5.5 Liability of Directors of Bankrupt Companies**

Upon the initiation of bankruptcy proceedings, directors or managers of the company may be subject to a civil liability or may be found guilty of a criminal offence.<sup>231</sup> Article 695 of the Commercial Code gives a bankruptcy trustee the right

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<sup>229</sup> Ibid.

<sup>230</sup> Section 365 of the US Bankruptcy Code.

<sup>231</sup> Article 695 of the CC; Article 301 of Oman’s Penal Code 1974.

to seek court permission to order all members of the Board of Directors or all of the managers, or some of them jointly or severally to pay all or some of the debts of the company unless they establish that they have exercised necessary care in running the business of the company. It is stated that in determining the liability of the managers for compensating the damages resulting from their weakness in managing the company, such compensation should be restricted to the level of their faults.<sup>232</sup> Further, the company's directors may incur criminal liability in the case where the company's bankruptcy has been caused by fraudulent actions on their part, pursuant to Article 301 of Oman's Penal Code of 1974 which provides for imprisonment for a period not exceeding seven years. The Penal Code provides examples of actions that are considered as fraudulent actions, including concealment, mutilation or destruction of the company's books or concealment of assets.<sup>233</sup> It can be said that the rationale behind such liabilities is to encourage the directors or managers of the company to initiate bankruptcy proceedings once they perceive a financial crisis, even though they will be displaced during the process. Running the business, despite such trouble, is against the interests of creditors and might lead to further loss.

#### **4.5.6 Set-off in Bankruptcy**

Set-off is defined by Roy Goode as "the right of a debtor who is owed money by his creditor on another account or dealing to secure payment for what is owed to

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<sup>232</sup> Sarkhoh Y., 'The Manager of A Limited Liability Company under Kuwait Commercial Companies Law: A Comparative Study', (1990) 5 A.L.Q. 163, p. 202.

<sup>233</sup> Article 300 of the Omani Penal Code of 1974.

him by setting this off in reduction of his own liability”.<sup>234</sup> In clarifying such a concept Wood states that “a creditor with a set-off on insolvency is a super-priority creditor: the bankrupt owes him 100, he owes the bankrupt 100. On set-off the creditor is paid in full. If there is no set-off, then the creditor pays 100 to the bankrupt and may get little or nothing on the 100 which the bankrupt owes the creditors”.<sup>235</sup> Both English and the US laws recognise the concept of set-off in insolvency, although with some differences.<sup>236</sup> For instance, in the US, even though the Bankruptcy Code does not create a right of set-off,<sup>237</sup> it recognises the right of set-off existing under non-bankruptcy laws.<sup>238</sup> However, in the US whether or not to allow a set-off right on a specific contract is entirely within the discretion of the bankruptcy judge.<sup>239</sup> In England, insolvency set-off is mandatory and contracting out of insolvency set-off is not allowed.<sup>240</sup> In this regard, Rule 4.90 of the Insolvency Act 1986 makes all actual, contingent and future debts subject to set-off whether they are owed by or to the debtor company.

In Oman, Article 604 of the Commercial Code declares that upon the adjudication of bankruptcy, the bankrupt debtor is forbidden from receiving or

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<sup>234</sup> Goode R., above 8, p. 277; however, Derham stated that “it is difficult to give a comprehensive definition of set-off without reference to the various forms that it can take, but on a general level it can be defined as the setting of money cross-claims against each other to produce a balance”: Derham R., *The Law of Set-off*, (3<sup>rd</sup> edition, Oxford University Press, 2003), p. 1.

<sup>235</sup> Wood P., above 216, p. 403.

<sup>236</sup> Prewitt P., ‘Netting/ Set-off Under the Bankruptcy Code’, (2003), 27 (3) G.E.R., p. 46; Finch V., above 83, p. 614.

<sup>237</sup> It should be noted, here, that Article 553 of the US Bankruptcy Code provides a number of conditions in order to pursue the right of set-off.

<sup>238</sup> For more details about set-off on bankruptcy in the US: see Prewitt P., above 236, pp. 46-52.

<sup>239</sup> Ibid

<sup>240</sup> For more discussion: see Goode R., above 8, pp. 277-282; Finch V., above 83, pp. 614-621.

making any payments. Thus, in principle, bankruptcy set-off is not allowed under the current bankruptcy regime. However, Article 607 provides certain requirements that, if met, render set-off rights to be accepted. Accordingly, on the bankruptcy of the debtor, set-off arrangements are allowed if it is demonstrated that the rights and obligations of the parties are ‘associated’.<sup>241</sup> Association of the rights and obligations of the parties exists specifically if they result from a ‘single cause’ or are included in a ‘current account’.<sup>242</sup> Therefore, Omani courts might dismiss any setting-off arrangements if they are satisfied that the rights and obligations of the parties are not sufficiently associated.

#### **4.6 Composition with Creditors**

Omani Commercial Code regulates two types of compositions that can be concluded between a trader and his creditors. The first type is a ‘Judicial Composition’,<sup>243</sup> while the second type is a ‘Preventive Composition’, each having a different aim.<sup>244</sup>

(A) Judicial Composition: initiated by a bankruptcy judge after a declaration of bankruptcy. The Commercial Code does not state what is meant by a judicial composition. However, a commentator defines it as “a composition, made by a bankruptcy judge following an adjudication of bankruptcy, between a bankrupt and his creditors in order to allow the bankrupt to retain

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<sup>241</sup> Article 607 of the CC.

<sup>242</sup> Ibid, Article.

<sup>243</sup> Ibid, Articles 698 to 721 set out the procedures of judicial composition.

<sup>244</sup> Ibid, Articles 753 to 786 set out the procedures of preventive composition.

his rights after taking a number of precautionary measures to protect the creditors".<sup>245</sup>

(B) Preventive Composition: proposed by a trader prior to the issuance of the bankruptcy judgment to avoid the declaration of bankruptcy.<sup>246</sup> Similar to the case of the Judicial Composition, it is not defined by the Commercial Code, although the procedures to be followed are set out.

Mostly, the procedures to be followed in order to conclude such compositions are similar in a number of aspects. For instance, once judicial or preventive composition is initiated, a creditor committee is automatically established and all approved creditors are invited by the bankruptcy judge to vote on the proposed composition.<sup>247</sup> It is worth noting that secured creditors are not considered part of the Creditor Committee<sup>248</sup> and, as a result, they are not allowed to participate in voting in favour of or against the composition, unless they relinquish their securities.<sup>249</sup> It is argued that the ability of the secured creditors to enforce their securities at any time is behind their exclusion.<sup>250</sup> Also, both compositions require court approval to formally sanction the proposed composition.<sup>251</sup>

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<sup>245</sup> Abd Al-Twaab M., *A Comprehensive Series in Bankruptcy*, (2<sup>nd</sup> edition, Law & knowledge Library Press, 2003), p. 486.

<sup>246</sup> Article 753 of the CC.

<sup>247</sup> Articles 771,772,773 and 701 of the CC.

<sup>248</sup> Ibid, Article 615.

<sup>249</sup> Ibid, Articles 702 & 773.

<sup>250</sup> Darmaki S., above 28, p. 15.

<sup>251</sup> Articles 715 & 780 of the CC.

Notwithstanding the similarities of procedures of both Judicial and Preventive Composition, a number of divergences exist.<sup>252</sup> During judicial composition procedures the trader is declared legally bankrupt and all the above-mentioned consequences of bankruptcy are applied.<sup>253</sup> If approved by the majority of creditors, the court can issue an order annulling the bankruptcy and hand the management back to the debtor.<sup>254</sup> However, during preventive composition procedures the status of bankruptcy does not yet exist.<sup>255</sup> Hence, it can be said that the aim of preventive composition is to escape the status of bankruptcy being declared, while the aim of judicial composition is to alleviate the impact of a bankruptcy judgment and grant a debtor the chance to pursue his business and discharge him from being bankrupt if composition is reached and approved. It is stated<sup>256</sup> that preventive composition aims to achieve a number of benefits. These include: preventing the distressed trader from falling into bankruptcy; benefiting the creditors by giving them an alternative to avoid the length, complexities and cost of bankruptcy procedures; and also having an impact on the public interest since maintaining the business of the company, while paying creditors' debts, can result in preserving jobs and protecting the interests of other stakeholders.<sup>257</sup> Thus, a trader, whether a sole merchant or a company, may avoid the consequences of an adjudication of bankruptcy if the trader is able to present an acceptable deal to his

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<sup>252</sup> See AL-Hinai S., above 35, pp. 20-22.

<sup>253</sup> Ibid, p. 21.

<sup>254</sup> Article 714 of the CC states that "all effects of bankruptcy shall be eliminated upon the judgment of ratification of the composition being delivered".

<sup>255</sup> Article 753 of the CC.

<sup>256</sup> Naseef A., above 160, p. 19.

<sup>257</sup> Ibid.

creditors through what is called 'preventive composition' or a 'composition scheme with creditors'.

Since each of these compositions has its own aim, it is essential to deal with them separately.

#### **4.6.1 Judicial Composition**

As stated above,<sup>258</sup> the aim of a judicial composition is to terminate the effects of the bankruptcy on the trader. This thesis argues that it is difficult to consider this composition as a rescuing process since rescuing the business of the company is not the purpose of such a composition. According to the Commercial Code, the purpose of initiating a judicial composition is to terminate the bankruptcy adjudication.<sup>259</sup> Also, since this composition is initiated by a bankruptcy judge after a bankruptcy adjudication is declared, normally secured creditors have already enforced their securities during bankruptcy proceedings, which renders any attempt to rescue the business challenging, especially if the availability of such assets are important to continue the business.<sup>260</sup> Further, once a trader is declared bankrupt, his reputation will be affected, and as a consequence, although a judicial composition is concluded, suppliers will be frustrated from contracting with a distressed trader.

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<sup>258</sup> See above section 4.3.

<sup>259</sup> Section Three of the Part Five of the CC details the circumstances, whereby if met, the bankruptcy judgment will be terminated; one of these circumstances is judicial composition with creditors.

<sup>260</sup> As stated above, during bankruptcy procedures, secured creditors claims are not stayed and as a result secured creditors are allowed to enforce their claims.

Once a bankruptcy judgment is delivered, a bankruptcy judge can initiate a voluntary judicial composition between the bankrupt and his creditors. However, although it is possible in the event of negligent bankruptcy, the bankruptcy judge is not allowed to initiate such a composition in the event of fraudulent bankruptcy.<sup>261</sup> It is claimed that the objective of judicial composition is to honour the trader who is declared bankrupt without committing any kind of fraud.<sup>262</sup> This is affirmed by Article 715 where it is provided that the composition should be annulled if the debtor is subsequently convicted of fraudulent bankruptcy or “where after ratification a deception arises as a result of the bankrupt having concealed assets or exaggerated his debts”. If initiated, all approved creditors, whose debts have been finally or temporarily admitted, are invited to hear the submission of the trustee and vote on the proposed composition.<sup>263</sup> Secured creditors are not allowed to vote on the proposed composition unless they relinquish their rights as secured creditors.<sup>264</sup> If any of the secured creditors participate in the voting on composition without declaring whether he assigned his securities in whole or in part, he is considered to have dispensed with the whole security.<sup>265</sup> The court will not sanction the composition unless it is approved by a majority of creditors,

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<sup>261</sup> Article 698 of the CC states that “A contract of composition may not be concluded with a bankrupt who has been convicted of fraudulent bankruptcy”. However, Article 699 states that “conviction of a bankrupt for negligent bankruptcy shall not preclude composition being concluded with him”.

<sup>262</sup> Al-Hinai S., above 35, p. 38.

<sup>263</sup> Article 700 of the CC.

<sup>264</sup> Ibid, Article 703 states that “...such assignment may be restricted to a part of the securities provided that it is equivalent to no less than half of the debt”.

<sup>265</sup> Ibid, Article 704.

holding two thirds of the debts.<sup>266</sup> In determining the majority, it is clearly stated that non-voting creditors are not counted.<sup>267</sup> Such composition usually includes provisions whereby the debtor is granted respite for payment of the debts and it may be a compromise whereby the release of the debtor from part of his debt is agreed.<sup>268</sup>

#### **4.6.2 Preventive Composition**

The title of Part Four of the Fifth book of the Commercial Code is 'Preventive Composition from Bankruptcy'. This title indicates that the aim of the preventive composition is merely to prevent the trader from bankruptcy. Thus, preventive composition is an alternative available for a distressed trader to avoid a declaration of bankruptcy and to continue the operation of the business if a composition with creditors is reached. However, as will be shown below,<sup>269</sup> lack of regulating a number of issues renders the Preventive Composition regime insufficient to promote rescue culture. Examples of such issues are imposing stay on secured creditor's actions and allowing post-petition financing. Since preventive composition is distinct proceedings under the current regime, it is necessary to examine its efficiency.

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<sup>266</sup> Ibid, Article 706.

<sup>267</sup> Ibid.

<sup>268</sup> Ibid, Article 708.

<sup>269</sup> See below section 4.8.3.

#### **4.6.2.1 Eligibility to Applying for Preventive Composition**

An application for a preventive composition can be made by the trader itself.<sup>270</sup> Unlike the case in the bankruptcy procedure, a court and creditors are not eligible to submit such an application. Thus, the preventive composition is open merely to sole traders and companies facing difficulties with making payments to their creditors. In the case of a company, an application for a composition by a company should be made by the director who represents the company.<sup>271</sup> However, the director is not permitted to submit an application unless he obtains the consent of a majority of partners in the case of general partnerships and limited partnerships; the consent of the ordinary general assembly in the case of joint stock companies; and the consent of the partners' committee in the case of limited liability companies.<sup>272</sup>

The rights of a sole merchant or a company to request a preventive composition is not without restrictions.<sup>273</sup> As a consequence, it is not possible for any trader to submit an application unless a number of conditions are met. Articles 753, 755 and 758 of the Commercial Code set out conditions whereby if met the trader is eligible to initiate preventive composition proceedings.

#### **(A) Disturbance of the Trader's Business**

Article 753 of the Commercial Code states that any individual trader or company whose financial affairs are so disturbed as to lead to a suspension of payments

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<sup>270</sup> Ibid, Article 753.

<sup>271</sup> Ibid, Article 755.

<sup>272</sup> Ibid.

<sup>273</sup> Ibid, Article 753; see AL-Hinai S., above 35, pp. 27-47; Darmaki S., above 28, pp. 19-26.

may apply for a composition with its creditors. Unlike the case in bankruptcy, cessation of payment of a commercial debt is not a prerequisite for initiating a composition scheme, but rather the disturbance or instability of business activities in a manner which leads to such a cessation is sufficient.<sup>274</sup> However, the criteria to be used to determine the level of business disruption and its consequence on paying debts are not defined. In this case, it is the task of the court to assess the level of disturbance and its effect on paying debts.<sup>275</sup> This is clear from Article 758 of the Commercial Code whereby the trader is required to present before the court a number of documents before approving the commencement of such a composition. In this regard, the petitioner is required to present his application to the court accompanied by an explanation of the disruption of his business activities, a detailed composition proposal and various other documents (including the principal commercial books, a copy of the balance sheet and profit and loss account, a list of the names of creditors, a detailed statement of personal expenses over the two years preceding the application for composition, and various other documents).<sup>276</sup> If a request for preventive composition is submitted by a company, there are additional documentary requirements including a certified copy of the company's articles of association and a copy of the resolution of the partners or the general assembly consenting to the presentation of the application leading to a composition with the creditors.<sup>277</sup>

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<sup>274</sup> Article 753 of the CC; AL-Hinai S., above 35, p. 33.

<sup>275</sup> AL-Hinai S., above 35, p. 37.

<sup>276</sup> Article 758 of the CC.

<sup>277</sup> *Ibid*, Article 759.

Further, it is rightly argued that since any trader whose business activities are disturbed is allowed to submit a composition application, it is inevitable that any trader that has already ceased paying commercial debts is eligible to request a preventive composition.<sup>278</sup> Thus, once a cessation of payment takes place, the trader is allowed to initiate a composition scheme application.<sup>279</sup> However, it is unclear whether or not it is possible for the trader to request a preventive composition with creditors during bankruptcy proceedings. There is no provision under Oman's Commercial Code. This is unlike the position in Egypt where it is clearly stated that "the court must order the postponement of the bankruptcy application, if the debtor submits a formal application for a composition with his creditors. In such a case, the court must deal with the debtor application and postpone bankruptcy proceedings".<sup>280</sup>

Once the debtor realises that his business activities are in trouble or ceases paying a due commercial debt, he has the right to request a preventive arrangement to be concluded with his creditors. It is worth noting that Oman's Commercial Code does not set a time-limit for submitting such a request. Thus, the trader has the right to submit a composition application at any point in time, as long as the adjudication of bankruptcy is not yet declared. This is unlike the case in Egypt,<sup>281</sup> where the trader is required to apply within 14 days (20 days in UAE)<sup>282</sup> of being unable to make payment. If this period has elapsed, the trader is not able

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<sup>278</sup> Al-Hinai S., above 35, p. 34.

<sup>279</sup> Ibid.

<sup>280</sup> Egyptian Supreme Court ruling Number 359/1970; see Al-Hinai S., above 35, p. 36.

<sup>281</sup> Article 553 of Egyptian Commercial Law of 1999.

<sup>282</sup> Article 831 of UAE Commercial Transaction Law of 1993.

to request a preventive composition scheme. It is claimed that the reason for stipulating an exact period is to encourage the trader to request a preventive composition at an early stage and to protect the interests of the creditors.<sup>283</sup> However, in this regard, this thesis argues that the approach adopted by the Omani legislator provides more flexibility for the trader and gives him the chance to initiate a formal scheme of arrangement with his creditors as long as an adjudication of bankruptcy is not declared. Restricting the period of submission to 15 or 20 days from cessation of payment means that both the trader and his creditors have to bear the cost and the length of bankruptcy procedures and it also means that any attempt to rescue the business of the company will be hampered.

### **(B) Non-Committal of Fraud or Gross Fault**

It is not enough for the trader to allege that his business activities are so disrupted as to lead to a cessation of payment. He has to prove, further, that such disturbance is not caused by his gross fault or as a result of fraud.<sup>284</sup> Hence, the trader is unable to initiate a composition scheme if it is demonstrated that the trader committed an act of fraud, for example, by concealing some of his assets with the intention of obtaining a preventive composition with his creditors.<sup>285</sup> Also, it is not possible to opt for a preventive composition scheme if the trader commits a gross fault.<sup>286</sup>

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<sup>283</sup> Al-Hinai S., above 35, p. 36.

<sup>284</sup> Article 753 of the CC.

<sup>285</sup> Ibid, Article 784.

<sup>286</sup> Ibid, Article 753.

Even though the Commercial Code does not state what is meant by gross fault or an act of fraud, both Oman's Commercial Code and Penal Law provide a number of circumstances that, if committed, lead to fraud and gross fault. Article 784 of the Commercial Code provides a number of acts that amount to fraud committed by the trader; these include: exaggerating the evaluation of his assets in order to persuade the court to commence a preventive composition with his creditors; enabling, deliberately, a fictitious creditor to participate in voting on the composition; or if the trader deliberately omits to mention a creditor within the list of the creditors. Further, Article 302 of Oman's Penal Law provides examples of circumstances that amount to gross fault, including if the trader's personal expenses being high compared to his normal spending or gambling with the company's money. It is worth pointing out that the acts included in both the Commercial Code and Penal Law are not inclusive and the court has full discretion to determine whether or not such an act amounts to fraud or gross fault.<sup>287</sup>

### **(C) Trading Continuously for at Least Two Years**

In addition to the above mentioned requirements, a trader should demonstrate that he has traded continuously for two years preceding the submission of the application.<sup>288</sup> As a consequence, if the trader has closed his shop or postponed his business during these two years, he is not eligible to request a preventive composition scheme. It is claimed that such a requirement reflects the intention of

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<sup>287</sup> Darmaki S., above 28, p. 24.

<sup>288</sup> Ibid; this is the case also in Egypt (Article 762 of the Egyptian Commercial Code). However, the case in Bahrain and UAE differs. The trader has to demonstrate that he traded continuously for only one year. (see Article 177 of 1987 Bankruptcy and Preventive Composition scheme Act & Article 833 of UAE Commercial Transactions Law of 1993).

the legislator to prevent any fresh trader from benefiting from this scheme and to allow the old and the serious trader to seek the benefits of such a scheme.<sup>289</sup> This means that any new trader or any old trader who postpones his trading within a period of two years before submitting such an application is unable to submit a composition application. This, as a result, means that bankruptcy proceedings are the only available option for both new traders and old traders who closed or postponed their business activities even for a short period of time. However, this thesis argues that all honest traders must be given the chance to have recourse to such a scheme. A new trader, as well as an old trader, may face a temporary financial crisis.

#### **4.6.2.2 Opening of Composition Proceedings**

Once the trader submits a preventive composition application accompanied by all the required documents, the court will examine this application.<sup>290</sup> During this phase, the court might order that all necessary measures be taken to safeguard the assets of the trader pending the determination of the application.<sup>291</sup> Article 763 of the Commercial Code provides that the court should reject the application if the debtor fails to state the causes of the disturbance of his business activities, some required documents are missing, or the trader has previously been convicted of fraudulent bankruptcy, forgery, theft, fraud, breach of trust or embezzlement of public funds. Having dismissed the debtor's request, the court can initiate

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<sup>289</sup> Darmaki S., above 28, p. 18.

<sup>290</sup> Article 762 of the CC.

<sup>291</sup> Ibid, Article 762.

bankruptcy proceedings if it is satisfied that the requisite conditions are met.<sup>292</sup> If after examining the application, the court decides to accept the request, the court must order the opening of composition proceedings.<sup>293</sup> Article 764 states that such an order must also appoint one of its member judges as a commissioner for preventive composition to supervise the proceedings; appoint one or more supervisors to carry out the proceedings, set a date for the meeting of creditors to verify debts and to discuss the proposal, and this meeting must be held within 30 days from the date of the opening of the proceedings.<sup>294</sup>

#### **4.6.2.3 Management of the Business during Preventive Composition Proceedings**

Unlike the case in bankruptcy, during preventive composition proceedings, the trader retains the right to administer the company's assets under the supervision of the composition trustee.<sup>295</sup> However, in order to protect the interests of creditors, the trader is forbidden from practising a number of activities that are not required for the continuation of his normal business activities without prior permission from the composition trustee.<sup>296</sup> Such acts include granting gifts, disposing of assets by mortgage or transferring ownership.<sup>297</sup> It is worth noting that the role of the

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<sup>292</sup> Ibid, Article 763.

<sup>293</sup> Ibid, Article 764.

<sup>294</sup> Ibid.

<sup>295</sup> Ibid, Article 774.

<sup>296</sup> Ibid.

<sup>297</sup> Ibid.

composition trustee is not to intervene in the management of the business; rather it is merely to supervise the trader's actions and report them to the commissioner.<sup>298</sup>

As discussed above,<sup>299</sup> in determining the optimism of any insolvency regime, the availability of a number of criteria should be within the judgment.<sup>300</sup> Providing incentives for directors in order to encourage them to file for the process as early as possible is one of the criteria used.<sup>301</sup> As explained in the previous chapter,<sup>302</sup> the difference between the US Chapter 11 and the administration regime is that in England once the administrator is appointed the management of the company is displaced unless the administrator decides otherwise. In the US, the notion of debtor-in-possession is adopted, which provides some sort of encouragement to directors to apply for Chapter 11 once they are aware of the financial crisis.<sup>303</sup> This notion is also adopted in England, mainly during CVA and scheme of arrangement proceedings, although in the CVA the management runs the company under the supervision of an insolvency practitioner.<sup>304</sup> Leaving previous management in control without any kind of supervision has its merits, although this might lead to a number of undesired consequences, such as overinvestment and losing creditors' trust.<sup>305</sup> In this regard, this thesis<sup>306</sup> argues that leaving the management in place

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<sup>298</sup> Ibid.

<sup>299</sup> See above p. 13.

<sup>300</sup> Tolmie F., above 17, p. 64.

<sup>301</sup> Ibid.

<sup>302</sup> See above section 3.4.1.

<sup>303</sup> Wood P., above 216, p. 42.

<sup>304</sup> Milman D., 'Scheme of Arrangement and Other Restructuring Regimes under UK Company Law in Context', (2011) C.L.N. 1, pp. 1-2.

<sup>305</sup> See McCormack G., above 10; LoPucki L., 'Chapter 11: An Agenda for Basic Reform', (1995) 69 A.B.L.J. 573.

<sup>306</sup> For discussing this view further: see below section 5.5.4.4.

while appointing a trustee to supervise their conduct provides a level of credibility and assurance for creditors. This is the case during preventive composition where the management of the business retain their position, however their conduct is supervised by the composition trustee. Westbrook, rightly argued that even though they are flawed, the existing management will run the company and preserve its value better than will a court-appointed trustee who knows nothing about it.<sup>307</sup> She based her argument on the fact that the concern of the court-appointed trustee will be to investigate past wrongdoing, such as questionable transactions with lenders and other creditors, while the focus of the management will be on searching for practical steps to maintain the business.<sup>308</sup>

It is worth noting that even though the management of the business is given the right to stay during composition proceedings, this does not mean that the trader, under the current regime, has an incentive to apply for a composition scheme with creditors. Despite the advantage of retaining management, the trader might be subject to bankruptcy proceedings being commenced by the court. Article 763 provides that if the court dismisses the debtor's request for a preventive composition with his creditors, the court can initiate bankruptcy proceedings if it is satisfied that the required conditions apply. In this case, this thesis puts forward the argument that the trader might be discouraged from applying for a preventive scheme, even if he senses a disturbance in his business activities.

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<sup>307</sup> Westbrook J., 'Chapter 11 Reorganisation in the United States', in Rajak H., *Insolvency Law: Theory and Practice*, (London, Sweet & Maxwell, 1993), p. 351.

<sup>308</sup> *Ibid.*

#### 4.6.2.4 Stay on Creditors' Actions (Moratorium)

Upon the court's decision to commence the composition, all bankruptcy proceedings, other claims and enforcement actions relating to the trader are automatically stayed.<sup>309</sup> Such a stay applies to both secured and unsecured creditors.<sup>310</sup> Also, it is worth noting that the court may make protective orders in order to preserve the trader's assets until the application of preventive composition is determined.<sup>311</sup>

The difference between bankruptcy and preventive composition proceedings is that while secured creditors' claims are not stayed during bankruptcy proceedings, all claims, whether secured or unsecured, are stayed during preventive composition proceedings. Staying all creditors' claims, while negotiating the composition with creditors, has an impact on the success of the process and in preserving the assets of the debtor. The trader will not be able to reach an agreement with his creditors if any of them are allowed to pursue their claim during the process. Thus, the stay is designed to protect the assets of the trader for a specific period of time in which the trader is enabled to sort out his financial difficulties by concluding a composition arrangement with his creditors. It is argued that that if creditors, secured and unsecured, were left free to pursue their rights against the company's assets, these assets would be destroyed and, as a result, the purpose of the rescue regime frustrated.<sup>312</sup> Further, it is said that without such

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<sup>309</sup> Article 776 of the CC.

<sup>310</sup> Ibid.

<sup>311</sup> Ibid, Article 762.

<sup>312</sup> Goode R., above 8, pp. 63-64.

a moratorium “the creditors would take enforcement action before negotiations could be undertaken”.<sup>313</sup>

Although their debts are secured, secured creditors are bound by such a stay. However, they are given the right to apply to the court in order to have the stay lifted. The position adopted by Oman is similar to that of England,<sup>314</sup> where total discretion is given to the court to decide whether to lift the stay or not, after balancing the interests of all creditors.

#### **4.6.2.5 Voting System and the Concept of ‘Cram Down’**

Once the composition trustee is notified by the court of his appointment, he must, within five days of the notification, notify the Commercial Registry of the opening of composition proceedings and publish the initial consent to commence composition proceedings in the Official Gazette together with an open invitation to creditors to attend the first set of creditors’ meetings to present proof of their debts.<sup>315</sup> During this meeting, which should be held under the presidency of the commissioner,<sup>316</sup> creditors are required to specify the amount of their debts supported by the necessary evidence, and the trader is given the chance to dispute any debt.<sup>317</sup> Once verification of debts is concluded, the composition trustee will present a report on the financial condition of the trader together with his or her

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<sup>313</sup> Finch V., ‘The Recasting of Insolvency Law’, (2005) 86 M.L.R. 713, p. 728.

<sup>314</sup> Ian F., *The Law of Insolvency*, (London, Sweet & Maxwell, 2011), p. 543; see above pp. 153-154.

<sup>315</sup> Article 768 of the CC.

<sup>316</sup> Ibid, Article 771.

<sup>317</sup> Ibid, Article 772.

opinion on the terms of the proposed composition.<sup>318</sup> In this case, the participating creditors are given the right to discuss the proposed composition scheme before voting on it.<sup>319</sup>

All unsecured creditors whose debts have been accepted may vote in favour of or against the composition arrangement.<sup>320</sup> It is worth noting that the issue of classification of classes<sup>321</sup> is absent under the preventive composition since all unsecured creditors are treated as a single class for voting purposes. The preventive composition proposal should be accepted by a simple majority voting in favour, provided that this simple majority holds at least two-thirds of the total debt of the trader.<sup>322</sup> As in the case of the judicial composition, secured creditors are also prevented from participating in such voting unless they relinquish their rights as secured creditors.<sup>323</sup> If the secured creditor participates in the voting on composition without declaring whether he has assigned his securities in whole or in part, he is considered to have dispensed with the whole security.<sup>324</sup>

Having been approved by a simple majority of creditors, court approval is required to formally sanction the implementation of the voted composition.<sup>325</sup> In this

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<sup>318</sup> Ibid.

<sup>319</sup> Ibid, Article 772.

<sup>320</sup> Ibid, Article 773.

<sup>321</sup> As discussed in the previous chapter, the issue of classification of classes appears under both the US Chapter 11 and scheme of arrangement proceedings where creditors are divided into different classes based on a number of criteria, usually based on the ranking of claims: see above p. 130 & pp. 164-165.

<sup>322</sup> Article 706 of the CC.

<sup>323</sup> Ibid, Article 703.

<sup>324</sup> Ibid, Article 704.

<sup>325</sup> Ibid, Article 780.

regard, the concept of 'cram-down', where a bankruptcy court can impose the plan over the wishes of the dissenting creditors,<sup>326</sup> is adopted by the Commercial Code. Article 712 states that "ratification of the composition shall render it effective in respect of all creditors from whom the body of creditors is composed, even their debts are not ascertained". However, the outcome of such composition would not affect the position of secured creditors as they are given the right to enforce their securities.

#### **4.7 Liquidation Procedures**

Under the current regime in Oman, liquidation procedures, as mentioned above, apply merely to companies. In this regard, Article 14 of the Commercial Companies Law of 1974 sets out the grounds upon which a company is dissolved and, as a result, liquidated. Examples of these grounds are expiration of the fixed term of the company, accomplishment of the purpose for which the company was established, bankruptcy of the company and agreement of the partners to dissolve the company. According to this Article, bankruptcy is one of the grounds upon which a company may be wound up.<sup>327</sup> Thus, if the company ceases to pay its commercial debts, bankruptcy procedures will be initiated followed by liquidation procedures.

Winding up or liquidation is defined as a collective insolvency procedure leading to the end of the company's existence.<sup>328</sup> This process is carried out by a person called a liquidator whose functions are to collect and realise the assets, discharge

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<sup>326</sup> See Klee K., 'All You Ever Wanted to Know About Cram Down Under the New Bankruptcy Code', (1979) 53 A.B.L.J 133.

<sup>327</sup> Article 14 of the Omani Commercial Companies Law 1974.

<sup>328</sup> Goode R., above 8, p. 36.

the company's liabilities to its creditors and distribute the surplus by way of dividends to creditors.<sup>329</sup> Thus, the role of the liquidator is important since he is the only person to administer the assets of the company during the process. However, under the current regime there is no regulation in place whereby the liquidator is obliged to obtain a professional qualification. Furthermore, as in the case of a bankruptcy procedure, during liquidation processes secured creditors' actions are not stayed and, as a consequence, they have the right to pursue their claims.<sup>330</sup> The only claims that are stayed are those of unsecured creditors.<sup>331</sup>

#### **4.8 Assessing the Efficiency of Oman's Current Bankruptcy Regime**

Having highlighted some features of both bankruptcy and composition with creditors; proceedings under the current Omani system, the aim of this part is to assess the efficiency of such procedures. This assessment will be based on what has been discussed above and on the 2014 Doing Business Report issued by the World Bank.<sup>332</sup> This thesis argues that assessing the workability of a bankruptcy law in normal times is important since such an assessment will determine the level of suitability of such law during a financial crisis. In this regard, it is rightly asserted that "to judge how efficient bankruptcy regimes may be in times of systemic

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<sup>329</sup> See Keenan S. & Bisacre J., *Smith and Keenan's Company Law*, (13<sup>th</sup> edition, Pearson Longman, 2005), pp. 535-536; Goode R., above 8, pp. 36-37.

<sup>330</sup> Al-Miqdadi A., *Commercial Companies Law in Oman*, (2<sup>nd</sup> edition, Sultan Qaboos University Press, 2006), pp. 52-53.

<sup>331</sup> Ibid.

<sup>332</sup> The World Bank, 'Economy Profile: Oman', ( Doing Business 2014), available at: [http://www.doingbusiness.org/Reports/~/\\_media/GIAWB/Doing%20Business/Documents/Profiles/Country/OMN.pdf](http://www.doingbusiness.org/Reports/~/_media/GIAWB/Doing%20Business/Documents/Profiles/Country/OMN.pdf). accessed on 10/03/2014.

distress, it is useful to know how they perform in normal times”.<sup>333</sup> A study of 88 high and middle income countries was conducted and revealed that bankruptcy procedures for companies are costly, time consuming and the processes are inefficient.<sup>334</sup> This part of the thesis will consider a number of points. First, Oman’s ranking based on the World Bank Doing Business Report of 2014 will be dealt with. In this regard, the reasons, based on the view of this thesis, behind the lower ranking of Oman will be highlighted. Then, this part will examine whether the Omani bankruptcy system, as it currently stands, is considered to be a creditor-friendly regime or a debtor-friendly regime. Further, how far the preventive composition scheme can be regarded as a scheme that promotes the concept of a rescue culture will be discussed. Finally, the notion of collectivity under Oman’s current bankruptcy system will be examined.

#### **4.8.1 Bankruptcy Efficiency in Oman and the World Bank Report**

In judging the efficiency of bankruptcy systems, the World Bank uses various benchmarks, including the cost of the proceedings, the length of the process, and the recovery rate for creditors.<sup>335</sup>

According to the latest data collected by the World Bank,<sup>336</sup> Oman stands at 72 in the ranking of 189 economies on the ease of resolving insolvency (figure 1). The

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<sup>333</sup> Djankov S., ‘Bankruptcy Regimes during Financial Distress’, p. 6, Mimeo, Euro-money Seminars (May 2009), Trade and Supply Chain Finance in the Americas Conference, available at: <http://www.doingbusiness.org/~media/FPDKM/Doing%20Business/Documents/Miscellaneous/tbd/bankruptcy-regimes-during-financial-distress.pdf>. accessed on 22/01/2014.

<sup>334</sup> Djankov S., Hart O., McLiesh C. & Shleifer A., ‘Debt Enforcement around the World’, (2008) 116 (6) J.P.E. 1105.

<sup>335</sup> The World Bank, ‘Economy Profile: Oman’, above 332, p. 90.

ranking on the ease of resolving insolvency is based on the creditors' recovery rate, which is recorded as cents on the dollar recovered by creditors through reorganisation, liquidation and debt enforcement proceedings.<sup>337</sup> The recovery rate is also a function of time, cost and other factors, such as the lending rate and the likelihood of the company continuing to operate.<sup>338</sup> Out of 189 economies included in the World Bank report, Japan is ranked number 1 in the easing of resolving insolvency,<sup>339</sup> while the UK is ranked 7<sup>340</sup> and the USA is ranked 17.<sup>341</sup> At the level of Gulf Cooperation Countries (GCC),<sup>342</sup> in comparison, Saudi Arabia is number 106 and UAE is number 101.<sup>343</sup> However, the ranking of Bahrain and Qatar is higher than that of Oman. Bahrain comes at the top on the ease of resolving insolvency cases. This is due to that fact that, in Bahrain, in most bankruptcy cases, the most likely outcome is that the company will be sold as a going concern entity and not as a piecemeal sale.<sup>344</sup> Resolving insolvency takes 2.5 years on

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<sup>336</sup> Ibid, pp. 90-94.

<sup>337</sup> Ibid, p. 90.

<sup>338</sup> Ibid.

<sup>339</sup> The World Bank, 'Economy Profile: Japan', ( Doing Business 2014), p. 90, available at: <http://www.doingbusiness.org/~media/giawb/doing%20business/documents/profiles/country/JPN.pdf>. accessed on 10/03/2014.

<sup>340</sup> The World Bank, 'Economy Profile: United Kingdom', ( Doing Business 2014), p. 96, available at: <http://www.doingbusiness.org/~media/giawb/doing%20business/documents/profiles/country/GBR.pdf>. accessed on 10/03/2014.

<sup>341</sup> The World Bank, 'Economy Profile: United States', ( Doing Business 2014), p. 94, available at: <http://www.doingbusiness.org/data/exploreeconomies/~media/giawb/doing%20business/documents/profiles/country/USA.pdf?ver=2>. accessed on 10/03/2014.

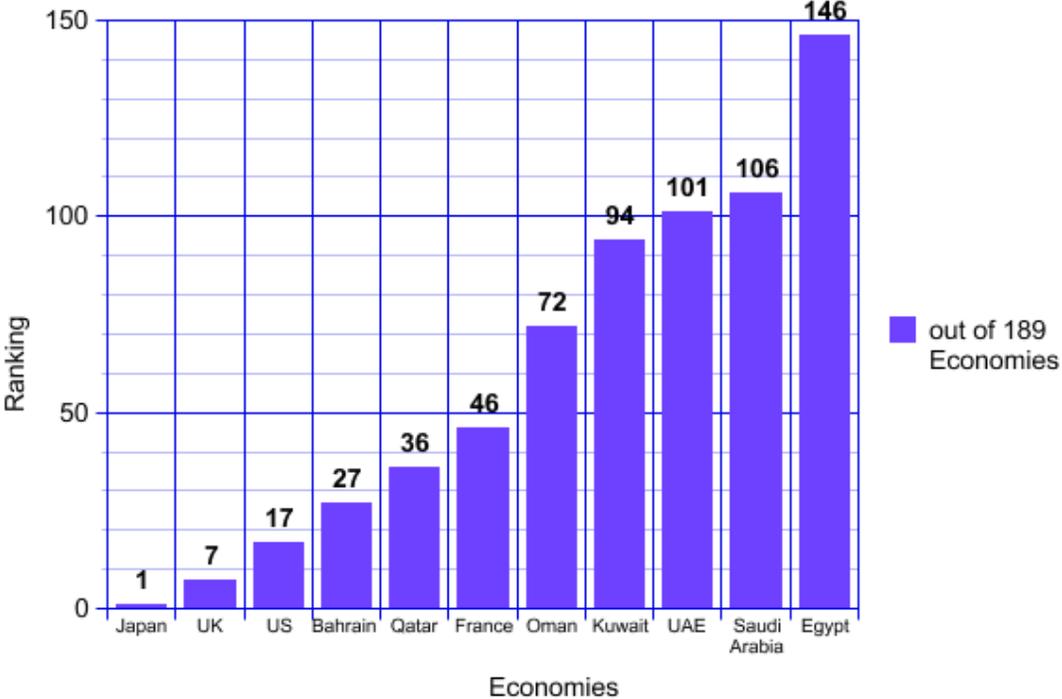
<sup>342</sup> Which include Oman, Qatar, Kuwait, Bahrain, Saudi Arabia and UAE.

<sup>343</sup> The World Bank, 'Economy Profile: Oman', above 332, p. 91.

<sup>344</sup> The World Bank, 'Economy Profile: Bahrain', ( Doing Business 2014), p. 89, available at: <http://www.doingbusiness.org/~media/giawb/doing%20business/documents/profiles/country/bhr.pdf>. accessed on 10/03/2014.

average and costs 10% of the debtor’s estate with the average recovery rate being 67.4 cents on the dollar.<sup>345</sup>

Figure1. How Oman and Comparator Economies Rank on the Ease of Resolving Insolvency



World Bank, Doing Business Report 2014

The case in Oman is significantly different. In this regard, this thesis argues that there are a number of reasons behind the lower ranking of Oman. First, according to the latest World Bank report, most bankruptcy cases in Oman end up with selling the assets of the company piecemeal and not as a going concern.<sup>346</sup> This is due to the fact that under the current bankruptcy regime secured creditors are able to enforce their securities, even though bankruptcy proceedings are initiated.<sup>347</sup> Thus, there is no compulsory mechanism in which all creditors’ claims are stayed.

<sup>345</sup> Ibid, p. 89.

<sup>346</sup> The World Bank, ‘Economy Profile: Oman’, above 332, p. 90.

<sup>347</sup> Article 620 of the CC.

According to the creditors' bargain theory,<sup>348</sup> bankruptcy creates what is called a 'common pool' problem arising when diverse creditors affirm rights against a common pool of assets.<sup>349</sup> The supporters of this theory propose the establishment of a compulsory debt collection system which helps in reducing the cost of debt collection and in increasing the aggregate pool of assets. This kind of system requires imposing a stay on creditors' actions to prevent the race to the courthouse between creditors.<sup>350</sup> In this regard, as explained in Chapter Three,<sup>351</sup> both England and the US adopt the concept of staying creditors' claims during the US Chapter 11 and administration proceedings in England. In Oman, the lack of a moratorium during bankruptcy processes encourages secured creditors to enforce their securities against the company. This, as a result, might impede any attempt to sell the company as a going concern entity.

Secondly, under the current regime there is no exact time-limit whereby bankruptcy processes should be completed. For example, during bankruptcy proceedings, Article 665 of the Commercial Code states that within thirty days of the date of his appointment the bankruptcy trustee should present to the court a statement containing the reasons behind the cessation of payment; however, the court can extend this period at its own discretion. Also, Article 669 states that once the debts have been verified, the bankruptcy trustee, within sixty days, should deposit to the court a list containing the names of the secured creditors and the

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<sup>348</sup> See above section 2.2.1.

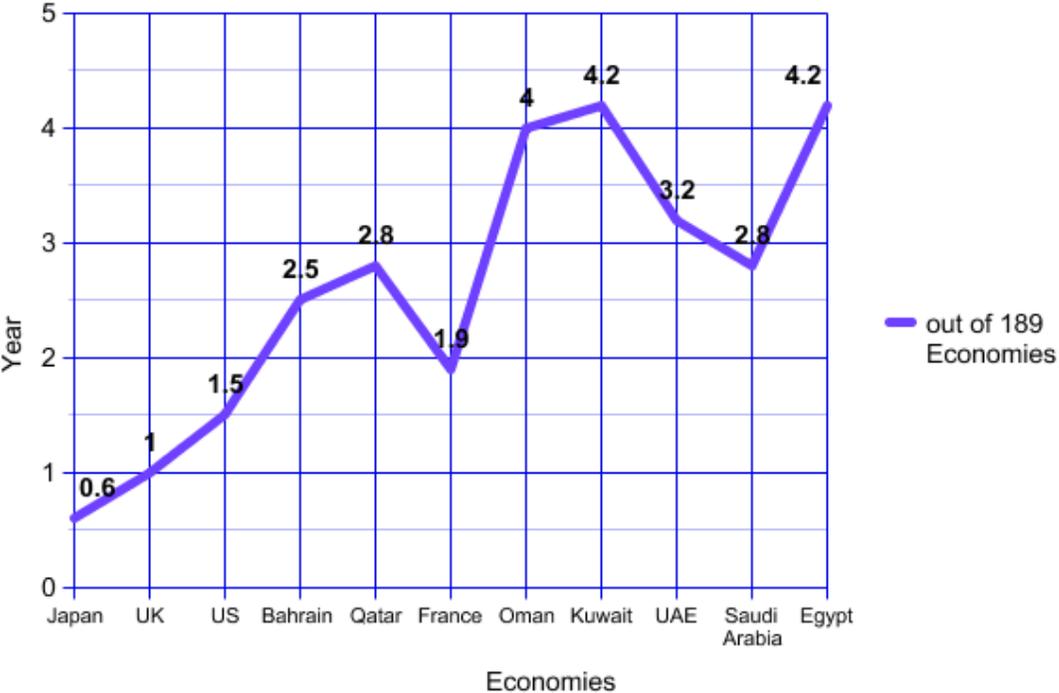
<sup>349</sup> See, for example, Jackson T., *The Logic and Limits of Bankruptcy Law*, (Harvard University Press, 1986); Baird D. & Jackson T., 'Bargaining After the Fall and the Contours of the Absolute Priority Rule', (1988) 55 U.C.L.R. 738; Finch V., above 83, p. 32.

<sup>350</sup> Jackson T., above 349, pp. 14-16

<sup>351</sup> See above section 3.4.2.

amount of their securities; however, where necessary the court has the power to extend such period. Hence, in both articles the court is given the power to extend the period without setting a maximum period. According to the latest World Bank Doing Business Report, resolving bankruptcy cases in Oman takes 4.0 years on average, while resolving such cases takes less than two years in many other countries.<sup>352</sup> As shown in Figure 2, resolving insolvency takes only 6 months in Japan, a year in the UK, 1.5 years in the USA and 1.9 years in France. At the GCC level, the ranking of Oman is far below the desired level. Resolving bankruptcy cases takes 2.5 years in Bahrain, 2.8 years in both Qatar and Saudi Arabia and 3.2 years in the UAE.<sup>353</sup>

Figure 2. Average Time to Complete the Bankruptcy Processes in Oman compared to other Economies



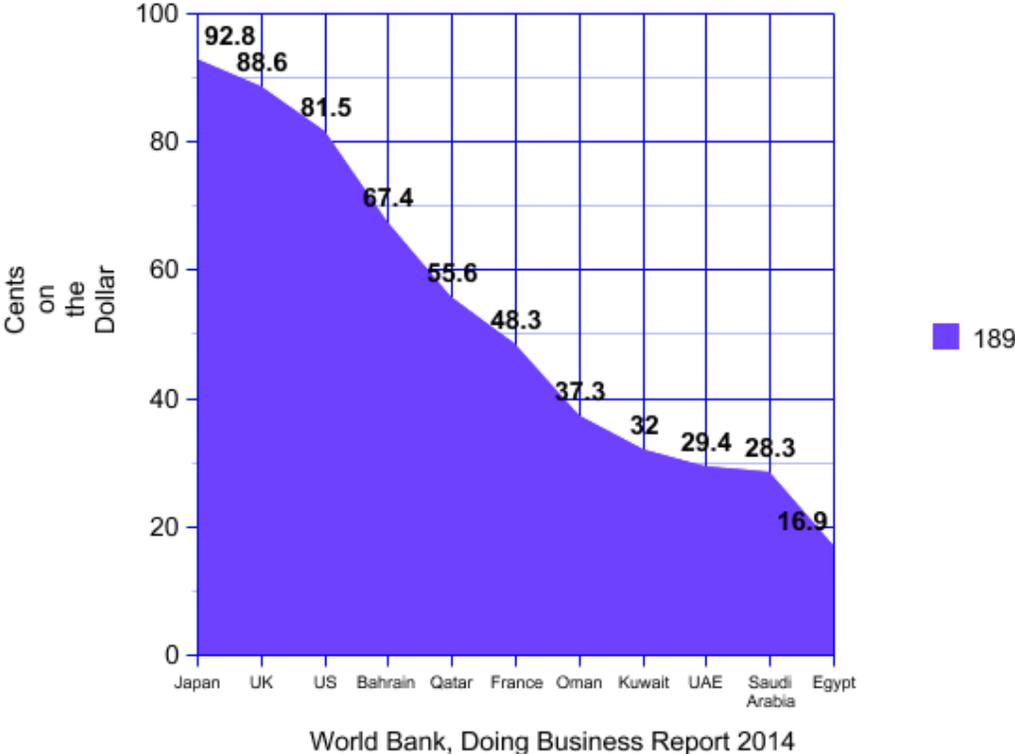
World Bank, Doing Business Report 2014

<sup>352</sup> The Word Bank, 'Economy Profile: Oman', above 332, p. 91.

<sup>353</sup> Ibid.

Spending years to resolve a bankruptcy case has its impact on wasting the resources of the debtor’s assets which means that the recovery rate of creditors is diminished. This is reflected in the weak recovery rate received by creditors in Oman compared with other countries.

Figure. 3 Creditors' Recovery Rate in Oman Compared to Other Economies



As can be seen in Figure 3, the average recovery rate in Oman is 36.6 per cent compared to 66.2% in Bahrain and 55.5 in Qatar.<sup>354</sup>

**4.8.2 Pro-Debtor or Pro-Creditor Regime?**

Based on the availability of a number of legal characteristics, bankruptcy regimes are generally divided into debtor-friendly regimes and creditor-friendly

<sup>354</sup> Ibid.

regimes.<sup>355</sup> The main characteristics of a debtor-friendly regime are that of allowing easy access to bankruptcy proceedings, maintaining management and not displacing them, staying all creditors' actions, granting a super-priority to the new lender, and adopting the concept of cram-down where dissenting creditors are forced to accept a reorganisation plan.<sup>356</sup> Further, the company is given the right to assume or reject so-called executory contracts since '*ipso facto*' clauses are invalidated.<sup>357</sup> It is argued that the main characteristics of a debtor-friendly regime are based on Chapter 11 of the US Bankruptcy Code.<sup>358</sup> This is obvious from the discussion in the previous chapter, where it is shown that the main features of the US Chapter 11 are leaving the management of the company in place during bankruptcy proceedings and imposing an automatic stay on all secured and unsecured creditors' claims.<sup>359</sup> In addition, the court has the discretion to impose the reorganisation plan over the wishes of the dissenting creditors, although this subject to two tests, namely 'the best interest of creditors test' and a 'feasibility test'.<sup>360</sup>

One of the main characteristics of a creditor-friendly regime is that creditors' interests are favoured over those of the debtor.<sup>361</sup> This is the case, for instance,

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<sup>355</sup> McCormack G., above 112, pp. 110-112.

<sup>356</sup> Ibid, p. 109.

<sup>357</sup> Ibid.

<sup>358</sup> Franken S., 'Creditor- and Debtor-Oriented Corporate Bankruptcy Regimes Revisited', (2004) E.B.O.R. 645, p. 650.

<sup>359</sup> See above section 3.3.1.

<sup>360</sup> See above section 3.4.4.

<sup>361</sup> Philippe F., 'Theoretical Foundation for A Debtor Friendly Bankruptcy Law in Favour of Creditors', (2007) 24 (3) E.J.L.E. 201, p. 203.

under the receivership regime in England<sup>362</sup> where a floating charge holder is given the right to appoint an administrative receiver to protect his interests. In this regard, the aim of this regime is not to protect the interests of the debtor by saving the assets of the company, but rather it is to maximise the returns of the floating charge holder.<sup>363</sup> Moreover, it is said that another key feature of a creditor-friendly regime is the treatment granted to priorities.<sup>364</sup> Unlike the case in the US where a post-bankruptcy new lender can be granted super priority over pre-bankruptcy secured creditors, in England, no super priority status is granted and pre-bankruptcy priorities are respected.<sup>365</sup> In addition, during administration proceedings the managers are displaced during the process, which is one of the main features of the creditor-friendly regime.<sup>366</sup> It is argued that a purely creditor-friendly regime is found under the insolvency system where priority and security are mainly given to secured creditors and where managers are replaced during bankruptcy proceedings.<sup>367</sup> However, McCormack stated that the level of differences between the US and the UK insolvency laws are exaggerated and he criticised the idea that the US law is pro-debtor and the UK law is pro-creditor.<sup>368</sup> As shown in the previous chapter,<sup>369</sup> a closer examination of the administration regime in England reveals the fact that even though the management of the

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<sup>362</sup> Although partially abolished by the enactment of the Enterprise Act 2002, creditors with 'qualifying' floating charges that were created before the 2002 Act may still appoint administrative receivers: see above section 3.2.2.

<sup>363</sup> Goode R., above 8, p. 332.

<sup>364</sup> Philippe F., above 361, p. 203.

<sup>365</sup> See above section 3.4.3.

<sup>366</sup> See above section 3.2.1.

<sup>367</sup> Philippe F., above 361, p. 205.

<sup>368</sup> See McCormack G., above 112, p. 110.

<sup>369</sup> See above section 3.4.

business is displaced, secured and unsecured creditors' actions are stayed and the concept of cram-down on dissenting creditors is recognised. These are also features of the debtor-friendly regime. Hence, this thesis is in favour of McCormack's assertion that the degree of divergences between the US and the UK regimes is exaggerated.

Based on what has been discussed above, this thesis argues that the Omani regime, as it stands today, can be categorised as a creditor-friendly regime. This is due to a number of reasons. First, the Omani bankruptcy regime still lacks a proper reorganisation procedure. Under the current regime, a merchant debtor has no choice except to apply for bankruptcy proceedings. Applying for such procedures means that the debtor will be punished<sup>370</sup> and secured creditors will be able to seize the assets.<sup>371</sup> As stated above,<sup>372</sup> during bankruptcy procedures, secured creditors are able to enforce their claims against the debtor since no stay is imposed on them. Further, management is displaced during bankruptcy proceedings and a bankruptcy trustee is appointed to administer the process.<sup>373</sup> The aim of the trustee is not to save the business of the debtor, but instead it is to collect the assets and protect the interests of the creditors.<sup>374</sup> Hence, it can be said that the aims of bankruptcy procedures are to safeguard the interests of the creditors and to penalise the debtor.

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<sup>370</sup> See above section 4.4 (B).

<sup>371</sup> See above section 4.4 (D).

<sup>372</sup> See above section 4.5.4 (B).

<sup>373</sup> See above section 4.5.4 (A).

<sup>374</sup> Ibid.

Even though the debtor opts to apply for a preventive composition scheme, protection of secured creditors is also evident. During preventive composition proceedings, all claims, whether secured or not, are stayed.<sup>375</sup> However, the problem is that secured creditors are not allowed to vote on the composition plan unless they waive their securities. Also, once the plan is approved by a majority of unsecured creditors, the court does not have the right to impose the plan over the wishes of secured creditors.<sup>376</sup> Thus, secured creditors are given the right to pursue their claims, despite the approval of such a plan. Moreover, once the company enters a liquidation phase, secured creditors are able to enforce their securities since their claims are not stayed during liquidation processes.<sup>377</sup> Thus, there is no mechanism in place in which all claims are stayed and in which all assets are collected by the trustee in order to distribute them between various creditors, both secured and unsecured.

#### **4.8.3 Preventive Composition Scheme and the Concept of ‘Rescue Culture’**

The preventive composition scheme is one of the options available for a distressed trader to avoid the hardship of bankruptcy proceedings. The main aims of such a scheme are to avoid the consequences of being a bankrupt debtor and it is an attempt to conclude a composition plan with unsecured creditors.<sup>378</sup> However, the concern to be raised here is how far this scheme is from being a rescue process. In approaching such a concern, it is necessary to examine the availability of a number of criteria during a preventive composition regime. Tolmie stated that

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<sup>375</sup> See above section 4.6.2.4.

<sup>376</sup> Ibid.

<sup>377</sup> See above section 4.4.3.

<sup>378</sup> Article 753 of the CC; see above section 4.7.

there are a number of requirements for having a successful rescue regime.<sup>379</sup> Examples of such requirements are the ease and speed of accessing the process, the possibility of requesting new financing during the rescue process, imposing a moratorium on creditors' claims (stay on creditors), and providing incentives for directors in order to encourage them to file for the process an early stage.<sup>380</sup>

An application for a preventive composition cannot be made by creditors and the court. The only option available to them is to apply for bankruptcy procedures. The right to apply for such a composition is given only to the trader itself, whether it is a sole merchant or a company.<sup>381</sup> However, it is not possible for the trader to request the initiation of such a process unless a number of conditions have been met.<sup>382</sup> As explained above,<sup>383</sup> the debtor has the right to request a preventive composition with creditors once he perceives the disturbance of his business activities<sup>384</sup> in a way that leads to a cessation of payment of commercial debts. Nevertheless, the trader has to demonstrate that he has traded continuously for two years preceding the submission of the application for a preventive composition regime.<sup>385</sup> This requirement makes it impossible for any new trader or an old trader who postponed his business during these two years, for whatsoever reason, to apply for such a regime. Further, it is important for the trader to demonstrate that

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<sup>379</sup> Tolmie F., above 17, p. 64.

<sup>380</sup> Ibid.

<sup>381</sup> Article 753 of the CC.

<sup>382</sup> Ibid.

<sup>383</sup> See above section 4.6.2.1.

<sup>384</sup> The problem here is that the criteria to be used in determining the level of business disturbance and its effect on cessation of payment are not defined under the law. Thus, the court has full discretion in assessing such a request.

<sup>385</sup> See above section 4.6.2.1 (C).

the disturbance of business activities is not caused by his gross fault or as a result of fraud.<sup>386</sup> Hence, this thesis argues that under the current regime, it is not easy to access a composition arrangement scheme since all the above-mentioned requirements have to be satisfied. Also, proving the occurrence of such factors is rather difficult and time-consuming. In the absence of such criteria and of previous court cases, it is not clear how the disturbance of business activity is assessed.

In addition, during a preventive composition process, the management retain their position and run the business under the supervision of the composition trustee.<sup>387</sup> Not displacing the management has its impact on encouraging them to apply for such a regime as early as they sense trouble. According to the Commercial Code, the management is allowed to conduct any act that is required for carrying on business activities without the need to seek permission from the composition trustee.<sup>388</sup> By implication, this might include seeking new financing from an existing creditor or from a new lender. However, the management is forbidden from granting a new security to the lender.<sup>389</sup> Hence, as is the case under the administration regime in England,<sup>390</sup> granting a super priority status to the new lender is not allowed during the composition. Thus, the new lender would be considered as an unsecured creditor. This might have the effect of discouraging others from providing such financing to troubled businesses.

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<sup>386</sup> Darmaki S., above 28, p. 24; see Article 753 of the CC.

<sup>387</sup> Article 774 of the CC; see above section 4.6.2.3.

<sup>388</sup> Article 774 of the CC.

<sup>389</sup> Ibid.

<sup>390</sup> See above section 3.2.1.

Furthermore, one of the main drawbacks of the composition scheme is that secured creditors do not have a say in negotiating a composition plan,<sup>391</sup> though their claims are stayed during the process.<sup>392</sup> If they want to participate, they have to relinquish their rights as secured creditors.<sup>393</sup> Since they are not allowed to vote on the composition plan, the court does not have the right to impose the plan over their wishes.<sup>394</sup> Thus, they are given the right to enforce their securities. This, as this thesis believes, leads secured creditors to go to the court in order to enforce their securities and, as a result, the assets of the debtor will be wasted. This also has its impact on deterring any attempt to rescue the business of the debtor, particularly if the assets are essential to continue the business.

Based on what has been stated above, this thesis argues that the preventive composition regime is far from being a rescue process. The aim of this regime, as designed by the legislator, is merely to escape bankruptcy procedures and the consequences of bankruptcy declaration.<sup>395</sup> Even though some of the criteria of a successful rescue regime are found under this regime,<sup>396</sup> the lack of a number of requirements renders it inefficient to be considered as a rescue regime. Complicating the access to this regime, preventing secured creditors from voting on a composition plan, not providing an incentive for a new lender and not imposing the plan over the wishes of secured creditors all play a central role in causing the inefficiency of such an option.

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<sup>391</sup> See above section 4.6.2.5.

<sup>392</sup> See above section 4.6.2.4.

<sup>393</sup> Ibid; Article 704 of the CC.

<sup>394</sup> See above section 4.6.2.5.

<sup>395</sup> Article 753 of the CC.

<sup>396</sup> For instance, all creditors' claims are stayed and management retains their position.

#### 4.8.4 Bankruptcy and Liquidation *vis-à-vis* the Notion of Collectivity

As discussed in Chapter Two,<sup>397</sup> even though the principles of the creditors' bargain theory and the multiple values theory vary, both theories recognise the importance of having in place a compulsory debt-collection system. Having such a system would help in protecting the assets of the debtor from being seized by secured creditors and in preventing a loss of value for all creditors if the debtor's assets are worth more as a whole than as a collection of pieces.<sup>398</sup> In this regard, under both the US Chapter 7 liquidation and winding-up proceedings in England, the notion of collectivity is recognised. For instance, in England on entry into liquidation, the assets of the company are protected from hostile and damaging action by creditors.<sup>399</sup> However, unlike the case under administration, in the company voluntary arrangement and scheme of arrangement regimes, under the liquidation regime, the notion of collectivity prevails and the main function of the liquidator is to collect the assets of the insolvent company in order to maximise returns for creditors.<sup>400</sup>

In Oman, during both bankruptcy and liquidation procedures secured creditors are given the right to enforce their securities. As shown above,<sup>401</sup> even though the concept of staying creditors' claims is adopted under both regimes, the only claims stayed are those of unsecured creditors. Not staying secured creditors' actions

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<sup>397</sup> See above section 2.9.

<sup>398</sup> Jackson T., above 75, p. 867; see also Aghion P., Hart O. & Moore J., 'The Economics of Bankruptcy Reform', (1992) 8 (3) J.L.E.O. 523.

<sup>399</sup> Milman D., 'Winding up of Companies: Recent Litigation and Legislative Development', (2003) 4 Insolvency Lawyer 157, p. 157.

<sup>400</sup> See above section 4.7.

<sup>401</sup> See above sections 4.6.2.2 & 4.7.

means that creditors will waste the assets in order to be first to seize their securities or to obtain a judgment against the debtor in what is described as 'race to the court house' between creditors.<sup>402</sup> Hence, the notion of collectivity is not adopted under the current regime. This might be one of the reasons behind the lower ranking of Oman in easing insolvency that in the World Bank Doing Business Report. As shown in Figure 3 above,<sup>403</sup> the average recovery rate in Oman is 37.3 per cent. Adopting the notion of collectivity might help in increasing creditors' recovery rate since the assets will be collected by the liquidator instead of allowing creditors to seize their own securities. Allowing creditors to pursue their claims also means that the liquidator needs to use the debtor's resources to defend secured creditors' allegations before the court and to pay lawyer's fees. All of these actions have an impact on wasting the assets of the debtor. Furthermore, dealing with secured creditors' actions means that the time required to accomplish all bankruptcy or liquidation proceedings would be increased.

#### **4.9 Concluding Remarks**

In this chapter, an overview of the current bankruptcy regime in Oman was provided. As explained, there are three bankruptcy proceedings available: bankruptcy procedures,<sup>404</sup> preventive composition procedures<sup>405</sup> and liquidation proceedings.<sup>406</sup> However, the liquidation regime is only available for companies whether they are bankrupt or not since there are a number of grounds upon which

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<sup>402</sup> See Jackson J., above 75, p. 862.

<sup>403</sup> See above p. 247.

<sup>404</sup> See above section 4.5.

<sup>405</sup> See above section 4.6.

<sup>406</sup> See above section 4.7.

companies are liquidated; bankruptcy is one of them.<sup>407</sup> Further, bankruptcy procedures apply for all types of traders whether an individual trader or a large, medium or small company. Hence, under the current regime there is no special bankruptcy procedure designed merely for medium and small companies. This is one of the main issues with the current bankruptcy regime since all traders, despite their size, have to follow the same bankruptcy procedures. Moreover, the preventive composition proceeding, as mentioned above,<sup>408</sup> is not meant to be a rescue procedure; rather, it is a scheme used to escape the consequences of bankruptcy declaration.

This chapter explored the various reasons behind the inefficiency of the bankruptcy regime in Oman.<sup>409</sup> For instance, all current bankruptcy regimes share the problem that persons administering the processes are not required to obtain a particular qualification.<sup>410</sup> Also, the main obstacle of both bankruptcy proceedings and liquidation proceedings is that secured creditors are given the right to enforce their securities during the process without having to wait until the end of such proceedings.<sup>411</sup> During preventive composition proceedings all claims, whether secured or not, are stayed. Nonetheless, the problem is that secured creditors are not permitted to participate in voting on the plan unless they relinquish their securities.<sup>412</sup> This means that even though the composition plan is approved by

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<sup>407</sup> Article 14 of the Omani Commercial Companies Law of 1974.

<sup>408</sup> See above section 4.6.2.

<sup>409</sup> See above section 4.8.1.

<sup>410</sup> See above section 4.4 (E).

<sup>411</sup> See above section 4.4 (D).

<sup>412</sup> See above section 4.6.2.5.

unsecured creditors, secured creditors are not bound by such a plan and they have the right to pursue their claims.<sup>413</sup>

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<sup>413</sup> Ibid.

## Chapter Five: A Call for Future Bankruptcy Reform in Oman

### 5.1 Introduction

In the first chapter, it was demonstrated that, at present, Oman does not have a separate bankruptcy law.<sup>1</sup> Rather, in dealing with the bankruptcy of traders, both the Commercial Code of 1990 and Commercial Companies Law of 1974 make a number of provisions. Nevertheless, it was argued that for a number of reasons<sup>2</sup>, the current bankruptcy regime in Oman is insufficiently regulated.<sup>3</sup> For instance, currently, there are no formal rescue proceedings available for distressed debtors. Instead, the current provisions under the Commercial Code are mostly in the form of preventive composition procedures<sup>4</sup> that allow a postponement of a declaration of bankruptcy in an attempt to secure preventive settlement with creditors. If such a preventive composition fails, suffering the consequences of bankruptcy declaration is inevitable. Hence, the philosophy of a rescue culture is not recognised under either the Commercial Code or the Commercial Companies Law. This is unlike the case in both England and the US. As discussed in Chapter Three, in promoting the concept of rescue culture, England, for example, modernised the administration

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<sup>1</sup> As stated in Chapter one the issue is not with the absence of a *separate* bankruptcy law. Rather, the main issue debated in this thesis is that the bankruptcy proceedings should be designed in a way that facilitates the rescue of viable enterprises and promptly liquidates those which are unviable.

<sup>2</sup> As discussed in the previous chapter, these reasons include the following facts: at present, the concept of cram-down dissenting creditors is not recognised, there is no exact time-limit for bankruptcy proceedings; secured creditors' actions are not stayed during either bankruptcy or liquidation procedures: see above section 4.6.

<sup>3</sup> See above section 4.8.

<sup>4</sup> See above section 4.6.2.

regime by the enactment of the Enterprise Act 2002. Under this Act, rescuing the business of the company as a going concern becomes the overriding objective of the administration regime.<sup>5</sup> It was demonstrated that establishing a rescue procedure has an impact on preserving the value of viable enterprises, saving jobs and maximising the interests of secured creditors.<sup>6</sup> However, it was established that the costs of corporate rescue proceedings have been increased by greater professional regulation.<sup>7</sup> Hence, it is suggested that to protect the UK rescue culture, the rising costs of running an administration need to be properly defined.<sup>8</sup>

The bankruptcy proceedings in Oman, as they currently stand, suffer from a number of drawbacks. As discussed in the previous chapter,<sup>9</sup> there are three bankruptcy proceedings in Oman, namely bankruptcy proceedings, preventive composition proceedings and liquidation proceedings. However, there are a

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<sup>5</sup> The new Schedule B1 of the UK Insolvency Act 1986, Para 3 (1) (a), (b) and (c); see above p. 122.

<sup>6</sup> As mentioned above in pp. 121-122, the rescue of Game Group saved nearly 3200 jobs. Also, it was empirically demonstrated that, after the enactment of the Enterprise Act 2002, rescuing the business of the company through an administration regime in the UK delivered more returns to secured creditors: Frisby S., 'Interim Report to the Insolvency Service on Returns to Creditors from Pre-and-Post Enterprise Act Insolvency Procedures', p. 14, Baker & McKenzie Lecturers in Company and Commercial Law, 24 July 2007, available at:

<http://www.insolvencydirect.bis.gov.uk/insolvencyprofessionandlegislation/research/returntocreditors.pdf>. accessed on 22/01/2014.

<sup>7</sup> See Armour J., Hus A. & Walters A., 'The Impact of the Enterprise Act 2002 on Realisations and Costs in Corporate Rescue Proceedings', p. 26, a Report Prepared for the Insolvency Service, December 2006, available at:

[www.insolvency.gov.uk/insolvencyprofessionandlegislation/research/corpdocs/ImpactofEARReport.pdf](http://www.insolvency.gov.uk/insolvencyprofessionandlegislation/research/corpdocs/ImpactofEARReport.pdf). accessed on 22/01/2014.

<sup>8</sup> See Association of Business Recovery Professionals, available at:

[http://www.r3.org.uk/media/documents/policy/policy\\_papers/corporate\\_insolvency/R3\\_Administration\\_Expenses\\_Paper\\_Final\\_July\\_2012.pdf](http://www.r3.org.uk/media/documents/policy/policy_papers/corporate_insolvency/R3_Administration_Expenses_Paper_Final_July_2012.pdf). accessed on 22/01/2014.

<sup>9</sup> See above section 4.8.

number of deficiencies in regard to each of these proceedings.<sup>10</sup> Whilst one of the main obstacles of the current bankruptcy procedures is that secured creditors' actions are not stayed during the process, this problem is overcome during preventive composition proceedings since all claims, secured and unsecured, are stayed. Nevertheless, the composition scheme is not regarded as a rescue process; rather it is an alternative means to escape the consequences of bankruptcy declaration.<sup>11</sup> It was argued<sup>12</sup> that under this scheme secured creditors are not given the right to participate in voting on a composition plan unless they relinquish their rights as secured creditors. Also, the trader cannot apply for this composition scheme unless it has been established that he has traded continuously for two years prior to the submission of the application for a preventive composition regime, and the disturbance of business activities has not been caused by his gross fault or as a result of fraud.<sup>13</sup> Furthermore, the liquidation regime<sup>14</sup> is not a true collective procedure because secured creditors are not forbidden from enforcing their securities during the assets' realisation phase.<sup>15</sup>

Taking lessons from the experience of both England and the US may help in overcoming such obstacles. However, it is worth noting that caution should be exercised since what might be appropriate in England and in the US might not be suitable in Oman. Hence, this thesis endeavours to propose a regime that is appropriate to be adopted by the Omani legislator. It is not the aim of this chapter

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<sup>10</sup> Ibid.

<sup>11</sup> See above section 4.8.3.

<sup>12</sup> Ibid.

<sup>13</sup> For further discussions: see above sections 4.6.2.1 & 4.8.3.

<sup>14</sup> Ibid.

<sup>15</sup> For further discussions: see above section 4.8.4.

to propose wholesale transplantations of England or the US bankruptcy regimes. Rather, the aim is to opt for principles that would seem appropriate in promoting the concept of rescue culture *in Oman* and for promoting the concept of collectivity during the liquidation phase in Oman. For instance, as will be argued below,<sup>16</sup> it is not appropriate for Oman to transplant the concept of the debtor-in-possession as it stands in the US, where directors run the company during the US Chapter 11 without any kind of supervision. However, it is argued that opting for the CVA approach of England is more suitable for Oman since directors retain their position and they run the company under the supervision of bankruptcy practitioners.<sup>17</sup>

In addition, it is worth explaining that such a proposal will take into account the evaluations that have been undertaken in the previous chapters. For instance, as discussed in Chapter Two, whether the aim of bankruptcy law is merely to maximise the return of creditors or whether there are other interests that deserve equal protection is, theoretically, subject to debate.<sup>18</sup> Each of the discussed theories incorporated some justification for bankruptcy law and its procedures.<sup>19</sup> However, it was demonstrated<sup>20</sup> that this thesis supports the view that in designing bankruptcy law it is necessary not to focus only on maximising the interests of secured creditors. That is to say, the aim of any proposed bankruptcy regime should not be to maximise merely the interests of secured creditors, but rather take into account the interests of all stakeholders. Nevertheless, it is worth noting that in

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<sup>16</sup> See below section 5.5.4.2.

<sup>17</sup> For further discussions: see below section 5.5.4.2

<sup>18</sup> For in-depth discussion: see above Chapter Two.

<sup>19</sup> For in-depth discussion: see above pp. 104-110.

<sup>20</sup> See above section 2.8.

taking into account the interests of employees, suppliers and customers, secured creditors should not be left unprotected. Thus, in this case, it is necessary to strike a balance between the interests of creditors and the interests of others. In this regard, it is useful to take note of the experience of both England and the US. As discussed above,<sup>21</sup> even though both jurisdictions encourage the rehabilitation of distressed debtors, the rescue plan will not be forced upon the wishes of the dissenting creditors unless they are sufficiently protected.

Furthermore, in proposing a rescue regime, a number of factors should be present.<sup>22</sup> The importance of each factor has been highlighted in Chapter Three.<sup>23</sup> Encouraging the debtor to apply for bankruptcy proceedings as they sense the crisis looming, staying all creditors' actions, facilitating access to funding and adopting the concept of cram-down, are all examples of such factors. However, as will be demonstrated below,<sup>24</sup> in proposing these factors care should be taken since it may not be appropriate to transplant the whole experience of England or the US.

## **5.2 Structure of the Chapter**

This chapter, first of all, is going to explore the theories underpinning legal transplantation. Then, the possible consequences of legal transplantation in the receiving countries and the criteria used to measure the success of legal transplants will be examined. Furthermore, the general importance of transplanting

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<sup>21</sup> See above section 3.4.4.

<sup>22</sup> Tolmie F., *Introduction to Corporate and Personal Insolvency Law*, (London, Cavendish Publishing Limited, 2003), p. 64.

<sup>23</sup> See above sections 3.4.1- 3.4.4.

<sup>24</sup> See below sections 5.5.4.

bankruptcy laws will be highlighted. After that, this chapter will demonstrate the fact that Oman can be considered as a country which imports many legal rules and why it is important for Oman to adopt some of the bankruptcy principles that are found in other jurisdictions.<sup>25</sup> In addition, the necessity for introducing bankruptcy reform in Oman will be dealt with and in this regard, particular focus will be placed on Oman's economic vision of 2020 and the role of Small and Medium Enterprises (SMEs) in promoting the national economy. Finally, this chapter will propose a map for future bankruptcy reform in Oman and what needs to be done in order to have a modern bankruptcy law.

### 5.3 Legal Transplants

There is a spectrum of different possibilities as to what is meant by 'transplant'. Watson, for instance, states that a legal transplant is "the moving of a rule or a system of law from one country to another or from one people to another".<sup>26</sup> However, in criticising such a definition, it is argued that Watson's definition of a legal transplant is both narrow and loose from a number of perspectives. It is narrow because it is only concerned with legal history and the examples provided in his book are mainly inspired by the various influences exercised by Roman law on different peoples.<sup>27</sup> Also, Watson concerns himself only with the area of private law.<sup>28</sup> Further, it is argued that in defining the concept of a legal transplant Watson

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<sup>25</sup> This thesis is arguing for Oman's bankruptcy law to be inspired by England and the US jurisdictions.

<sup>26</sup> Watson A., *Legal Transplants*, (Edinburgh, Scottish Academic Press, 1974), p. 21.

<sup>27</sup> See Dupré C., *Importing the Law in Post-Communist Transition: The Hungarian Constitutional Court and the Right to Human Dignity*, (Hart Publishing, 2003), p. 40.

<sup>28</sup> *Ibid*, p. 41.

overlooked the necessity of acknowledging the strong determining role of the cultures of the 'sending' or 'receiving' countries when assessing the fate of such transplantation.<sup>29</sup> It is asserted that "legal transplants have now become a generic phrase to refer broadly to the influence of foreign law on the drafting of new legislation and to the movement of law beyond national borders".<sup>30</sup> Thus, currently the term 'legal transplant' is used as a generic term for all transnational or cross-border spread of law.<sup>31</sup>

### **A- Theoretical Debates**

Whether legal transplants are possible or not is subject to intense debate.<sup>32</sup> The debates have centred on the following issue: is it possible to transplant laws and legal institutions from one legal system to another? In answering such a question, various approaches have been developed since legal scholars approach law in many ways. As Orucu stated, legal scholars "are dedicated to various trends such as 'law as rules', 'law as system', 'law as culture', 'law as tradition', 'law as social fact', 'law in context', 'law and history', 'law and economics', and 'law and legal theory'.<sup>33</sup> However, based on various conflicting views, the aim of this part is to explore the possibility of legal transplantations.

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<sup>29</sup> Shah P., 'Globalisation and the Challenge of Asian Legal Transplants in Europe', (2005) S.J.L.S. 348, p. 348.

<sup>30</sup> Dupré C., above 27, p. 42.

<sup>31</sup> Orucu E., 'Law as Transposition', (2002) 51 I.C.L.Q. 205, p. 205.

<sup>32</sup> Ibid; Mousourakis G., 'Transplanting Legal Models across Culturally Diverse Societies: A Comparative Law Perspective', (2010) 57 O.U.L.R. 87.

<sup>33</sup> Orucu E., above 31, p. 205.

On one side of the debate, there are some scholars who oppose the idea of legal transplants. For instance, in his book, *"The Spirit of Laws"*, Montesquieu argues that "the political and civil laws of each nation ought to be only the particular cases in which human reason is applied. They should be adopted in such a manner to the people whom they are framed, as to render it very unlikely for those of one nation to be proper for another".<sup>34</sup> Thus, according to Montesquieu, legal rules cannot cross cultural boundaries since they express the spirit of nations and are, as a result, "deeply embedded in, and inseparable from their geographic, customary and political context".<sup>35</sup> In line with Montesquieu, Pierre Legrand also opposes the possibility of legal transplantation. He stated that "anyone who takes the view that 'the law' or 'the rule of the law' can travel across jurisdictions must envisage that law is a somewhat autonomous entity unencumbered by historical, epistemological, or cultural baggage".<sup>36</sup> However, he believes that such a view is mistaken. Legrand views the rule of the law as "an incorporative cultural form, as an accretion of cultural elements, it is buttressed by important historical and ideological formation"<sup>37</sup> and, as a consequence, "rules cannot travel" and legal transplants are impossible.<sup>38</sup> Since legal rules mirror the society in which they have evolved, their meaning does not survive the journey from one jurisdiction to another.<sup>39</sup> Accordingly, he argues that "at best, what can be displaced from one

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<sup>34</sup> Montesquieu C., *The Spirit of Laws*, (J. & M. Roberson, 1793), p. 7.

<sup>35</sup> See Ibid; Gillespie J., 'Transplanted Company Law: An Ideological and Cultural Analysis of Market-Entry in Vietnam', (2002) 51 (3) I.C.L.Q. 641, p. 644.

<sup>36</sup> Legrand P., 'What 'Legal Transplants'?', in Nelken D. & Feest J., *Adopting Legal Culture*, (Hart Publisher, 2001), p. 57.

<sup>37</sup> Ibid, p. 59.

<sup>38</sup> Ibid, p. 57.

<sup>39</sup> Ibid, p. 60.

jurisdiction to another is, literally, a meaningless form of words” and “in any meaningful sense of the term, ‘legal transplants’, therefore, cannot happen”.<sup>40</sup> However, in response to such allegations, it is rightly argued that the spread of Roman law throughout the continent of Europe, or international or transnational commercial law<sup>41</sup> of today, demonstrates the possibilities of legal transplants.<sup>42</sup> The movement of legal rules, practices, and institutions has been a normal occurrence all around the world and it is hard to find a legal system in the developed world that has not imitated or borrowed from another country’s law.<sup>43</sup> This leads Miller to state that “the economic development, democratization, and globalization have today so sharply increased the number of legal transplants that at least in developing countries, most major legislation now has a foreign

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<sup>40</sup> Ibid, p. 63.

<sup>41</sup> Transnational commercial law can be referred to as a set of private law principles and rules, from whatever sources, which governs international commercial transactions and is common to legal systems generally or to a significant number of legal systems: see Goode R., Kronke H. & Mckendrick E., *Transnational Commercial Law: Text, Cases and Materials*, (Oxford University Press, 2007), p. 4; Goode defines “transnational commercial law” “as law which is not particular to or the product of any one legal system but represents a convergence of rules drawn from several legal systems or even, in the view of its more expansive exponents, a collection of rules which are entirely national and have their force by virtue of international usage and its observance by the merchant community”: see Goode R., ‘Usage and its Reception in Transnational Commercial Law’, (1997) 46 (1) I.C.L.Q. 1, p. 2.

<sup>42</sup> See Richard S., ‘Cut-and-Paste? Rule of Law Promotion and Legal Transplants in War or Peace Transition’, in Engelbrekt A. & Nergelius J., *New Direction in Comparative Law*, (Edward Elgar, 2010). p. 56; However, it is argued that there are a number of factors affecting the ability of a country to borrow the laws of another jurisdiction. These include the development of legal institutions in the importing country, problems of languages and the lack of a developed infrastructure: see Kahn- Freund, ‘One Uses and Misuses of Comparative Law’, (1974) 37 (1) M.L.R. 1, p. 12; see Goode R., Kronke H. & Mckendrick E, above 41, p.185.

<sup>43</sup> Markovits I., ‘Exporting Law Reform- but Will it Travel’, (2004) 37 C.I.L.J. 95, p. 95.

component”.<sup>44</sup> In this regard, despite the difference in culture, transplanting foreign rules or doctrines might help in filling a gap or meet a particular need in the importing countries.<sup>45</sup> As will be demonstrated below,<sup>46</sup> in order to promote the concept of rescue culture, many countries have reformed their bankruptcy laws through transplanting the experience of other jurisdictions.

On the other side of the debate, a number of scholars recognised the importance of legal transplants in developing national laws. Watson, through a number of books and articles, views direct transplants of whole legal systems as constituting the most important fertile source for legal development.<sup>47</sup> He argues that legal transplants are “socially easy” and, indeed, they are as alive and well as they were in the age of Hammurabi.<sup>48</sup> This is due to the fact that “legal rules are not particularly formulated for the society in which they operate;<sup>49</sup> rather they are the intellectual creation of clever lawyers, easily adaptable to local use by other clever lawyers elsewhere on the globe”.<sup>50</sup> According to this approach, despite the historical origin of legal rules, they “can survive without any close connection to any particular people, any particular period of time or any particular place”.<sup>51</sup> Hence, to

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<sup>44</sup> Miller J., ‘A Typology of Legal Transplants: Using Sociology, Legal History and Argentine Examples to Explain the Transplant Process’, (2003) 51 A.J.C.L. 839, pp. 839-840.

<sup>45</sup> Mousourakis G., above 32, p. 93.

<sup>46</sup> See below section 5.3.1.

<sup>47</sup> Watson A., *Society & Legal Change*, (Scottish Academic Press, 1977), p. 95.

<sup>48</sup> Watson A., ‘Legal Transplants and European Private Law’, (2000) 4 (4) E.J.C.P.L., available at: <http://www.ejcl.org/44/art44-2.html>. accessed on 20/01/2014.

<sup>49</sup> Watson A., *The Evolution of Law*, (Johns Hopkins U. Press 1985), p. 8.

<sup>50</sup> See Markovits I., above 43, p. 95.

<sup>51</sup> Watson A., ‘Legal Transplants and Law Reform’, (1976) 92 L.Q.R. 79, p. 80.

him, legal borrowing is, in fact, the key to how law is changed and developed.<sup>52</sup> In supporting his arguments, Watson provides a number of examples of the reception of Roman law and the spread of English common law. In one of his arguments, Watson contends that successful transplantation could be achieved even when nothing was known by the importing country of the political, social or economic situations of the foreign law.<sup>53</sup> However, in criticising Watson's approach it is stated that "free transplant theory" loses sight of the law's unavoidable susceptibility to some external pressures from culture and society".<sup>54</sup> Nevertheless, Watson acknowledges the fact that a tomato plant that moves from X to Y is still a tomato plant. Nevertheless, its subsequent development depends on Y's soil, temperature, wildlife and so on.<sup>55</sup>

As stated above,<sup>56</sup> whereas Watson opposes the idea that legal rules mirror the society in which they have developed, Legrand supports such an idea and, as a consequence, he argues that legal transplantations are impossible. However, it is stated that there are many scholars who tend to fall between these two positions, seeing legal rules both as embedded in a legal system and a culture and subject to be transplanted from one jurisdiction to another.<sup>57</sup> In this regard, even though Kahn-Freund, for instance, recognises the possibility of legal transplants, he asserts that to avoid serious risk of rejection, sometimes having knowledge of the

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<sup>52</sup> Watson A., 'Comparative Law and Legal Change', (1978) 37 C.L.J. 313, p. 321.

<sup>53</sup> Watson A., above 48, p. 79.

<sup>54</sup> Chen-Wishart M., 'Legal Transplant and Undue Influence: Lost in Translation or a Working Misunderstanding?', (2013) 62 (1) I.C.L.Q. 1, p. 2.

<sup>55</sup> Watson A., above 48, P. 80.

<sup>56</sup> See above p. 266.

<sup>57</sup> Elis J., 'General Principles and Comparative Law', (2011) 22 (4) E.J.I.L. 949, p. 964.

political and social conditions in the donor system is necessary.<sup>58</sup> Thus, even though he acknowledges the possibility of legal transplantations, the chances of survival or risk of rejection of the transplanted legal rules or institutions depend on political factors.<sup>59</sup> In his article, Kahn-Freund refers to Montesquieu's opinion that it was only in the most exceptional circumstances that the institutions of one country could serve those of another at all.<sup>60</sup> Based on Montesquieu's view, a range of factors militate against transplantation, such as geography (for example, the size and geographic position of a country), social and economic (for instance occupation, destiny, wealth of the population, trade), cultural (such as religion, traditions, customs) and political factors (such as the nature of the government).<sup>61</sup> However, Kahn-Freund affirms that the geographical, the economic and social, and the cultural elements have greatly lost their importance over time, but that the political factors have equally greatly gained in importance.<sup>62</sup> Then, he differentiates between two types of institutional transfer.<sup>63</sup> In this regard, he suggests a continuum of legal rules, the terminal points of which are, on one side, a rule which can easily be 'transferred' by mechanical insertion and, on the other side, a rule

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<sup>58</sup> Kahn-Freund, above 42, pp. 3-4; see Stein E., 'Uses, Misuses-and- Nonuses of Comparative Law', (1977-78) 72 N.U.L.R. 198.

<sup>59</sup> Kahn-Freund, above 42, p. 7.

<sup>60</sup> Ibid, p. 6.

<sup>61</sup> Ibid, p. 7; see also Stein E., above 58, p. 199; Forsyth A., 'The 'Transplantability' Debate in Comparative Law: Implications for Australian Borrowing from European Labour Law', p. 3, (2006), Centre for Employment and Labour Relations Law, the University of Melbourne, Working Paper No.8, available at: <http://www.law.unimelb.edu.au/files/dmfile/wp381.pdf>. accessed on 20/02/2014.

<sup>62</sup> In supporting his argument, Kahn-Freund provided a number of examples; for in-depth discussion see Kahn-Freund, above 42, pp. 8-17.

<sup>63</sup> Ibid, p. 6; for a summary of Kahn-Freund: see Stein E., above 58; see also Teubner G., 'Legal Irritants: Good Faith in British Law or How Unifying Law Ends up in New Divergences', (1998) 61 (1) M.L.R. 11, p. 17.

analogous to the transplant of a kidney from one person to another, with the attendant risk of rejection by the home environment.<sup>64</sup> He argues that any given rule or institution may be placed at an appropriate point of this continuum.<sup>65</sup> In supporting his argument, Kahn-Freund offers a number of examples.<sup>66</sup> For instance, within the area of family law, there are significant variations in the conditions and the consequences of a divorce, mainly as regards alimony.<sup>67</sup> In this case, even though fundamental rules of divorce laws have been transplanted successfully from Australia and New Zealand to England, radical changes in the same direction have occurred in Canada and in New York.<sup>68</sup> Hence, the law of divorce and alimony would *prima facie* appear to be most closely linked to local environmental factors, such as moral and religious beliefs.<sup>69</sup> Also, he provides an example involving rules of an institutional nature where the power factors appear much more strongly than in divorce law.<sup>70</sup> Examples of these rules are those which organise constitutional, legislative, administrative or judicial institutions and procedures, and above all, policy-making power.<sup>71</sup> According to him, all these rules are closest to the second side of the continuum and “they are the ones most

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<sup>64</sup> Kahn-Freund, above 42, p. 6.

<sup>65</sup> Kahn-Freund states that “in the metaphorical language I am using, the kidney and the carburetor are the terminal points of a continuum, and any given legal rule or institution may be found at a different point of it”: *ibid*

<sup>66</sup> See *ibid*, pp. 13-27.

<sup>67</sup> *Ibid*, p. 13.

<sup>68</sup> *Ibid*, p. 14; see also Deech R., ‘Comparative Approaches to Divorce: Canada and England’, (1972) 35 (2) M.L.R. 113.

<sup>69</sup> Stein E., above 58, p. 200.

<sup>70</sup> *Ibid*, p. 201; Kahn-Freund, above 42, p. 17.

<sup>71</sup> Kahn-Freund, above 42, p. 17.

resistant to transplantation”.<sup>72</sup> For instance, he states that the failed attempt to transplant the English jury system to the Continent in the Nineteenth Century and the unsuccessful attempt to export the British parliamentary institutions into countries which do not share a particular feature in history, or a social structure, and of political consensus characteristic of the UK, demonstrates how such rules and institutions are resistant to transplantation.<sup>73</sup>

In addition, scholars such as Orucu and Sacco highlight the importance of legal transplantation. In his article, Orucu asserts that the movement of legal rules and institutions is a natural stage in legal development. According to Orucu, the future development of laws and institutions is closely tied to the movement of ideas and institutions from one place to another.<sup>74</sup> Moreover, both Orucu<sup>75</sup> and Sacco<sup>76</sup> argue that borrowing and imitating others’ legal systems is of crucial importance in understanding the course of legal change. However, Orucu argues that many problems may arise for recipient legal systems as a result of the transmigration of law.<sup>77</sup> The scope of these problems depends on factors such as the size of the transmigration, the characteristics of legal movement, the success or otherwise of transpositions and ‘tuning’, the element of force or choice inherent in the move and the social culture of the new environment.<sup>78</sup> Thus, particular consideration should

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<sup>72</sup> *Ibid.*, p. 17.

<sup>73</sup> *Ibid.*, pp. 17 & 18.

<sup>74</sup> Orucu E., above 31, p. 205.

<sup>75</sup> *Ibid.*

<sup>76</sup> Sacco R., ‘Legal Formats: A Dynamic Approach to Comparative Law’, (1991) 39 A.J.C.L. 1.

<sup>77</sup> Orucu E., above 31, p. 212.

<sup>78</sup> *Ibid.*

be paid to legal-cultural convergence and non-convergence which may come about as a consequence of import.<sup>79</sup>

To sum up, according to many scholars legal transplants are possible.<sup>80</sup> However, those scholars who recognise the importance of legal transplants disagree on the method of such transfers. While Watson acknowledges the possibility of legal transplantations despite cultural differences between the exporting and importing jurisdictions,<sup>81</sup> Kahn- Freund is of the view that for such a transplant to be successful, knowledge of the political and social conditions of the exported legal rules is crucial.<sup>82</sup> However, in this regard, Xanthaki<sup>83</sup> makes the statement that:

*“What matters when selecting a legal system for comparative examination in the process of legal transplantation is not the similarity of its characteristics with that of the receiving legal order, but the functionality of the proposal. If the policy, concept or legislation of a foreign legal system can serve the receiving system well, then the origin of the transplant is irrelevant to its success. As long as the transplant can serve the social need to be addressed, the transplant can work well in the new legal ground.”*

This thesis supports Xanthaki’s assertion by arguing that despite the origin of transplanted rules or principles, they can be adopted in order to overcome the deficiencies of the legal system in the importing country. In this regard, the appropriateness of foreign rules and principles can be judged by trying to assess

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<sup>79</sup> Ibid.

<sup>80</sup> See the discussion above pp. 266-270.

<sup>81</sup> Watson A., above 51, p. 79.

<sup>82</sup> Kahn-Freund, above 42, pp. 3-4.

<sup>83</sup> Xanthaki H., ‘Legal Transplants in Legislation: Defusing the Trap’, (2008) 57 (3) I.C.L.Q. 659. p. 662.

their workability and functionality before adopting them. This can be done by consulting a number of national and foreign experts and organising government symposiums in order to predict the workability and functionality of the proposed rules and principles. However, in assessing the functionality of such rules or principles, recourse should be made to a number of factors. For instance, in proposing foreign rules or principles, it is important to take into account cultural factors in the importing country (people's attitudes towards the proposed principles, religious convictions). It is true that sometimes transferring the institutional context of foreign countries is not appropriate. This is due to social, cultural and political factors in the importing country. For example, Kahn-Freund provided examples of the attempted failures to transplant the English jury system to the Continent and the transplant of British parliamentary institutions to other countries.<sup>84</sup> Also, it is necessary to take into consideration the difference between the infrastructure in the importing and exporting countries. This includes, for example, the competence of courts in dealing with proposed principles and the qualifications of persons administering the law. In this regard, even though one of the aims of this thesis is to take notes from the experience of both England and the US, it is not appropriate to adopt all bankruptcy principles that are adopted by both these jurisdictions. Rather, the aim is to opt for bankruptcy principles that are appropriate for Oman. As will be discussed below,<sup>85</sup> even though the notion of debtor-in-possession (DIP) is adopted in the US,<sup>86</sup> it is not suitable to be wholly adopted by the Omani legislator. This is due to a cultural factor that while in the US bankruptcy is

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<sup>84</sup> Khan-Freund, above 42, pp. 17 & 18.

<sup>85</sup> See below section: 5.5.4.2.

<sup>86</sup> See above section 3.3.1.

considered as a result of doing business;<sup>87</sup> in Oman bankruptcy is considered as a disgrace and might be a result of management failure. Due to such a belief, in Oman, it is not suitable to allow the management to run the company without some kind of supervision. As will be demonstrated below,<sup>88</sup> the adoption of the notion of DIP as it is adopted under the company voluntary arrangement in England may be better. Thus, the differences between Oman, England and the US will be taken into account when proposing bankruptcy concepts or principles for Omani legislation.

## **B. The Effect of Legal Transplants**

It was argued above that transplanting the experience of other countries is important in legal development, as long as foreign rules or principles serve the needs<sup>89</sup> of the importing country. However, when an importing country applies a rule that has been transplanted from another country, it is effectively applying a rule to its own local circumstances and, as a result, the interpretation of a legal rule may vary more in the importing country than in its origin.<sup>90</sup> As Watson states, a tomato plant that moves from X to Y is still a tomato plant. Nevertheless, its subsequent development depends on Y's soil, temperature, wildlife and so on.<sup>91</sup> Transplant countries, as a consequence, are likely to suffer from what is called 'the transplant effect'; that is, the mismatch between pre-existing conditions and

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<sup>87</sup> Moss G., 'Chapter 11- An English Lawyer Critique', (1998) 11 *Insolvency International* 17, p. 17.

<sup>88</sup> See below section 5.5.4.2.

<sup>89</sup> The needs of an importing country can be judged by identifying the drawbacks of its legal system and seeing how such drawbacks are dealt with under other jurisdictions.

<sup>90</sup> Berkowitz D., Pistor K. & Richard J., 'The Transplant Effect', (2003) *A.J.C.L.* 163, p. 177; also see Berkowitz D., Pistor K. & Richard J., 'Economic Development, Legality, and the Transplant Effect', (2003) 47 *E.E.R.* 165.

<sup>91</sup> Watson A., above 48, p. 80.

institutions and the transplanted law, which might weaken the efficiency of the imported legal order.<sup>92</sup> Also, as is empirically demonstrated,<sup>93</sup> it can be argued that the differences of infrastructure between the importing and exporting countries might have an impact on increasing the effects of the transplant. For instance, in their study, Daniel Berkowitz, Katharina Pistor and Jean Richard analysed the consequences of legal borrowing by comparing the ‘level of legality’<sup>94</sup> achieved over the last two hundred years in forty- nine different countries.<sup>95</sup> Their study develops and tests the proposition that “the way in which a country received its formal law is a much more important determinant of the current effectiveness of its legal institutions than the particular legal family that it adopted”.<sup>96</sup> They based their argument on two key perceptions.<sup>97</sup> First, for the law to be efficient, it must be meaningful in the context in which it is applied so society has an incentive to use the law and to demand the establishment of institutions that work to enforce and develop the law.<sup>98</sup> Second, the judges, practitioners and other legal elites that are responsible for developing the law must be able to increase the quality of law in a way that is responsive to demand for legality.<sup>99</sup> Thus, for law to be functioning, a demand for law should exist so the law on the books will be used in practice and

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<sup>92</sup> Berkowitz D., Pistor K. & Richard J., above 90, p. 171.

<sup>93</sup> Ibid.

<sup>94</sup> In measuring the level of legality they used survey data measuring the effectiveness of the judiciary, rule of law, the absence of corruption, low risk of contract repudiation and low risk of government expropriation observed during 1980-1995: *ibid*, p. 183.

<sup>95</sup> Ibid.

<sup>96</sup> They argued that the way in which the law is transplanted is a more important determinant of legality than the supply of a particular family: *ibid*, pp. 167 & 183.

<sup>97</sup> *Ibid*, p. 167.

<sup>98</sup> Ibid.

<sup>99</sup> Ibid.

legal persons responsible for developing and administering the law will be responsive to this demand. Also, they assumed that if the transplanted law matches local conditions in the importing country, the law will be used and function as in an origin country,<sup>100</sup> and as a result, strong public demand for institutions to enforce this law would follow.<sup>101</sup> However, if the transplanted laws do not match local circumstances, or if they were imposed via colonization and the population within the transplant was not familiar with the law, then the demand for using these laws would be weak.<sup>102</sup> They assumed that countries that received the law in this fashion were subject to the ‘transplant effect’.<sup>103</sup> Hence, their main argument was that “legality is largely a function of demand for law. Only if demand for law is high, will there be a high voluntary compliance and will a society invest in the legal institutions necessary for upholding the legal order”.<sup>104</sup> Therefore, based on their view, voluntary reforms initiated by the receiving countries (receptive transplants) are more likely to achieve better results than reforms imposed by outside forces (unreceptive transplants).<sup>105</sup> Even though they recognised the possibility of legal borrowing from other countries, they argued that “a good fit of foreign with domestic law may not be only a lucky coincidence, but could be enhanced by

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<sup>100</sup> They argued that “there may be cases where the transplanted law is more or less compatible with the initial order and this could offset the fact that law was transplanted. This possibility is reflected in our classification of different transplants”: *ibid*, p. 179.

<sup>101</sup> *Ibid*, p. 168.

<sup>102</sup> *Ibid*.

<sup>103</sup> *Ibid*.

<sup>104</sup> *Ibid*, p. 189.

<sup>105</sup> In their study, they classified countries into those that developed their formal legal order internally (origins) and those that received their formal legal order from other countries (transplants): see Berkowitz D., Pistor K. & Richard J., above 90, pp. 167 & 179-180; see Markovits I., above 43, p. 97.

meaningful adaptation of imported laws to local conditions”.<sup>106</sup> Furthermore, in his article ‘the codification of law and the transplant effect’, Pistor argues that over the past two hundred years of legal transplant, countries that transplanted a legal system wholesale have less efficient legal institutions<sup>107</sup> today than countries that developed their own rules.<sup>108</sup> This is, in her view, attributed to: initial economic conditions in the importing country, the political regime, cultural divergences, and inconsistency with pre-existing legal institutions.<sup>109</sup>

Hence, both of the above-mentioned studies acknowledged the existence of legal transplantations. However, such transplantations have an impact on the receiving countries in a way that might affect the implementation of such rules. It is argued that the effect of legal rules depends mainly on its “context-institutions, social and political forces and legal culture”.<sup>110</sup> Thus, while it is normally an easy task to copy the text of foreign law, it is extremely difficult to transfer this context.<sup>111</sup> However, this does not undermine the importance of taking lessons from the experience of other jurisdictions. Thus, this thesis stresses that in the course of drafting or revising laws, it is desirable to adopt foreign rules or principles if these are appropriate in filling the gap in the importing country. As will be demonstrated

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<sup>106</sup> Berkowitz D., Pistor K. & Richard J., above 90, p. 190.

<sup>107</sup> This means the workability of the legal institution in the importing country is less than that in the country of origin.

<sup>108</sup> Pistor K., ‘The Codification of Law and the Transplant Effect’, (2008) Sesquicentennial Essays of the Faculty of Columbia Law School, Columbia Law School, p. 182.

<sup>109</sup> Ibid.

<sup>110</sup> Gunderson J. & Waelde T., ‘Legislative Reform in Transition Economies: Western Transplants- a Short –Cut to Social Market Economy Status’, (1994) 43 (2) I.C.L.Q. 347, p. 372.

<sup>111</sup> Ibid.

by examples,<sup>112</sup> during its legislation path, Oman has tended to adopt some foreign legal principles. The aim of this thesis is, also, to take lessons from the experience of both England and the US by adopting some of the bankruptcy concepts or principles available under both jurisdictions. However, since Oman might be subject to ‘transplant effect’, this thesis argues that minimising the effect of transplantations can be planned for by assessing in advance the workability and functionality of the proposed foreign rules. Also, as will be discussed below,<sup>113</sup> in assessing the impact of the imported legal principles on the importing country, it is important to continually review the effects of such transplantation.

### **C. Measuring the Success of Legal Transplants**

It is argued that legal transplants are as old as the law.<sup>114</sup> However, as discussed above, the importing countries may suffer from what is called ‘the transplant effect’;<sup>115</sup> that is, the mismatch of local conditions between the countries of origin and the importing countries.<sup>116</sup> Hence, the question to be asked is whether it is possible to measure or anticipate the level of success of the transplanted legal rules. A number of scholars have approached this question but have failed to elaborate specific criteria<sup>117</sup> to be used in judging the success of legal

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<sup>112</sup> See below section 5.3.2.

<sup>113</sup> See below section 5.5.

<sup>114</sup> Watson A., *Legal Transplants: An Approach to Comparative Law*, (London, University of Georgia Press, 1993).

<sup>115</sup> See Berkowitz D., Pistor K. & Richard J., above 90, pp. 171-183.

<sup>116</sup> Ibid.

<sup>117</sup> This might be due to the vagueness of the concept of success and the way to measure it.

transplants.<sup>118</sup> Watson, for instance, states that “a successful legal transplant- like that of a human organ- will grow in its new body, and become part of that body just as the rule or institution would have continued to develop in its parent system”, and “subsequent development in the host system should not be confused with rejection”.<sup>119</sup> Thus, according to him, the success of a legal transplant depends largely on the recipient country’s desire for the foreign transplanted legal rule, rather than an awareness of, or similarities with, its context.<sup>120</sup> However, in response to Watson, it is argued that measuring the effectiveness of the transplanted rules is too difficult since societies often have different ideas<sup>121</sup> and what is considered success from one point of view does not necessarily entail success from another.<sup>122</sup> Further, Neiken states that the meaning of success is vague and he raised a number of concerns,<sup>123</sup> such as whether success should be judged from the perspective of those promoting or those receiving the transfer. Does the meaning to be given to success depend on the aims of the intentions and interests of those promoting an adaptation, and those who then do (or do not) make use of new opportunities, or submit to new controls or requirements (or resist and avoid them)? Or is it something for the scholar to assess in terms of external criteria, taking into account perhaps also those factors and unintended outcomes

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<sup>118</sup> Neiken D., ‘The Meaning of Success in Transplantation Legal Transfers’, (2001) 19 W.Y.A.J. 349, p. 352; Zhuang S., ‘Legal Transplantation in the People’s Republic of China: A Response to Alan Watson’, (2006) 7 E.J.L.R 215, p. 223.

<sup>119</sup> Watson A., above 114, p. 27.

<sup>120</sup> Watson A., above 51, p. 83; Forsyth A., above 61, p. 2.

<sup>121</sup> There are even different views within a specific society.

<sup>122</sup> Zhuang S., above 118, p. 223; also Neiken states that “ambiguity over the meaning of success regularly leads to the slaying of straw men”, above 118, p. 352.

<sup>123</sup> Neiken D., above 118, p. 362.

which could not have been known to the social actors concerned, such as the way a given change is affected by the differentiating and integrating effects of globalisation? Thus, he argues that the most essential question from which there is no escape is who gets to establish what is meant by success.<sup>124</sup> “What some observers and participants will see as success, others may well see as failure.”<sup>125</sup>

Since it is difficult to define the notion of success, it is proposed that such success can be assessed on a case by case basis, with particular reference to the specific reality considered.<sup>126</sup> As a consequence, legal transplants are considered to be successful when they have shown to have resolved<sup>127</sup> the judicial problems for which they have been made.<sup>128</sup> Furthermore, in her book, Dupré argues that the success of any law importation will depend on the expectations that might be associated with it.<sup>129</sup> For instance, it is necessary to have the expectation that transplanting legal rules from a foreign country would not turn the legal system of the imported country into an ideal one. However, legal transplants should be viewed as a successful process since normally something new will come out of it.

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<sup>124</sup> Ibid, p. 363.

<sup>125</sup> Ibid.

<sup>126</sup> Costa J., Jorge O. & Cardinal P., *One Country, Two System, Three Legal Orders- Perspective of Evolution*, (Springer, 2009), p. 83.

<sup>127</sup> However, it is unclear how this can be judged.

<sup>128</sup> Ibid.

<sup>129</sup> In her book, she highlights the importance of three types of expectations, namely: (1) taking into account the expectation that the imported rules will bring something new to the imported country; (1) the expectation that the cultural gap between exporter and importer are considered and bridged; and (3) that viewing the success of the rules from the exporter's point of view; for further explanation: see Dupré C., above 27, pp. 60-61.

### 5.3.1 Transplanting Bankruptcy Laws

It has been already noted that the movement of legal rules, practices and institutions has been a normal occurrence all around the world and globalisation has increased the number of legal transplants.<sup>130</sup> As will be demonstrated below,<sup>131</sup> many countries have reformed their bankruptcy laws through transplanting, imitating and borrowing other countries' laws. In this regard, there are a number of drivers for reforming bankruptcy laws.<sup>132</sup> First, some countries reform their laws, in particular corporate and bankruptcy laws, in order to attract foreign investment and to show foreign investors from various countries that they comply with the best recognised standards.<sup>133</sup> Secondly, because of globalisation, many countries believe that building a viable bankruptcy system "will help fuel a market economy".<sup>134</sup> As a consequence, many countries<sup>135</sup> have attempted to establish a reorganisation regime for failing traders like Chapter 11 of the US Bankruptcy Code.<sup>136</sup> Further, several international organisations, such as funding agencies like the International Monetary Fund (IMF) and the World Bank, normally make loan agreements to developing countries conditional upon adopting a specific model,

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<sup>130</sup> Markovits I., above 43, p. 95; Miller J., above 44, pp. 839-840.

<sup>131</sup> See below pp. 283-287.

<sup>132</sup> Berkowitz D., Pistor K. & Richard J., above 90, p. 163; Costa J., Jorge O. & Cardinal P., above 126, p. 84; Gillespie J., above 35, p. 641.

<sup>133</sup> Ibid.

<sup>134</sup> Martin N., 'The Role of History and Culture in Developing Bankruptcy and Insolvency Systems: The Perils of Legal Transplantation', (2005) 28 B.C.I.C.L.R. 1, p. 4.

<sup>135</sup> China, Indonesia, Hong Kong and Malaysia: see Tomasic R., Little P., Francis A., Kamarul K. & Wang K., 'Insolvency Law Administration and Culture in Six Asian Legal Systems', (1996) 6 A.J.C.L. 248, p. 248; Martin N., above 134, p. 4.

<sup>136</sup> Martin N., above 134, p. 4.

generally the Anglo-American model.<sup>137</sup> This type of conditionality was also an essential feature of efforts made by the IMF to rescue banks and other financial institutions during the Asian Financial Crisis.<sup>138</sup> However, it is stated that countries in financial crisis, as a result, are significantly dependent on infusions of funds from multilateral institutions, and are likely to be much more susceptible to lawmaking influence by these institutions than countries in stable financial circumstances.<sup>139</sup> Also, it is argued that since insolvency laws are integral to the development and growth of markets, many countries have recognised the importance of introducing bankruptcy reforms.<sup>140</sup>

Based on the above-mentioned factors and in recognition of the importance of rescue culture, many countries have reformed, and some are in process of reforming, their bankruptcy laws.<sup>141</sup> However, in most cases, these new reforms or proposed reforms do not arise from existing cultural conditions;<sup>142</sup> instead, the rules of such laws are transplanted from elsewhere and the cultural views are

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<sup>137</sup> Gillespie J., above 35, p. 643. It is stated that the US leads the world in its experience with reorganisation of corporations through bankruptcy law and its philosophy of corporate rehabilitation has been incorporated in the global standards by International Financial Institutions: see Haliday T. & Bruce C., 'The Recursivity of Law: Global Norm Making and National Law-making in the Globalization of Corporate Insolvency Regimes', (2007) 112 (4) A.J.S. 1135, p. 1187.

<sup>138</sup> See Tomasic R., 'Raising Corporate Governance Standards in Response to Corporate Rescue and Insolvency', (2009) 2 (1) C.R.I. 5, p. 4.

<sup>139</sup> See Haliday T. & Bruce C., above 137, p. 1153.

<sup>140</sup> Tomasic R., Little P., Francis A., Kamarul K. & Wang K., above 135, p. 248.

<sup>141</sup> China, Indonesia, Hong Kong and Malaysia have already reformed their bankruptcy Laws. UAE is in the process of reforming its bankruptcy law: see *ibid*; see also: [http://www.zawya.com/story/Hopes\\_renewed\\_for\\_UAE\\_bankruptcy\\_law\\_by\\_quarter\\_s\\_end-GN\\_20012013\\_210112/](http://www.zawya.com/story/Hopes_renewed_for_UAE_bankruptcy_law_by_quarter_s_end-GN_20012013_210112/). accessed on 27/01/2014.

<sup>142</sup> As argued by Khan-Freund, in order to avoid the risk of rejection, it is necessary to have knowledge of the political and social conditions in the exporting jurisdictions: see Khan-Freund, above 42, pp. 3-4.

expected to change with such reforms.<sup>143</sup> It is stated that in many areas of commercial law, national law reforms can no longer be purely national.<sup>144</sup> To one degree or another, the force for reform, the content of reform, and the 'trajectory' of reform proceeds from or responds to transnational and global context.<sup>145</sup> The great majority of the national bankruptcy reforms of the past 15 years are influenced by transnational or international developments.<sup>146</sup> It is stated that such reforms are not, normally, derived from the traditional cultural values of these countries; however, the reforms are attributed to the influence of ideas drawn from the notion of rescue culture.<sup>147</sup> Thus, in recognition of the importance of rescue culture, many new bankruptcy laws have been transplanted from the United States.<sup>148</sup>

Despite the increase in transplantations of the US bankruptcy system, it is argued that the new reforms or proposed reforms have little impact, in reality, on the transplanted countries, if cultural views<sup>149</sup> or attitudes are not changed.<sup>150</sup> In her study, Martin examined the role of history and culture in developing bankruptcy and insolvency systems in a number of developed and developing countries.<sup>151</sup> In

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<sup>143</sup> Martin N., above 134, p. 76.

<sup>144</sup> Haliday T. & Bruce C., above 137, p. 1173.

<sup>145</sup> Ibid.

<sup>146</sup> Ibid.

<sup>147</sup> Tomasic R., Little P., Francis A., Kamarul K. & Wang K., above 135, p. 485.

<sup>148</sup> It is stated that "the US model of law and development introduced 'ideal' legal models to the newly independent states": Cisse H., Muller S., Thomas C. & Chenguang W., 'The World Bank Legal Review: Legal Innovation and Empowerment for Development', p. 162, available at: [http://econ.worldbank.org/external/default/main?pagePK=64165259&theSitePK=469372&piPK=64165421&menuPK=64166093&entityID=000356161\\_201212220072334](http://econ.worldbank.org/external/default/main?pagePK=64165259&theSitePK=469372&piPK=64165421&menuPK=64166093&entityID=000356161_201212220072334); Martin N., above 134, p. 2.

<sup>149</sup> It is argued that cultural views can be changed by raising awareness amongst all stakeholders and communities about the advantages of using rescue proceedings: *ibid.*

<sup>150</sup> Martin N., above 134, p. 6.

<sup>151</sup> *Ibid.*

this regard, she argued that importing countries should avoid the wholesale transplantation of bankruptcy laws; rather, these countries should take into account the economic needs of their societies and their unique cultural components.<sup>152</sup> This is due to that fact that regardless of what bankruptcy law says, the reality may be quite different.<sup>153</sup> For instance, in Germany, the enacted Insolvency Code of 1999 adopted the concept of a debtor-in-possession.<sup>154</sup> However, the adaptation of this concept has been criticised and mistrusted by most of German society for a considerable time regardless of what the law says.<sup>155</sup> Also, despite the technical requirement that an appointed administrator shall be independent, in reality the lead bank chooses an administrator who is friendly to its interests.<sup>156</sup> As a result, Martin states that “long-held and strong cultural values may stand in the way, despite the best intentions of lawmakers”.<sup>157</sup>

Furthermore, an empirical and a legal study in six Asian legal systems (China, Hong Kong, Indonesia, Malaysia, Singapore and Taiwan) was conducted to examine how local legal cultures shape national approaches to corporate insolvency law and practice.<sup>158</sup> That study suggested that law reforms which can mesh with pre-existing traditional attitudes, even if the source of the reform is a foreign one, are more likely to be successfully implemented.<sup>159</sup> Also, this study demonstrated that despite the different cultures between these Asian systems and

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<sup>152</sup> Ibid, p. 76.

<sup>153</sup> Ibid, p. 48.

<sup>154</sup> Ibid, p. 49.

<sup>155</sup> Ibid, p. 49.

<sup>156</sup> Ibid, p. 49.

<sup>157</sup> Ibid, p. 52.

<sup>158</sup> Tomasic R., Little P., Francis A., Kamarul K. & Wang K., above 135, pp. 248-280.

<sup>159</sup> Ibid, p. 285.

the exported legal systems, traditional cultural values and attitudes to debt have been changing.<sup>160</sup> As a consequence, this empirical study concluded that while the cultural attitudes in these Asian countries might continue to operate to some degree, particularly amongst the smaller and family companies, their impact on the imported bankruptcy laws seems to be declining.<sup>161</sup> However, this is not to claim that cultural attitudes are not expected to change with such reforms. For instance, in China cultural views toward insolvency have changed over time as people have become more accustomed to the concept of insolvency.<sup>162</sup> In their empirical study, one of the interviewees noted that “[I]n the beginning, people regarded bankruptcy as a loss of face; now they see they are given other opportunities as a result of bankruptcy. Employees see it as fortunate and only reasonable that their enterprise go bankrupt”.<sup>163</sup> Also, in Japan there is a call to change cultural attitudes toward bankruptcy. For example, Japan’s Economy Minister has called for a change in both the laws and the attitudes towards debt repayment.<sup>164</sup> In promoting the use of the Corporate Reorganisation Act, the Japanese Government broadcasted on prime-time television the merits of using this Act.<sup>165</sup> In addition, within the area of business law, another empirical study examined the viability of transplanted foreign

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<sup>160</sup> Ibid.

<sup>161</sup> It is stated that sometimes there is an overlap between the extent to which corporate rescue and reconstruction philosophies operate in tandem with traditional attitudes which encourage settlement and accommodation of commercial dealings: *ibid.*

<sup>162</sup> *Ibid.*, p. 14.

<sup>163</sup> However, this is not to suggest that the process of change attitudes to insolvency is uniform through China since in some areas of southern China the application of bankruptcy laws has proved far more difficult: see *ibid.*, p. 28.

<sup>164</sup> Martin argues that it is far easier to change law than attitudes: above 134, p. 75.

<sup>165</sup> *Ibid.*, p. 63.

investment code in Kazakhstan.<sup>166</sup> This study also reached the conclusion that even though the transplanted law in question did not emerge from the culture of Kazakhstan and does not comport with Kazakhstan's culture, the law has been accepted.<sup>167</sup>

These studies contradict the view of the supporters of the conventional theories that a specific culture requires a specific legal system and the view of both Montesquieu and Legrand that legal rules cannot cross cultural boundaries since they mirror the culture of the home country. Hence, it is argued that transplanted laws that grow outside the land of the importing countries can be accepted, even though this might occur after the passage of a period of time. The examples stated above demonstrate how cultural attitudes have changed as a result of such reform. However, cultural views can be changed by raising awareness amongst all stakeholders and communities about the advantages of using rescue proceedings. It was emphasised in a recent EU study that even though domestic policymakers adopt laws that promote the philosophy of a fresh start, there is a need to introduce a European cultural campaign promoting rescue culture.<sup>168</sup>

### **5.3.2 Oman as an Importing Country**

Although Oman is an Islamic country, most of its laws have western characteristics.<sup>169</sup> In this regard, laws were enacted, even though some of their features contradict the principles of Sharia law. For example, one of the earliest

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<sup>166</sup> Nicholas P., 'Viability of Transplanted Law: Kazakhstani Reception of a Transplanted Foreign Investment Code', (1997)18 (4), U.P.A.J.I.E.L. 1235.

<sup>167</sup> Ibid, p. 1236.

<sup>168</sup> Martin N., above 134, pp. 51-52.

<sup>169</sup> Hirst A., 'Contemporary Mercantile Jurisdiction in Oman', (1992-1993) 7 A.L.Q. 3, p. 4.

laws that was enacted in 1973 was the Law Relating to the Interpretation of Certain Terms and General Provisions (3/73). This law introduced a number of technical provisions normally encountered in western jurisdictions, such as rules governing the effect on private rights caused by the repeal of an existing law and its replacement by a new law.<sup>170</sup> Furthermore, as is the case in most Arab States, the Omani Penal Law of 1974 abandoned the penal principles of Sharia and transplanted instead western notions of criminality and punishment.<sup>171</sup> This is especially significant because the Islamic rules of crime and punishment, particularly what are called the *hudud* crimes, were abandoned.<sup>172</sup> These include the most forbidden crimes, such as adultery, false accusation of adultery, drinking alcohol, theft, brigandage (a group of corrupt people joining together to use arms, cut off highways, steal property, kill people and prevent the free passage of persons, called highway robbers and brigands)<sup>173</sup> and apostasy (the partial or complete abandonment or rejection of the beliefs and practice of a religion by a

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<sup>170</sup> Article 9 & 10 of the Law Relating to the Interpretation of Certain Terms and General Provisions (3/73); see Hirst A., above 169, p. 4.

<sup>171</sup> It is argued that “the emergence of Western hegemony in the nineteenth century greatly affected the legal system in the Islamic world. In most Islamic countries that came under European colonial rule, Sharia criminal law was immediately substituted by Western-type penal code”. In some other countries, however, the departure was a result of the intervention of international organisations: see Peters R., *Crime and Punishment in Islamic Law: Theory and Practice from the Sixteenth to the Twenty-First Century*, (Cambridge University Press, 2005), pp. 3-4.

<sup>172</sup> It is worth noting that Saudi Arabia has consistently maintained Sharia criminal law and the law of 2001 includes elements of classical Sharia criminal law, particularly in regard to the so-called *hudud* crimes. Also, as it was noted in the previous chapter, Oman’s Penal Code of 1974 plays a role in bankruptcy cases. In this regard, the company’s directors may incur criminal liability in the case where the company’s bankruptcy has been caused by fraudulent actions on their part: see Article 301 of the Penal Code 1974.

<sup>173</sup> Shah N., *Islamic Law and the Law of Armed Conflict: The Conflict in Pakistan*, (Taylor & Francis, 2011), p. 63.

person who is a follower of that religion).<sup>174</sup> However, this does not mean that the role of Sharia has totally been discarded;<sup>175</sup> rather, it is limited to the laws of family, including marriage, divorce, wills and inheritance.<sup>176</sup> This leads a commentator to classify Oman as having a hybrid Islamic- Napoleonic system.<sup>177</sup> Thus, the laws of Oman and the laws of some Arab countries, as described by Sfeir, are a composite of:<sup>178</sup>

*“(1) a residual of Islamic law rules, whether in modern statutory form, as is the case with laws of domestic relations, or in its classical form applicable in Saudi Arabia as the common law of land where no statutory legislation exists, (2) the European-based codes, which constitute the backbone of the law in the private and public law fields, some of which succeeded in incorporating certain Islamic law rules of contracts and obligations considered viable under today’s conditions, and (3) a growing number of major, topical legislation, in the form of comprehensive statutes in such fields as arbitration, banking, copyright, environment, maritime, social security, taxation and so forth.”*

It is true that Oman’s Penal Law, Company law, Civil and Criminal Procedures, Law of Evidence and Maritime Law are designed to imitate, repeat and copy Western laws.<sup>179</sup> Except when dealing with some cases, Sharia courts have been

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<sup>174</sup> Campo J., *Encyclopedia of Islam*, (Infobase Publishing, 2009), p. 48.

<sup>175</sup> Sfeir G., ‘The Place of Islamic Law in Modern Arab Legal Systems: A Brief for Researcher and Reference Librarians’, (2000) 28 I.J.L.I. 117.

<sup>176</sup> It is stated that the share of Islamic law today in the Arab legal systems (roughly speaking 25% to 30%) is bound to diminish as a distinct factor with new statutory enactments continuously generated by changing social and economic conditions and global developments: see Sfeir G., above 175, p. 120.

<sup>177</sup> Wood P., *Principles of International Insolvency*, (London, Sweet & Maxwell, 2007), p. 64.

<sup>178</sup> Sfeir G., above 175, p. 121.

<sup>179</sup> See Abu-Odeh L., ‘The Politics of (Mis) Recognition: Islamic Law Pedagogy in American Academia’, (2004) 52 A.J.C.L. 789, pp. 789-790.

replaced by modern civil courts. Currently, Sharia principles appear only rarely in the *Official Gazette*, and, when they do, it is usually only for the purpose of measuring a traditional Sharia obligation, such as a bloodwite (compensation paid by a murderer to the family of the victim) or dower (paid by the groom to the bride under Islamic law).<sup>180</sup>

In addition, the Commercial Code was enacted in 1990 and includes a number of general principles of contracts and tort contained in the Napoleonic Code.<sup>181</sup> It is worth noting that before the enactment of this law, reliance was on the principles of Sharia law.<sup>182</sup> However, after the issuance of the Commercial Code, the role of Sharia in determining commercial acts has been narrowed considerably from its original position as the sole source of law. In this regard, Article 5 of this Code clearly states that Sharia law applies only in the absence of specific legislative provisions and in the absence of local or general customs. Hence, in the event of bankruptcy, if the court is unable to resolve an issue because of lack of a statutory provision, in this case the recourse will not be to Sharia rules, but rather the court should, firstly, look at local or general bankruptcy usages.<sup>183</sup> In the absence of

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<sup>180</sup> Hirst A., above 169, p. 8; Buchler A., 'Islamic Family Law in Europe? From Dichotomies to Discourse or: Beyond Cultural and Religious Identity in Family Law', (2012) 8 (2) I.J.L.C. 196, p. 201.

<sup>181</sup> Hirst A., above 169, p. 6; also Wood states that Oman has Napoleonic Commercial Law: above 177, p. 64.

<sup>182</sup> Nabil S., *The General Principles of Saudi Arabian and Oman Company Laws: Statutes and Sharia*, (Namara Publications, 1981), p. 108.

<sup>183</sup> It is stated that trade usage, like custom in public international law, may vary widely both in its sphere of influence and its degree of specificity. For instance, an international trader usage might be confined to a particular type of business activity (e.g. bank documentary payment undertakings) but may be near-universal in geographical scope, whilst on the other hand there may be usages

such usages, the principles of Sharia will be utilised. This is despite the fact that Oman's Basic Statute (known also as a Constitutional law) of 1996 clearly states that "Islamic Sharia is the basis for legislation".<sup>184</sup> However, this Basic Statute also contains provisions that point in another direction: the duty of obedience of the Basic Law, the principle of democracy and the legislation authority of the constitutional councils, the enactment of human rights such as the principle of equality, freedom of religion and others which might be against the principles of Sharia. This led a commentator to argue, rightly, that constitutional laws in most Muslim countries normally have one foundation basic norm that seems to say: the basic idea of this state is the compatibility of Sharia and Rule of Law; however, it appears that working out the details does not necessary reflect this norm.<sup>185</sup>

Since the core of this thesis is to examine the bankruptcy system in Oman, the specific question to be asked is what are the reasons for the lack of interest in Islamic principles in regard to bankruptcy. Why is Oman's Commercial Code transplanted from other jurisdictions while, in dealing with bankruptcy, Sharia has a number of principles?<sup>186</sup> It seems that this is due to a number of factors. First,

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which apply to business activities generally but only within a defined geographical area or a particular legal family: see Goode R., Kronke H. & Mckendrick E., above 41, p. 11.

<sup>184</sup> Article 2 of Oman's Basic Statute of 1996.

<sup>185</sup> See Otto J., *Sharia and National Law in Muslim Countries: Tensions and Opportunities for Dutch and EU Foreign Policy*, (Amsterdam University Press, 2008), pp. 18-19.

<sup>186</sup> Examples of Sharia bankruptcy principles are the prohibition of *riba*, obligation of socially responsible and the principle of discharge from debt (by death): for an in-depth discussion of Sharia bankruptcy principles: see Awad A. & Michael R., 'Iflas and Chapter 11: Classical Islamic Law and Modern Bankruptcy', (2010) 44 I.L.J 975. p. 980.

Oman is a modern<sup>187</sup> country and the enactment of written laws started in 1973. The enactment of the Commercial Companies Law was in 1974. Unlike the case in Sharia where the concept of corporation does not exist, the Commercial Companies Law of 1974 followed the modern trend in granting a company a separate legal entity.<sup>188</sup> Thus, in designing the Commercial Code the same approach was followed and, as a result, the rules governing the bankruptcy of companies in particular and the individual trader in general were transplanted.<sup>189</sup> Secondly, since the Commercial Code was enacted in 1990, it had to meet modern business needs in order to attract foreign investment.<sup>190</sup> It had to establish rules and procedures that conformed remarkably well not only in Oman but also across national boundaries. Such needs were acknowledged even before the enactment of the Commercial Code. For instance, in 1972, a special Committee for the Settlement of Commercial Disputes was established to deal with commercial matters.<sup>191</sup> Thus, even before the enactment of the Commercial Code in 1990,

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<sup>187</sup> It is a modern country because legal, economic and cultural developments began with the accession to power of Sultan Qaboos in 1970. It is also a modern country because the legislation path started after 1973.

<sup>188</sup> The reason for taking this decision might be that not granting a company a separate legal entity may play a role in discouraging domestic and foreign investment since partners would be severally and jointly liable for their business's debts to the full extent of their property: see Article 3 of the Oman's Commercial Companies Law of 1974.

<sup>189</sup> This appears from a number of provisions, such as the allowance of *riba* (interests) and considering a company a separate legal entity.

<sup>190</sup> Because the enactment of the Commercial Code was after the enactment of Foreign Business and Investment law of 1974 and after the enactment of the Commercial Agency Law of 1977.

<sup>191</sup> Also, in 1981, a Royal Decree has been issued whereby an Authority for the Settlement of Commercial Dispute is established. However, this Authority did not in practice supersede the former Committee for the Settlement of Commercial Disputes until the issuance of 1984 of detailed Rules governing the procedures before the Authority: see Haberbeck A. & Price R., *The Maritime Laws of the Arabian Gulf Cooperation Council States*, (Vol.1, BRILL, 1986), p. 29.

Sharia rules were abandoned and this Committee was established merely to handle commercial cases according to modern principles, to the local and general customs and to Sharia principles as a last resort.<sup>192</sup> Finally, as Hamoudi has argued,<sup>193</sup> such a departure might be due to the fact that the Sharia bankruptcy principles are not useful<sup>194</sup> or relevant to the order of modern commercial life and, as a consequence, the tendency has been to transplant other laws and ignore the rules of Sharia. For instance, the concept of cram-down is not recognised under Sharia law and, as a consequence, the debtor will be discharged from his debts in only two ways: full repayment of all unforgiven debts or death.<sup>195</sup> In his regard, Qatar has begun a process of Islamisation of its banking sector through issuing bank directives designed to expand Islamic banking within the country, and initiated a bankruptcy regime in a 2006 law that bears all of the hallmarks of a Western transplant.<sup>196</sup> However, it is worth mentioning that this does not mean Islamic law does not encourage the settlement of debts through partial or entire forgiveness or through granting respite. Rather, the Holy Quran encourages the creditors to forgive and grant debtors respite, even though such a demand constitutes purely a moral and not a mandatory obligation. In this regard, verse 2:280 of the Holy Quran says that “if a person is in difficulties, let there be respite until a time of ease. And if you give freely [i.e. if you forgive the debts voluntarily] it would be better for you, if only you knew”. This Quranic verse makes it certain that

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<sup>192</sup> See a report called ‘Oman Mineral & Mining Sector Investment and Business Guide’, prepared by USA International and Ibpus.com, (Int’l Business Publications, 2007), p. 129.

<sup>193</sup> Hamoudi H., ‘The Surprising Irrelevance of Islamic Bankruptcy’, (2011) 19 A.B.I.L.R. 505, p. 510.

<sup>194</sup> However, it is not clear what Hamoudi means by the word ‘useful’?

<sup>195</sup> Awad A. & Michael R., above 186, p. 980.

<sup>196</sup> Hamoudi H., above 193, p. 509.

the concepts of social responsibility and charity are at the heart of the Sharia's teaching.<sup>197</sup> Even though the obedience of these concepts is not mandatory, it is argued that "this forceful divine recommendation to be kind to one's debtor is balanced by the Quranic verse that compels a Muslim to repay their debts- making it a sin and not just a legal obligation not to pay off all of the debts that you have the capacity to repay: "O you who believe, you shall fulfill your covenants".<sup>198</sup> While Sharia encourages creditors to forgive their debtors or grant them respite, it urges the debtor to fulfill his obligation under the contract. Hence, it can be argued that Hamoudi's argument that Sharia bankruptcy principles are not relevant to the order of modern commercial life is far from the truth.<sup>199</sup>

From the above discussion, it is obvious that during the past forty years of the legislation path in Oman, the Omani law-making elites chose to import most laws from other jurisdictions. Hence, transplanting others countries' laws is not a new phenomenon in Oman. This leads to the question: in improving the bankruptcy regime in Oman, to what extent is it possible to learn from the experience of England and the US? To put it differently, what is the impact of proposing modern concepts to be adopted by the Omani legislator, such as the concept of rescue culture, the notion of 'cram-down', imposition of stay on secured creditors' claims and the notion of 'debtor-in-possession'. This thesis argues that such concepts, if proposed, might be accepted by the Omani legislator. This view is supported by a number of rationales. First, the current bankruptcy regime in Oman fails to deal

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<sup>197</sup> Awad A. & Michael R., above 186, p. 980.

<sup>198</sup> Ibid; see The Holy Quran verse 5:1.

<sup>199</sup> Since they are not mandatory, it is worth noting that in proposing future bankruptcy reform, this thesis places no particular emphasis on Sharia's bankruptcy principles.

with the needs of today's business. The law, as it stands today, is outdated and inconsistent with modern business requirements.<sup>200</sup> As discussed in the previous chapter,<sup>201</sup> the current regimes focus merely on the complete dissolution of the distressed debtors. However, the modern trend is the introduction of a rescue culture into bankruptcy frameworks, thereby rehabilitating viable firms instead of liquidating them. Hence, such concepts are unlikely to be rejected by the Omani legislator since they have the intention to follow the modern trend in the area of bankruptcy law. In this regard, in 2013, for instance, one of the issues discussed in the 'Government Symposium for the Development of Small and Medium Enterprises in Oman' was bankruptcy of small and medium enterprises and how reform of bankruptcy law is needed in order to encourage the concept of rescuing these enterprises instead of liquidating them. It is worth noting that, based on a royal order issued by His Majesty the Ruler of Oman, all recommendations stated in the final report of this symposium shall be considered as decisions that need to be implemented by the government and various institutions, not recommendations that have to be considered.<sup>202</sup> Thus, the importance of establishing a modern bankruptcy regime is fully acknowledged. Secondly, Oman's accession to the World Trade Organization in 2000 and Oman's Free trade Agreement with the United States, which came into force on January 1, 2009, fosters the government's desire to bring Omani commercial laws into conformity with internationally

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<sup>200</sup> See above section 4.8.

<sup>201</sup> Ibid.

<sup>202</sup> This was an exception. Usually, all government symposiums result in a number of recommendations that need to be taken into account by various governmental institutions if they opt for them. However, the recommendations made by this symposium are considered to be decisions that require implementation.

accepted standards.<sup>203</sup> In this regard, in 2011 the U.S. Department of Commerce started providing training and capacity building to encourage Omani policy-makers to update the current bankruptcy regimes to allow for appropriate restructuring of the distressed enterprises.<sup>204</sup> Also, in support of Oman's interest in increasing international trade and entrepreneurship, the Commercial Law Development Program (CLDP)<sup>205</sup> is providing technical assistance to Omani law makers in order to develop a bankruptcy law that supports the restructuring of struggling businesses.<sup>206</sup> Finally, it is argued that such reforms will be accepted, even though some of the notions that will be proposed are not recognised under Sharia law, such as the notion of cram-down. This is due to the fact that the Commercial Code of 1990 has already incorporated provisions that are inconsistent with the strict rules of Sharia. Nevertheless, such rules<sup>207</sup> were accepted and have been in force since the enactment of this Code. For instance, one of the fundamental principles of commercial transactions under Sharia is the prohibition of *riba*, which is translated as interest or usury, undue profits or excessive gain from a transaction.<sup>208</sup> However, such usury is not prohibited under the Commercial Code.

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<sup>203</sup> For example, providing minimum protection to intellectual property rights, easing market access for WTO members, recognising arbitral awards.

<sup>204</sup> See <http://www.state.gov/e/eb/rls/othr/ics/2012/191213.htm>.

<sup>205</sup> Established in 1992, CLDP is a division of the U.S. Department of Commerce that helps achieve U.S. foreign goals in developing and post-conflict countries through commercial legal reforms. For further details see <http://cldp.doc.gov/about-cldp>.

<sup>206</sup> See <http://cldp.doc.gov/countries-regions/middle-east-north-africa>.

<sup>207</sup> The allowance of *riba* (interest) and granting a company a separate legal entity.

<sup>208</sup> Under Islamic law, the payment and receipt of usury is strictly prohibited as the application of interest is regarded as an act of exploitation and injustice and therefore inconsistent with Islamic concepts of fairness and justice; see Fisho-Oriedi A., 'The Prohibition of *Riba* Under Islamic Law: What are the Implications for International Contracts?', (University of Dundee, 2010), available at:

In this regard, Article 80 of the Commercial Code states that “a creditor shall have the right to exact interest in exchange of the procurement by the debtor of a loan or commercial debt.... [W]here the debtor fails to make the repayment on the due date, the creditor shall be entitled to exact the agreed interest for the period of delay”. The acceptance of usury, although strictly forbidden under Sharia, indicates that the introduction of bankruptcy principles that are not recognised under Sharia law may not be rejected, since such principles are not strictly prohibited. This is manifested by the desire of the Omani legislator to bring commercial laws into conformity with the needs of today’s business.

Hence, as it is stated by Markovits “starting from scratch means one must look for models” and “working from scratch also means that legislatures can provide their new laws with equally new supportive institutions”.<sup>209</sup> Reforming Oman’s bankruptcy regime is important to avoid what is called ‘jurisdiction shopping’.<sup>210</sup> It is

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<http://www.dundee.ac.uk/cepmlp/gateway/?news=30851>. accessed on 20/11/2013.

<sup>209</sup> Markovits I., above 43, p. 100.

<sup>210</sup> Jurisdiction shopping or forum shopping may involve the transfer of judicial proceedings from one country to another, seeking to obtain a more favourable position. Also, such shopping takes place where those responsible for the formation of the company engineer its finances so that it becomes subject to the law of another country whose regulatory regime is more indulgent towards those who control and manage it: see Kastrinou A., ‘Forum Shopping under the EC Regulation on Insolvency Proceedings’, (2013) 24 (1) I.C.C.L.R. 20, p. 22; Belohlavek A., ‘Center of Mani Interest (COMI) and Jurisdiction of National Courts in Insolvency Matters (Insolvency Status)’, (2008) 50 (2) I.J.L.M. 53; It is worth noting that it is beyond the scope of this thesis to discuss the treatment of corporate groups. However, the treatment of such groups is one of the issues in international insolvency that has been approached by many scholars: see for examples Tollenaar N., ‘Dealing with the Insolvency of Multinational Groups under the European Insolvency Regulation’, (2010), 23 (5) *Insolvency Intelligence* 65; Mevorach I., *Insolvency within Multinational Enterprise Groups*, (Oxford, Oxford University Press, 2009); Dearborn M., ‘Enterprise Liability: Reviewing and Revitalizing Liability for Corporate Groups’, (2009), 97 *Cal. L. Rev.* 195; The treatment of corporate groups is also discussed in great detail in ‘UNCITRAL Legislative Guide on Insolvency Law:

stated that many Middle-eastern based institutions are electing to make use of debtor-friendly bankruptcy regimes, e.g. US Chapter 11, to escape the deficiencies of their home jurisdictions.<sup>211</sup> This can be done by a change of a company's Centre of Main Interest (COMI) to the jurisdiction having a competitive bankruptcy framework.<sup>212</sup> It is argued that bankruptcy laws vary widely with respect to the complexity of the proceedings and the possible outcome and, because of these potentially huge distinctions, it can be advantageous for companies in difficulty to choose a jurisdiction which provides procedures that allow them to reach their aims in the easiest, cheapest and most effective way.<sup>213</sup> In this regard, Hellas Telecommunication, for instance, considered the insolvency procedures in England to offer a 'more flexible environment' for rescuing the business of the company

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Treatment of Enterprise Groups in Insolvency (Part Three)', (43<sup>rd</sup> session, A/C.9/686, July 2010); see Goode R., *Principles of Corporate Insolvency Law*, (4<sup>th</sup> edition, sweet & Maxwell, 2011), pp. 788-790.

<sup>211</sup> See McCormack G., 'Jurisdictional Competition and Forum Shopping in Insolvency Proceedings', (2009), 68 (1) C.L.J. 169, p. 179; Elshurafa D., 'Insolvency Laws in Saudi Arabia: Time for Change?', (2012), 9 (5) I.C.R. 300, p. 302.

<sup>212</sup> For instance, Arcapita Bank, a USD 7.4 billion Bahraini investment firm that owns the clothier J. Jill filed for bankruptcy protection in New York in March 2012 after it was unable to extend a USD 1.1 billion credit Line. Arcapita was able to access the US bankruptcy jurisdiction by the establishment of a bank account in the US: see Elshurafa, *ibid*, p. 302; Also, in the case of *Sparkasse Hilden Ratingen Vilbert v Horst Konrad Bank* [2012] (EWHC 2432), Judge Purle QC emphasised in this case that the motive for changing one's COMI is unimportant; it is acceptable for a debtor to do so in order to take advantage of the more lenient English insolvency regime. However, what is important is that the COMI must genuinely have moved: see Rule O. & Murphy N., 'Bankruptcy Tourism and Forum Shopping' (Nov 2012), available at: <http://www.allenoverly.com/publications/en-gb/Pages/BankruptcyTourismAndForumShopping.aspx>. accessed on 14/08/2013.

<sup>213</sup> Klein J., 'Pre-Packed Administration: A Comparison between Germany and the United Kingdom (Part 1)', (2012) 33 (9) C.L. 261, p. 261.

than Luxembourg.<sup>214</sup> Thus, in order to avoid this kind of jurisdiction shopping and in order to follow the modern trend, the Omani legislator should learn from the experience of other jurisdictions. If we acknowledge the fact that 'business is business' all over the world,<sup>215</sup> then the best bankruptcy law practices can be the best everywhere as long as they serve the importing country.<sup>216</sup>

#### **5.4 The Necessity for Bankruptcy Reform in Oman**

In the previous chapter, it was argued that, from a number of angles, the current bankruptcy regime in Oman is outdated and inconsistent with the needs of business today.<sup>217</sup> This thesis supported such an argument by stating a number of justifications.<sup>218</sup> As a result, the view of this thesis is that the introduction of bankruptcy reform in Oman is more necessary now than in previous years. This is due to a number of reasons to be discussed below.

##### **A- Oman's Economic Vision of 2020**

It was acknowledged that in order to formulate a clear vision for Oman's economy, it was necessary to prepare the required studies for carrying out a comprehensive evaluation of production and service sectors. Thus, after conducting a number of studies<sup>219</sup> and examining a number of proposals

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<sup>214</sup> Ibid; for behavioural economics perspectives: see below p. 303.

<sup>215</sup> Paquin J., 'Business Law Transplants and Economic Development: An Empirical Study of Contract Enforcement in Dakar, Senegal', (McGill University, UMI Dissertations Publishing, 2010).

<sup>216</sup> See above p. 273.

<sup>217</sup> See above section 4.6.

<sup>218</sup> See above pp. 244-247 & 251-254; see also below section 5.4 (C).

<sup>219</sup> A number of studies on the evaluation of Oman's development process have been done. One study was based on a request from the Ministry of Development, where the World Bank conducted a study entitled 'Sustainable Growth and Economic Diversification'. Also, within the framework of its

conducted by various Ministerial Committees,<sup>220</sup> in 1995 a government conference was held in order to present “the draft statement of the Vision for Oman’s Economy (formulated by the various ministerial committees) to a wider audience in Oman”.<sup>221</sup> During this conference, a number of recommendations, which helped in formulating the final draft of the Vision for Oman’s Economy and its associated policies and mechanisms, were made. His Majesty Sultan Qaboos bin Said, Sultan of Oman, approved the final draft of ‘Oman’s Economic Vision: 2020’ in June 1995. Within the framework of such a vision, Oman’s economy will be able to shift from one that relies on government initiatives and spending, oil resources and expatriate labour as the main engines of economic activity, to one that relies “on private initiatives, national labour, and renewable resources that lead to achievement of sustainable development, and an improvement in the living standards of the Omani citizens”<sup>222</sup>.

It is aimed that Oman’s 2020 vision will be achieved through four major strategies:<sup>223</sup> sustainable development within a stable macroeconomic<sup>224</sup>

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annual consultations with the government of the Sultanate of Oman regarding the country’s financial and fiscal positions, the International Monetary Fund (IMF) suggested a group of measures related to the economic adjustment process. More examples of further studies: see Ministry of National Economy, ‘Long-Term Development Strategy (1996-2020): Vision for Oman’s Economy-2020’, (2<sup>nd</sup> edition, 2007), pp. 13-14.

<sup>220</sup> Proposals have been made by the Ministry of Development and Development Council and other ministries: see *ibid*, pp. 15-35.

<sup>221</sup> It was felt that a conference of this nature is useful in providing examples of planning experience from other countries: *ibid*, p. 21.

<sup>222</sup> *Ibid*, p. 7.

<sup>223</sup> *Ibid*.

<sup>224</sup> The subject-matter of economics has been divided into two parts: micro economics and macro-economics. The term micro economics is derived from the Greek word *mikros*, meaning ‘small’ and the term Macro Economics is derived from the Greek word *macros*, meaning ‘large’. Thus, micro economics deals with the analysis of small individual units of the economy, such as individual

framework,<sup>225</sup> human resources development,<sup>226</sup> diversification of economy<sup>227</sup> and development of the private sector.<sup>228</sup> These strategies are based on a number of dimensions, such as (i) upgrading the government role in the basic fields<sup>229</sup> and reducing its role in the production and service fields; (ii) offering suitable conditions for economic diversification through, for example, developing small and medium size establishments and the encouragement of foreign direct investment through the establishment of an encouraging climate for investment, through the promulgation of laws, institutional and administrative procedures and the development of the infrastructure necessary for attracting such investment. In order to implement these strategies and dimensions, the government has instituted a number of formal five-year development plans, the first of which was implemented during the period 1996-2000.<sup>230</sup> Currently, Oman is in the middle of the Eighth Five-Year Development Plan (2011-2015).<sup>231</sup>

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consumers, individual and small firms. On the other hand, Macro Economics concerns itself with the analysis of the economy as a whole and its large aggregate: Mishra R., *Industrial Economics and Management Principles*, (Firewall Media, 2008), p.24; It is also stated that Microeconomics deals with human behavior and choices as they relate to small units- an individual, a firm, an industry, a single market-. Macroeconomics deals with human behavior and choices as they relate to an entire economy. Microeconomics deals with the demand for a particular good or service, while macroeconomics deals with total demand for goods and services: see Arnold R., *Macroeconomics*, (Cengage Learning, 2006), p. 3.

<sup>225</sup> See Long-Term Development Strategy, above 219, pp. 43-62.

<sup>226</sup> Ibid, pp. 69-49.

<sup>227</sup> Ibid, pp. 103-122.

<sup>228</sup> Ibid, pp. 129-147.

<sup>229</sup> Such as education, health and social care.

<sup>230</sup> The five-year plans, which Oman began implementing in 1976, aim to deliver economic growth on a carefully studied basis as well as social welfare. They are constantly reviewed during their implementation, so that the challenges facing them can be identified and investigated: see *Oman: 2011/2012*, (Ministry of Information, 2011), p. 210.

One of the fundamental objectives of the 2020 economic vision of Oman is to diversify the economy through attracting foreign direct investment (FDI).<sup>232</sup> FDI is considered one of the sources that Oman relies on to implement the program adopted by the government within the framework of the 2020 economic vision.<sup>233</sup> It is clearly acknowledged that in order to encourage foreign investors, the government should create the proper climate<sup>234</sup> to induce such investment.<sup>235</sup> The government believes in the role that can be played by foreign investment in economic development,<sup>236</sup> creation of jobs for Omanis, transfer of technology and the opening of markets for Omani products.<sup>237</sup>

However, in encouraging such investment, each country has to offer the best environment for foreign investors. In this regard, there are a number of factors that acts as a determinant of FDI. It is argued that the size and the potential growth of

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<sup>231</sup> In this regard, the Supreme High Committee for the Five-Year Development Plans sets out the basic elements and guidelines for the five-year development plans. This involves carrying out half-yearly evaluation of the plans and monitoring their implementation in accordance with the provisions of Royal Decree No.1 2006. The Supreme High Committee plays a vital role in translating the priorities set out in each five-year national development plan: see *Oman: 2012/2013*, (Ministry of Information, 2012), p. 71.

<sup>232</sup> Omani National Centre for Statistics and Information, 'Foreign Investment 2006-2010', (2011), available at: [http://www.ncsi.gov.om/NCSI\\_website/NCSI\\_EN.aspx](http://www.ncsi.gov.om/NCSI_website/NCSI_EN.aspx).

<sup>233</sup> Long-Term Development Strategy, above 219, p. 100.

<sup>234</sup> However, this should include providing incentives for domestic and foreign investors, such as granting them lands, reducing taxes, and easing administrative procedures. Also, this includes promulgating laws that facilitate the entry and exit from the market.

<sup>235</sup> Long-Term Development Strategy, above 219, p. 110.

<sup>236</sup> In this regard, it is demonstrated that FDI means higher exports, access to international markets and international currencies, being an important source of financing and substituting bank loans.: see Denisia V., 'Foreign Direct Investment Theories: An Overview of the Main FDI Theories', (2012) 2 (2) European Journal of Interdisciplinary Studies 104, p. 104.

<sup>237</sup> The World Trade Organization, 'Trade Policy Review: Report by Oman', WT/TPR/G/201. (21 May 2008), available at: [www.wto.org/english/tratop\\_e/tp\\_r\\_e/tp301\\_e.htm](http://www.wto.org/english/tratop_e/tp_r_e/tp301_e.htm).

markets, strong institutions (i.e. the competence of the judiciary) and an investor-friendly environment (i.e. protecting creditors' rights, reducing taxes, and encouraging business reorganisation) are drivers of FDI.<sup>238</sup> Thus, due to a range of factors, it is necessary to enact a number of business laws in order to attract FDI.<sup>239</sup> First, it is stated that the flows of FDI are to some extent determined by the effectiveness of the legal system<sup>240</sup> of the host country.<sup>241</sup> Further, it is asserted that "the quality of the laws and regulation, and the extent to which this quality is reflected in their implementation, may be a useful signal to foreign investors of the overall quality of the business environment".<sup>242</sup> Nowadays, investors are more prudent in making their investment decisions since the risk of facing bankruptcy

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<sup>238</sup> Hornberger K., Battat J. & Kusek P., 'Attracting FDI: How Does Investment Climate Matters', view point, World Bank; available at:

<http://siteresources.worldbank.org/FINANCIALSECTOR/Resources/327-Attracting-FDI.pdf>.

accessed on 31/12/2012. However, these are only examples of the drivers of the FDI. There are a number of literatures on behavioural economics investigating the determinants of FDI decisions. For instance, Bockem & Tuschke analysed FDI decisions from the perspectives of economic and institutional theory and their analysis shows that a firm's decision to engage in a foreign market is influenced by the attractiveness of the targeted market and by prior FDI decisions of large and successful peers: see Bockem S. & Tuschke A., 'A Tale of Two Theories: Foreign Direct Investment Decisions from the Perspectives of Economic and Institutional Theory', (July 2010) SBR 62, pp. 260-290; see also Bolnigen B., 'A Review of the Empirical Literature on FDI Determinants', (2005) 33 A.E.J. 383.

<sup>239</sup> J. & Kusek P., above 238; Perry A., 'Effective Legal System and Foreign Direct Investment: In Search of the Evidence', (2000) 49 (4) I.C.L.Q 779, p. 779.

<sup>240</sup> In this case, the term 'legal system' is used here to describe all the institutions, including courts and bureaucracies, through which laws are implemented: see Perry A., *Ibid.*

<sup>241</sup> *Ibid.*

<sup>242</sup> The World Bank, 'Doing Business 2013: Smarter Regulations for Small and Medium-Size Enterprises', p. 47, available at:

<http://www.doingbusiness.org/~media/GIAWB/Doing%20Business/Documents/Annual-Reports/English/DB13-full-report.pdf>. accessed on 20/11/2013.

has increased considerably.<sup>243</sup> As a result, before choosing the destination of their business, foreign investors may look for effective bankruptcy law jurisdictions.<sup>244</sup>

Since the encouragement of FDI is one of the important pillars of Oman's economic vision of 2020, Oman has to provide a tempting economic climate in order to attract such investment. In an attempt to ease the access of foreign investment into the country, Oman has already provided incentives for foreign investors. Such incentives include establishing what is called a 'One Stop Shop', an e-Government initiative to provide on-line company registration to enable investors to set up companies in Oman while minimising paperwork, saving costs and time.<sup>245</sup> Also, while there is no personal income tax, the rate of corporate tax is a flat rate of 12% applicable to all companies registered in Oman, whether wholly Oman-owned, wholly foreign-owned or joint venture companies with a percentage of foreign equity.<sup>246</sup> Further, a number of laws have been enacted to provide protection and encouragement to both foreign and domestic investors, such as the Foreign Capital Investment Law of 1994, Privatisation Law of 2004, Arbitration Law of 1997, Industrial Property Rights Law of 2008 and the Copyrights Law of 2008. For instance, because of the increasing engagement of Oman in the world economy and the opening of the Omani market to foreign investors, the Arbitration Law of 1997 was issued in order to attract foreign investment by assuring them of

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<sup>243</sup> Moskván D. & Vrbová V., 'Connecting the Dots: Attracting Foreign Direct Investment through Harmonisation of European Insolvency Law', in Belohlávek A. & Rozehnalová N., *Regulatory Measures and Foreign Trade 2013*, (Czech Yearbook of International Law, 2013), p. 50.

<sup>244</sup> Ibid. p. 50; Kastrinou A., above 210, p. 22; Belohlávek A, above 210.

<sup>245</sup> 'Trade Policy Review: Report by Oman', above 237.

<sup>246</sup> Ibid.

the fact that they are free to opt for arbitration.<sup>247</sup> Further, the aims of establishing the Public Authority for Investment Promotion and Export Development (PAIPED) in 2011 are to increase the private sector's role in providing the investments needed for the Sultanate's development plans and to promote the export of Omani goods to countries around the world.<sup>248</sup>

Hence, the aim of these laws and the purpose of offering a number of incentives are to facilitate the access of foreign investment to the market. However, the view of this thesis is that it is not sufficient to facilitate merely the access to the market; rather, it is also important for Oman to regulate the exit from the market in an orderly manner. This is to say that future bankruptcy law should offer an alternative to liquidating the business of viable distressed enterprises. As stated above, because of the increased occurrence of bankruptcy worldwide,<sup>249</sup> investors tend to direct their investment to countries that have an effective bankruptcy law jurisdiction. As a result, in order to attract more potential foreign investment, Oman has to reform its bankruptcy law in a manner that attracts such investment. Reforming bankruptcy law in a way that encourages the rehabilitation of a distressed debtor's business instead of liquidating its assets, particularly if it is a viable business, can result in controlling its exit from the market. It is asserted that having effective market exit procedures could also help in accelerating the rate of

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<sup>247</sup> For a legal discussion regarding the development of Arbitration in Oman: see Al-Siyabi M., 'A Legal Analysis of the Development of Arbitration in Oman with Special Reference to the Enforcement of International Arbitral Award', (A PhD thesis, University of Hull, July 2008).

<sup>248</sup> See *Oman: 2012/2013*, (Ministry of Information, Oman, 2012), p. 238.

<sup>249</sup> See above pp. 297-299.

economic growth and has an effect in saving and creating jobs.<sup>250</sup> Hence, this thesis support the view that promoting the philosophy of the rescue culture leads to the implementation of Oman's economic vision 2020 since attracting foreign investment is one of its main pillars. However, as will be discussed below,<sup>251</sup> this is not to suggest that rescuing the business of the enterprises should be at the expense of secured creditors. Rather, their interests should be protected and the rescue plan should not be imposed on them unless sufficient protection is provided.

## **B- The Role of Small and Medium Enterprises**

Another factor that necessitates bankruptcy reform in Oman is the important role that is played by SMEs. The significant contributions that are made by SMEs in promoting national economies have been acknowledged by both developed<sup>252</sup> and developing countries.<sup>253</sup> As a consequence, in constructing their development strategies, countries often rely on these enterprises since they contribute

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<sup>250</sup> Helmy O., 'The Efficiency of the Bankruptcy System in Egypt', (2005) Working Paper No. 100, E.C.E.S. 1-27. p. 1.

<sup>251</sup> See below section 5.5.4.4.

<sup>252</sup> For example, since they represent 97 per cent of the annual turnover in the Union and since they employ 70 per cent of the total workforce in Europe, in 1994 the Commission of the European Communities decided to establish a community initiative concerning the adaptation of SMEs. Also, in the United Kingdom, SMEs represent 99 per cent of the total number of enterprises, they account for 50 per cent of the country's annual turnover and they employ 65 per cent of the workforce: see Bovis C., 'The Importance of Small and Medium Enterprises in the European Integration Process-Recent Development at European Level', (1995) 16 (6) Company Lawyer 183.

<sup>253</sup> ASEAN countries have described SMEs as the engine of economic growth and development, the backbone of national economies, the highest employment generators, and a potential tool of poverty alleviation by creating self-employment avenues: see Tambunan T., *Development of Small and Medium Enterprises in ASEAN Countries*, (Readworthy, 2009), p. 54.

considerably to the economy and their growth rate exceeds that of large firms.<sup>254</sup> However, at present, there is no common definition of small and medium enterprises and such definitions that do exist vary from country to country.<sup>255</sup> This difference emerges from the fact that countries usually define SMEs based on their own criteria, usually benchmarking against annual sales turnover, number of full-time employees and shareholders' funds.<sup>256</sup> For instance, under EU law and according to the Commission Recommendation of 6 May 2003 concerning the definition of micro, small and medium-sized enterprises, the main factors determining whether a company is an SME are the number of employees and either turnover or the total of the balance sheet.<sup>257</sup> Also, in the US, the Small Business Administration<sup>258</sup> sets small business criteria based on a number of factors, such as the number of employees, revenue and type of industry.

In Oman, there are two key factors that define the size of a business: the number of employees and the amount of annual sales turnover. This is based on a Ministerial Order issued by the Ministry of Trade and Industry in 2012.<sup>259</sup>

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<sup>254</sup> Central Bank of Oman, 'Al-Dhahab, 2001'; see also AL-Kharusi A., 'Financing Small Business in Oman, (A PhD Thesis, Loughborough University, 2003).

<sup>255</sup> Tambunan T., above 253, p. 10.

<sup>256</sup> Ibid.

<sup>257</sup> According to Title one of the Annex "the category of micro, small and medium-sized enterprises (SMEs) is made up of enterprises which employ fewer than 250 persons and which have an annual turnover not exceeding EYR 50 million, and/or annual balance sheet total not exceeding EUR 43 million".

<sup>258</sup> Small Business Administration (SBA) is a Government Agency in the United States that provides support to entrepreneurs and small businesses: see [www.sba.gov](http://www.sba.gov)

<sup>259</sup> Ministerial Decision issued by the Minister of the Ministry of Trade and Industry in 2012.

Table 1. Definition of SMEs in Oman

Type	No. of Employees	Annual Sales Turnover (R.O)
Micro	1-4	To 25.000
Small	5-9	25.000 - 250.000
Medium	10-99	250.000 - 1.500.000

As shown in Table 1, the criteria used to determine the type of SMEs do not differentiate between various manufacturing sectors. Thus, any enterprise will be categorised as a micro, small or medium enterprise if its number of employees and its annual sales turnover are within the limits specified by the Ministerial Order.

The number of SMEs in Oman is almost 75,000 (see Table 2) and these enterprises account for over 90 per cent of the registered enterprises.<sup>260</sup> Furthermore, these enterprises are the major contributors of Oman's GDP.<sup>261</sup> At the beginning of 2013, almost 13.8 per cent of Oman's GDP was accounted for by small and medium enterprises.<sup>262</sup> Further, SMEs are the engine for job creation since they are the main providers of many job opportunities for Omanis and

<sup>260</sup> AL-Shanfari D., AL-Said A., AL-Said F. & AL-Busaidi S., 'SME Development Symposium: Research Summary', Held in Seih AL-Shamikat in Oman, (21-23 January 2013), p. 1, available at: [http://thefirm.om/Projects\\_and\\_Publications\\_files/SME%20Development%20Symposium%20Brief%20v2.pdf](http://thefirm.om/Projects_and_Publications_files/SME%20Development%20Symposium%20Brief%20v2.pdf). accessed on 05/01/2014.

<sup>261</sup> Oman newspaper, 5<sup>th</sup> Dec. 2012, available at <http://www.omannews.gov.om/ona/english/newsDetails.jsp?newsID=155387>

<sup>262</sup> Ibid.

expatriates.<sup>263</sup> According to statistics released by the Ministry of Manpower<sup>264</sup> in 2012 it is shown that there are over 218,588 Omani employees and 1,460,645 foreign employees in the private sector. Most of these jobs are provided by small and medium enterprises.

Table 2. Number of SMEs in Oman in 2010

Sector	1-9	910-99
Agriculture/fishing/surgery	144	31
Mining	42	135
Raw material	14120	794
Construction	2558	911
Gas/electricity/water	66	53
Retail and wholesale	33835	1604
Hotels and restaurant	5488	540
Transport/storage/telecommunication	1103	241
Financial services	741	198
Housing/ hiring	3639	399
Educational services	339	300
Health/ charities	639	72
Social and personal services	6951	50
Total	69665	5328

Source: Ministry of National Economy

<sup>263</sup> Ibid.

<sup>264</sup> Ibid.

In recognition of the importance of SMEs for diversification and development of the economy, prospective increased employment opportunities and gainful use of domestic resources, the Directorate General for Development of SMEs,<sup>265</sup> in the Ministry of Commerce and Industry, was established in 2007. Furthermore, one of the main pillars of the Oman 2020 development vision is promotion of SMEs. In this regard, it is intended that SMEs will be responsible for 50 per cent of Oman's manufacturing by the year 2020.<sup>266</sup> In addition, in recognition of the relevance of SMEs for economic development and following a Royal Order made by Sultan Qaboos, the ruler of Oman, in January 2013 a three day 'Government Symposium for the Development of Small and Medium Enterprises in Oman' was held. One of the issues discussed in this symposium was 'bankruptcy of small and medium enterprises' and how the current bankruptcy regime is inconsistent with the requirements of business today.

The importance of SMEs in Oman is manifest.<sup>267</sup> Hence, due to their role in economic development, it is crucial to provide the necessary legal framework in order to preserve the continuous contributions of these types of enterprises. Oman has already launched several unique initiatives to help the SME sector in playing its role in the Sultanate's economic development. Such initiatives include facilitating access to the necessary funding to SMEs in order to help them expand

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<sup>265</sup> For the main role of this department see: <http://www.mocioman.gov.om/Main-Menu/Business-Services/Samll-and-medium-enterprises.aspx>.

<sup>266</sup> <http://www.nusacc.org/pressreleases/details-id=588.php.html>.

<sup>267</sup> This is clear from their contribution to Oman's GDP and their role in the growth of the economy: see above p. 308.

and create jobs. For instance, the Oman Development Bank<sup>268</sup> was established to provide finance to corporate, medium enterprises and small projects for the key sectors, such as industry, agriculture, tourism, fisheries, medicine and education. In this regard, the bank charges an interest rate of only 3 per cent per annum. It also provides interest free loans for small investors who are fully devoted to their projects and have no other commitments elsewhere.<sup>269</sup> Further, such incentives include granting these enterprises land to be used in running their businesses. However, to sustain the constant contributions of SMEs, this thesis argues that regulating the exit of unviable enterprises from the market in an organised manner is fundamental. In addition, offering SMEs an alternative route to liquidation procedures is necessary. In this regard, rehabilitating the viable enterprises helps in protecting existing jobs and maintaining the continuous contributions of SMEs to Oman's economy. As was discussed in Chapter Two,<sup>270</sup> many scholars were of the opinion that it is not the aim of bankruptcy law just to liquidate the assets of distressed debtors, but rather the role of bankruptcy law is also to rehabilitate the assets of viable enterprises.

### **C- Other Factors**

Another factor that necessitates the need for introducing bankruptcy law reform in Oman is that current bankruptcy regimes are ill-regulated due to a number of reasons. Firstly, as stated in the previous chapter,<sup>271</sup> the definition of the word

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<sup>268</sup> See <http://www.odb.com.om>.

<sup>269</sup> This means if the investor has a full-time job besides their project, they will not be entitled to this loan.

<sup>270</sup> For instance see above sections 2.4.1, 2.6.1 & 2.7.1.

<sup>271</sup> See above section 4.4 (A).

'bankruptcy' is vague and it is unclear what sort of tests are to be adhered to in determining the status of 'inability to pay debt'.<sup>272</sup> Whether reliance should be on the 'cash flow test' or 'balance sheet test' is ambiguous. Secondly, there is no definite time-limit for the completion of all bankruptcy procedures and this results in spending four years on average to resolve bankruptcy cases in Oman.<sup>273</sup> Such a lengthy period has an impact on wasting the assets of the company since secured creditors' actions are not stayed during the process. Thirdly, the lack of availability of restructuring procedures also renders the bankruptcy regime of Oman to be insufficiently regulated. Finally, the lower ranking of Oman in the World Bank Business Report of 2014, compared to other countries, in resolving insolvency cases also requires the introduction of such reform. As stated in the previous chapter,<sup>274</sup> Oman stands at 72 in the ranking of 189 economies on the easing of resolving insolvency. Where it only takes one year in the UK, 1.5 years in the USA, and 2.5 years in Bahrain, resolving bankruptcy cases takes 4 years in Oman.<sup>275</sup>

All the above factors call for an urgent reform of Oman's bankruptcy regime. However, any future bankruptcy reform should take into account the reasons behind the inefficiencies of the current bankruptcy regime. Examples of such reasons are that, as already discussed in the previous chapter, the current bankruptcy regime does not promote the rescue of the distressed debtors,<sup>276</sup>

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<sup>272</sup> Ibid

<sup>273</sup> World Bank, Economy Profile: Oman, ( Doing Business 2014), p. 94, available at: [http://www.doingbusiness.org/Reports/~/\\_/media/GIAWB/Doing%20Business/Documents/Profiles/Country/OMN.pdf](http://www.doingbusiness.org/Reports/~/_/media/GIAWB/Doing%20Business/Documents/Profiles/Country/OMN.pdf). accessed on 10/03/2014; see above section 4.8.1.

<sup>274</sup> See above section 4.8.1.

<sup>275</sup> See above figure 2, p. 246.

<sup>276</sup> See above section 5.4.3.

access to bankruptcy proceeding is not easy,<sup>277</sup> there is no a particular time-limit within which the bankruptcy procedure should be completed, the persons administering the proceedings are not required to be qualified,<sup>278</sup> and there is no clear priority rule.<sup>279</sup> In this regard, this thesis argues that future bankruptcy reform should address these issues and try to overcome such inadequacies by taking note from the experience of England and the US. Hence, proposing a map for future reform is the aim of the next part of this chapter.

### **5.5 A Map for Future Reform**

In Chapter Four,<sup>280</sup> it was clearly shown how Oman's current bankruptcy regime is inefficiently regulated. Such insufficiency emerges from the fact that the current bankruptcy regime does not encourage the rehabilitation of enterprises but rather that liquidating the assets of businesses is their main purpose. The importance of a rescue culture has not yet been recognised by the Omani legislator.<sup>281</sup> Even though Omani Law allows the distressed trader to opt for the preventive composition scheme, the aim of this scheme is not to rescue the company.<sup>282</sup> Rather, as it is stated in the Commercial Code,<sup>283</sup> the aim of this scheme is to allow the distressed debtor to escape the consequences of bankruptcy declaration. This

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<sup>277</sup> See above section 4.6.2.1.

<sup>278</sup> See above section 4.4 (E).

<sup>279</sup> See above section 4.4 (C).

<sup>280</sup> See above section 4.8.

<sup>281</sup> See above section 4.8.3.

<sup>282</sup> Ibid.

<sup>283</sup> Article 753 of the CC of 1990.

leads to a failure to encompass some of the principles that are considered vital to any modern bankruptcy regime.<sup>284</sup>

Currently, the Commercial Code, for instance, complicates access to the preventive composition scheme.<sup>285</sup> First, the only person who can apply for this scheme is the distressed debtor.<sup>286</sup> However, applying for this scheme is not without restrictions. The rights of an individual trader or a company to apply for this scheme is restricted and a number of conditions have to be met for such an application to be approved by the court.<sup>287</sup> As discussed above,<sup>288</sup> for such an application to be approved by the court, the suffering debtor has to demonstrate that his/ her business activities are disturbed in a way that leads to the cessation of payments,<sup>289</sup> he/she traded continuously for two years,<sup>290</sup> and that the disturbance of the business is not the result of gross fault or fraud.<sup>291</sup> Secondly, even though

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<sup>284</sup> As stated earlier, these principles include easing the access to the process, having in place a mechanism in which all secured and unsecured claims are stayed, cramming down dissenting creditors, providing an easy access to bankruptcy processes, allowing new financing during the process, and adhering to the notion of absolute priority: see Tolmie F., above 22, p. 64.

<sup>285</sup> See Articles 753, 755 & 758 of the CC; see also above section 4.6.2.1.

<sup>286</sup> As will be discussed below, the creditors should be given the right to apply for bankruptcy proceedings: see below section 5.4.4.1.

<sup>287</sup> Ibid.

<sup>288</sup> See above section 4.6.2.1.

<sup>289</sup> Article 753 of the CC. However, the problem with this requirement is that it is not clear what sort of criteria should be used in determining the level of the disturbance or instability of business that might cause the cessation of paying commercial debts.

<sup>290</sup> Article 753 of the CC. Nevertheless, the main problem with this requirement is that it prevents both an honest new trader and an old trader who closes or postpones his/her business activities for a short period of time from applying for this scheme.

<sup>291</sup> Article 753 of the CC. However, proving this condition is time-consuming since what amounts to gross fault or fraud is based on the determination of the court. Although what is meant by gross fault or fraud is not clear, both the Commercial Code of 1990 and the Penal Law of 1974 provide

the Commercial Code encourages the distressed debtor/ management of a company to file for a preventive composition scheme by allowing them to stay at office, there is no statutory obligation on them to apply for this scheme once they sense the disturbance of the business. However, as stated in the previous chapter,<sup>292</sup> Article 695 of the Commercial Code gives a bankruptcy trustee the right to seek a court permission to order all members of the Board of Directors or all the managers, or some of them jointly or severally to pay all or some of the debts of the company unless they establish that they have exercised the necessary care in running the business of the company. Also, the company's directors may incur criminal liability in the case where the company's bankruptcy has been caused by fraudulent actions on their part, pursuant to Article 301 of Oman's Penal Code of 1974 which provides for imprisonment for a period not exceeding seven years. Nevertheless, even though there is a reference to director liabilities under both the Commercial Code and Penal Code, there is are no detailed statutory provisions analogous to the UK law on wrongful trading and company director disqualification.<sup>293</sup> It is argued that the UK insolvency law offers company directors incentives as in 'sticks and carrots' in order to encourage them to take action once they sense the disturbance of the business.<sup>294</sup> Although the traders/ directors are

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examples of some acts that, if committed, amount to fraud or gross fault: see Article 784 of the CC and Article 302 of the Penal Law.

<sup>292</sup> See above section 4.5.5.

<sup>293</sup> McCormack G., 'Control and Corporate Rescue: An Anglo- American Evaluation', (2007) 56 (3) I.C.L.Q. 505, p. 526.

<sup>294</sup> On one hand, the provisions of 'wrongful trading' and 'director disqualification' contain statutory sticks to encourage directors to file for the administration regime as early as they notice the crisis. On the other hand, if directors acted at the 'earliest appropriate moment', they 'would have some hope of regaining control' since the administrator may opt for their stay; for further discussion: see

aware of the disturbance of the business's activities, in Oman they are not obliged to apply for a preventive composition scheme. Thirdly, one of the issues with the current composition scheme is that even though actions are stayed during the proceedings, secured creditors are not allowed to participate in the voting on the preventive composition plan unless they relinquish their securities.<sup>295</sup>

In addition, since creditors are not allowed to apply for a preventive composition scheme, the only option available to them is to apply for bankruptcy procedures. Applying for bankruptcy proceedings means that, if statutory conditions are met,<sup>296</sup> the court may declare the bankruptcy of the trader<sup>297</sup> and a bankruptcy trustee will be appointed to administer and realise the assets of the bankrupt company or sole merchant.<sup>298</sup> Furthermore, currently once bankruptcy procedures are initiated secured creditors are not prevented from enforcing their securities during bankruptcy proceedings.<sup>299</sup> This means that the assets of the debtors will be wasted since secured creditors will run to the court house to be first to secure the

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Armour J. & Mokal R., 'Reforming the Governance of Corporate Rescue: The Enterprise Act 2002', (2005) 1 L.M.C.L.Q. 28, p. 32; see above section 3.4.1.2.

<sup>295</sup> Article 704 of the CC; see above 4.6.2.5.

<sup>296</sup> These conditions include if an application is submitted by the trader itself, and if one of the creditors or the court and the trader ceases paying a due commercial debts: see Articles 579 & 581 of the CC; see also above sections 4.5.1 & 4.5.2.

<sup>297</sup> Declaring the bankruptcy of the distressed trader means that the bankrupt, including all general liability partners in a bankrupt company, will be prohibited from practising some civil rights. Also, the management will be displaced by bankruptcy trustees and the directors of the company might be subject to both civil and criminal liabilities: see Articles 580 & 695 of the CC; see also above sections 4.5.3 & 4.5.4 (A).

<sup>298</sup> Article 660 of the CC.

<sup>299</sup> Article 620 of the CC; see above section 4.5.4 (B).

enforcement of their securities.<sup>300</sup> The reason behind this behaviour is that secured creditors are not given the necessary incentives to negotiate a rescue deal with their debtors. Hence, it can be argued that not staying secured creditors' claims during bankruptcy proceedings is another issue with the current bankruptcy regime in Oman. As discussed in Chapter Two,<sup>301</sup> despite the divergences between the creditors' bargain theory and multiple values theory, in recognition of the importance of the notion of collectivity, both theories recognise the importance of staying creditors' actions during bankruptcy proceedings. For instance, Jackson stated that staying creditors' claims will help in increasing the common pool of assets and (help in increasing) also the returns of the creditors.<sup>302</sup> It was also discussed in Chapter Three<sup>303</sup> that under both England and the US bankruptcy laws, the notion of collectivity is recognised.<sup>304</sup>

From the above discussion, it is argued that Oman's current bankruptcy regime needs to be modernised.<sup>305</sup> However, such modernisation needs to reflect the requirements of today's business and needs to reflect Oman's economic vision 2020. As stated above,<sup>306</sup> there are a number of factors that necessitate the introduction of bankruptcy reform in Oman, such as the importance of SMEs in the development of the national economy and the desire to attract FDI. For instance,

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<sup>300</sup> Jackson T., 'Bankruptcy, Non-Bankruptcy Entitlement, and the Creditors' Bargain', (1991) Y.L.J. 857, p. 861.

<sup>301</sup> See above pp. 93-94.

<sup>302</sup> Jackson T., *The Logic and Limits of Bankruptcy Law*, (Harvard University Press, 1986), pp. 14-16.

<sup>303</sup> See above p. 171-172.

<sup>304</sup> Ibid.

<sup>305</sup> See above section 4.8.

<sup>306</sup> See above section 5.4.

even though its importance in the development of the economy is recognised,<sup>307</sup> there are no rescue bankruptcy procedures designed for SMEs.

The aim of this section is to draw a map for future bankruptcy regimes by acknowledging the importance of taking lessons from the experience of both England and the US regimes. Nonetheless, learning from the experience of these jurisdictions means recognising the fact that wholesale transplantations of both England and the US regimes are not appropriate, but rather the purpose is to adopt the principles that, based on the researcher's point of view,<sup>308</sup> are important for any future bankruptcy reform. In this regard, it is worth noting that proposing the adaptation of bankruptcy principles that are found in England or the US will be subject to a number of factors that should be taken into account. It was emphasised that<sup>309</sup> in proposing bankruptcy principles, it is necessary to take into consideration the differences in culture and infrastructure between the importing and exporting countries. In this regard, this thesis argues that the competence of the court and the professionalism of persons administering the bankruptcy processes are of great importance in administering bankruptcy cases.<sup>310</sup> Furthermore, even though this thesis places great emphasis on the importance of introducing a future rescue regime based on the experience of both England and

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<sup>307</sup> See above pp. 308-309.

<sup>308</sup> As was argued, the applicability of adopting such bankruptcy principles can be judged by trying to assess their workability and functionality. However, in assessing the workability of these principles, reference should be made to the difference in infrastructure between the importing and exporting country: see above pp. 273-275.

<sup>309</sup> Ibid.

<sup>310</sup> For the importance of having qualified bankruptcy practitioners: see below section 5.5.4.6; also see above section 4.4 (E).

the US, the proposed regime will take into account the particular characteristics<sup>311</sup> of Oman. Thus, it is not the aim of this thesis to suggest mere transplantations of bankruptcy principles that are found in England and the US. Whilst it is sometimes appropriate to combine the experience of both England and the US,<sup>312</sup> in some cases opting for only the US approach or the approach in England is the preferred choice.<sup>313</sup> As stated in Chapter Three,<sup>314</sup> even though both England and the US adopt the concept of a rescue culture, there are a number of differences between the legal frameworks governing corporate restructuring in the two jurisdictions. In this regard, Moss stated that while corporate insolvency in England is regarded as a disgrace,<sup>315</sup> in the US business failure is viewed as a result of misfortune rather than wrongdoing.<sup>316</sup> Also, whereas in the US risk taking is thought to be a good thing and creditors are perceived as being greedy, in the UK the judicial bias towards creditors reflects a general social attitude which is inclined to penalise risk-takers when the risk goes wrong and side with creditors who lose out.<sup>317</sup> As stated above,<sup>318</sup> both England and the US adopt the notion of DIP, the concept of

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<sup>311</sup> As stated above, this includes cultural and infrastructure factors.

<sup>312</sup> For example: see below pp. 342-343 & 360.

<sup>313</sup> For example: see below pp. 342-343 & p. 357.

<sup>314</sup> See above pp. 139-141; see above section 3.4.

<sup>315</sup> However, it is not clear for the researcher how this word is judged and whether this view is shared by everyone, particularly after the enactment of the UK Enterprise Act in 2002.

<sup>316</sup> Moss G., above 87, p. 17.

<sup>317</sup> Ibid, p. 17; see also Westbrook J., 'A Comparison of Bankruptcy Reorganisation in the US with the Administration Procedure in the UK', (1990) 6 I.I.P. 86; Nevertheless, McCormack challenged the traditional thesis that UK law in the sphere of corporate bankruptcy is pro-creditor whereas US law is pro-debtor. He argued that this characterisation is something of an over-simplification: see McCormack G., 'Apples & Oranges? Corporate Rescue and Functional Convergence in the US and UK', (2009) 18 (2) I.I.R. 109; McCormack G., above 293.

<sup>318</sup> See above section 3.4.1, 3.4.2 & 3.4.4.

moratorium and the notion of cram-down. However, because of such divergences, each of them adopts these concepts in a different manner. Hence, these differences will be taken into account when proposing bankruptcy concepts or principles to be adopted by the Omani legislator.

### **5.5.1 A Need for a Clear Statutory Mandate**

In the future, Oman's bankruptcy law should have a clear statutory vision as this will help in designing the appropriate procedures that reflect such mandate. In Chapter Two, various theories underpinning bankruptcy law were discussed. Each of these theories offers justifications for bankruptcy law and its processes. For instance, the creditors' bargain theory views bankruptcy law as having a single function to maximise the interests of creditors.<sup>319</sup> Because of this view, the supporters of this theory affirmed that the provisions of bankruptcy law should be designed to reflect these ends.<sup>320</sup> Thus, according to them, rehabilitating the business of the company should not be attempted unless it serves and maximises the interests of creditors as a whole. However, other theories, e.g. communitarian,<sup>321</sup> forum,<sup>322</sup> and the multiple values theory<sup>323</sup> oppose the creditors' bargain theory by asserting that besides protecting the interests of creditors, bankruptcy law should be directed to serve the interests of others, such as employees, customers, the government and so on. Thus, the supporters of these theories propose a number of aims that should be followed by bankruptcy laws.

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<sup>319</sup> See above section 2.2.

<sup>320</sup> Ibid.

<sup>321</sup> See above section 2.4.

<sup>322</sup> See above section 2.5.

<sup>323</sup> See above section 2.6.

These aims include establishing a forum in which all interests affected by the failure of the business can be heard,<sup>324</sup> establishing a compulsory debt collection system,<sup>325</sup> distributing the effects of financial distress among a broad range of actors<sup>326</sup> and establishing a clear priority rule.<sup>327</sup>

In this thesis, it is argued that bankruptcy law should be designed in a way that protects the interests of creditors whilst protecting the interests of other stakeholders, such as employees, customers and suppliers.<sup>328</sup> This is due to the fact that in the event of financial distress, certain confronting claimants outside the common pool of creditors arise exclusively because of the trader's bankruptcy and for no other reason.<sup>329</sup> As a result, bankruptcy law should take into account these claimants. However, caution should be taken since it is impossible to treat all stakeholders equally. Each group has its own interests.<sup>330</sup> For instance, the interest

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<sup>324</sup> This is the view of the forum theory: see above section 2.5.1.

<sup>325</sup> This is the view of both creditor bargain theory and multiple value theory. However, the difference between them is that the view of the creditor bargain theory this debt collection system should be designed to maximise the interests of creditors. However, the multiple value theory's view is that such a system should be designed in a way that maximises the interests of all stakeholders, including employees, customers and local community: see sections 2.2.1 & 2.6.1.

<sup>326</sup> This is the view of the multiple value theory, see above p. 91. However, Baird argued that redistributing losses in bankruptcy is the same as it is outside bankruptcy and as a consequence distribution of losses is not a bankruptcy concern and it should not be within the roles of bankruptcy law to achieve this aim: Baird D., 'Loss Distribution, Forum Shopping, And Bankruptcy: A Reply to Warrant', 54 U.C.L.R. 815, p. 817.

<sup>327</sup> This is the view of the multiple value theory: see above p. 91; However, this is opposed by the supporters of the creditors' bargain theory: see above pp. 91-93.

<sup>328</sup> See above section 2.8.

<sup>329</sup> See Goode R., *Principles of Corporate Insolvency Law*, (4<sup>th</sup> edition, sweet & Maxwell, 2011), p.73.

<sup>330</sup> Symes C., *Statutory Priorities in Corporate Insolvency Law: An Analysis of Preferred Creditor Status*, (Ashgate Publishing Ltd, 2008), p. 63.

of secured creditors is in enforcing their securities promptly; the interest of employees is in safeguarding their jobs and in receiving their salaries; the interest of suppliers is in enforcing their contracts; the interest of the government is in gaining taxes and the interest of the local community is in benefiting from the service of the company. Even though the legislator is advised to strike a balance between the various interests affected by the troubles of the debtor, it is worth mentioning that striking the right balance is sometimes difficult and someone will be targeted. For example, if it is unviable to rehabilitate the company, the employees will be the target and they will lose their jobs as a result of liquidating the assets of the trader. Also, even though the administrator decides to rehabilitate the enterprise, creditors' interests should not be prejudiced and sufficient protection should be provided. For instance, as discussed in Chapter Three,<sup>331</sup> the reorganisation plan will not be implemented unless it is proven that all pre-petition creditors are sufficiently protected. Also, in the US, a super priority status will not be granted to the new lender unless it is demonstrated that secured creditors interests are not affected.<sup>332</sup>

In addition, in designing bankruptcy law, the Omani legislator should state clearly the aim of each of bankruptcy proceedings. For instance, in designing a rescue regime the purpose of such a regime should be clearly stated in the bankruptcy law. In this case, a lesson can be learned from the position under the administration regime in England. Under the Enterprise Act 2002, the purpose of the administration regime has been clearly articulated in a single hierarchy of

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<sup>331</sup> See above pp. 166-167.

<sup>332</sup> See above pp. 160.

objectives. In paragraph 3 (1), it is clearly stated that the purpose of administration is to rescue the company as a going concern. However, if this is not applicable, the administrator should seek to implement the second objective, which is achieving a better result for the company's creditors (as a whole). If the implementation of the second objective is not applicable, the administrator should follow the final objective, which is to make distribution to one or more secured or preferential creditors. The Enterprise Act 2002 offers clarity in relation to the aims of the administration regime and the same should be done by the Omani legislator. Hence, if besides the liquidation regime, the Omani legislator opts for a single bankruptcy regime that applies to large enterprises with special provisions devoted to SMEs, the mandate of such a regime should be clear. In this regard, this thesis supports the view that the future bankruptcy regime of Oman should be designed in a way that encourages the rehabilitation of viable enterprises and puts into liquidation those which are not. Rescuing viable enterprises has its impact on maximising creditors' returns,<sup>333</sup> and saving employees' jobs.<sup>334</sup> Even though the bankruptcy regime should be devised to save the business of the company, this should be done through providing adequate protection to the creditors. This is due to the fact that secured creditors, usually banks, are the main providers of credit and bankruptcy law should take their interests into account during bankruptcy proceedings. In this case, a lesson should be taken from the position under the US

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<sup>333</sup> In this regard, in England, for instance, a recent empirical study shown that post-Enterprise Act administrations deliver more returns to secured creditors than pre-Enterprise Act administrations: see Frisby S., above 6.

<sup>334</sup> As stated above, for example the rescue of Game Group in the UK has saved nearly 3,200 jobs: see above p. 122.

Chapter 11. As stated above,<sup>335</sup> although the aim of Chapter 11 is to rescue the enterprise through proposing a rescue plan, such a plan will not be imposed over the wishes of objecting creditors unless it is proven that they are sufficiently protected. Also, if valid contracts are assumed during bankruptcy processes, the other contracting parties should be given adequate assurance of future performance. It is not suitable to oblige a supplier to continue to deliver goods or services to a bankrupt customer unless there is in place a sufficient guarantee that payment for any future deliveries will be made.<sup>336</sup>

### **5.5.2 Certainty and Predictability in Bankruptcy Law**

Besides having a clear statutory vision, this thesis argues that it is important for the Omani legislator to design a bankruptcy law that provides a level of certainty and predictability. There are a number of rationales supporting this argument. First, it is stated that “a predicable law promotes stability in commercial transactions, fosters lending and investment at lower risk premiums, and promotes consensual resolutions of disputes between a debtor and its creditors by establishing a backdrop against which parties can assess their relative rights”.<sup>337</sup> Secondly, in the absence of predictable and certain bankruptcy law and procedures, foreign investors might be reluctant to initiate their business. As stated above,<sup>338</sup> one of the determinants of the flows of FDI is the effectiveness of the legal system in the host

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<sup>335</sup> See above pp. 166-167.

<sup>336</sup> Milman D., ‘Moratoria in UK Insolvency Law: Policy and Practical Implication’, (317) 2012 C.L.N. 1-4, p. 3; for more discussion: see above section 4.5.4 (C).

<sup>337</sup> The World Bank, ‘The World Bank Principle and Guidelines for Effective Insolvency and Creditor Rights Systems’, April 2001, p. 25, available at: [http://www.worldbank.org/ifa/ipg\\_eng.pdf](http://www.worldbank.org/ifa/ipg_eng.pdf). accessed on 21/01/2014.

<sup>338</sup> Evidence from behavioural economics: see above p. 303.

country. Thirdly, this thesis argues that before initiating their investment, it is necessary for domestic and foreign investors to know *ex ante* the available bankruptcy regimes and the procedures that can be used in the event of financial distress.<sup>339</sup> Furthermore, it is important for the suppliers to know in advance the fate of their contractual arrangement with the troubled traders and the sort of protection available for them.<sup>340</sup> Finally, the bankruptcy law should be predictable in order to enable various participants to evaluate legal risks in advance to help them adjust their transactions to reflect those legal risks.<sup>341</sup> The aim of this part is to highlight the importance of offering clarity in regard to the bankruptcy test, and offering certainty and predictability in regard to priority entitlement.

#### **5.5.2.1 Certainty in Regard to Bankruptcy Tests**

Oman's Commercial Code of 1990 does not provide an exact meaning of the phrase of 'inability to pay debt'.<sup>342</sup> As stated in the previous chapter,<sup>343</sup> any trader who ceases to pay a due commercial debt might be declared bankrupt. In most jurisdictions, the expression 'inability to pay debt' is examined by making reference to two tests of bankruptcy. The cash flow bankruptcy test in which a company is insolvent if it is unable to pay its debts as they fall due<sup>344</sup> and the balance sheet

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<sup>339</sup> Moskvan D. & Vrbova V., above 243, p. 50; Kastrinou A., above 210, p. 22.

<sup>340</sup> Wood P., above 177, p. 6.

<sup>341</sup> Ibid.

<sup>342</sup> Article 579 of the CC.

<sup>343</sup> See above section 4.4 (A).

<sup>344</sup> Under this test a single unpaid commercial debt is enough to provoke the bankruptcy of distressed trader.

bankruptcy test where a company is insolvent if its liabilities exceed its assets.<sup>345</sup> As explained in Chapter Four,<sup>346</sup> this is the case in England where the definition of inability to pay debts is clearly stated in Section 123 of the Insolvency Act of 1986 and this definition includes both tests of insolvency. This provides clarity in the sense that in England directors are obliged to apply for the administration regime as soon as they become aware of the problem.<sup>347</sup> Thus, having a clear criterion in regard to the phrase ‘inability to pay debt’ helps them in avoiding the consequences of wrongful trading and disqualification proceedings.<sup>348</sup>

Under Oman’s current bankruptcy regime, the ‘inability to pay debts’ is vague and it is unclear what sort of tests are used to determine the status of insolvency.<sup>349</sup> For instance, in one of the High Court Rulings, it is clearly stated that “regardless of the amount of unpaid debt, the court has the right to declare the bankruptcy of any trader”.<sup>350</sup> Even though the debtor ceases to pay a single

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<sup>345</sup> The balance sheet test takes into account trader’s contingent and prospective liabilities. An example of contingent liability is a guarantee given by a parent company. A prospective liability could be a claim for damages for defective work. Thus, regardless of the expected difficulties, an estimate should be made of both liabilities: see Ramsey V., *Construction Law Handbook*, (Thomas Telford, 2007), p. 535.

<sup>346</sup> See above pp. 186-187.

<sup>347</sup> See above p. 147-148.

<sup>348</sup> In order to encourage the debtors/ directors to apply for bankruptcy proceedings as early as they notice the financial crisis, it is important to include within future bankruptcy reform wrongful trading and disqualification proceedings. As was argued above, although there is a reference to director liabilities under both the Commercial Code and Penal Code, there are no detailed statutory provisions analogous to the law in England on wrongful trading and company director disqualification: see above p. 315.

<sup>349</sup> See above section 4.4 (A).

<sup>350</sup> ‘A Set of the Supreme Court Judgments in Oman: 1992’, Commercial Department, case number 14/92.

commercial debt, the court has the right to declare the status of bankruptcy.<sup>351</sup> Based on this ruling, reliance is on the cash flow bankruptcy test without taking into consideration the fact that the liabilities of the debtor might exceed its assets. Also, this ruling does not distinguish between an honest and dishonest creditor. Provoking the bankruptcy of the trader due to a single unpaid debt means that viable businesses might be declared bankrupt. Hence, future bankruptcy law should establish clear criteria that can be relied on in determining the status of insolvency. In this case, it is important to examine the state of bankruptcy by making reference to two tests of bankruptcy. In this regard, the view of this thesis is that in determining a trader's inability to pay debts, both the cash flow test and the balance sheet test should be included within the definition of 'inability to pay debts'.<sup>352</sup> To clarify, establishing clear guidance helps in providing a level of certainty and predictability since it is not appropriate to declare the bankruptcy of traders who cease to pay only a single commercial debt. Also, it is advisable to prescribe a *de minimis* amount of the commercial debt that can be used in determining whether it is appropriate to declare the bankruptcy of a trader or not. Hence, as is the case in England and the US, future bankruptcy law in Oman should define the meaning of 'inability to pay debts' and such a definition should include both the cash flow test and balance sheet test. However, whether to

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<sup>351</sup> Ibid.

<sup>352</sup> See above section 4.4 (A).

declare the bankruptcy of the trader based on either test should be left to the discretion of the court to be considered on a case-by-case basis.<sup>353</sup>

### 5.5.2.2 Clarity and Certainty in Regard to Priority Rules

As discussed in the previous chapter,<sup>354</sup> the current bankruptcy regime in Oman is not clear in regard to the notion of ‘absolute priority’, whereby secured creditors are paid first, followed by general creditors (e.g. employees, government) and then shareholders if any residual remains, and is not fully articulated under the current regime. Thus, senior creditors are paid in full before junior creditors are paid anything.<sup>355</sup> When a company is liquidated, the distributions to creditors should be based on the absolute priority rule to the extent that assets are available.<sup>356</sup> Thus, in the event of bankruptcy, it is unclear what sort of ranking should be followed

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<sup>353</sup> This is the case in England, where the insolvency of each company is considered on a ‘case-by-case’ basis: see Mallon C. & Waisman S., *the Law and Practice of Restructuring in the UK and US*, (Oxford University Press, 2011), p. 114.

<sup>354</sup> See above section 4.4 (C).

<sup>355</sup> This means that a creditor with collateral over an asset of the debtor must be paid before general creditors. However, secured creditors are ranked as unsecured creditors with regard to any shortfall between the size of the claim and the proceeds of selling the security asset: Fabozzi F., *Bond Portfolio Management*, (John Wiley & Sons, 2001), p. 57; O’kane D. & Bawlf P., ‘Global Guide to Corporate Bankruptcy: A Comprehensive Guide to Corporate Bankruptcy and a Survey of Global Corporate Bankruptcy Regimes’, (Nomura International, July 2010), p. 133, available at: <http://www.scribd.com/doc/59845050/Bankruptcy-Guide>; Andrew Campbell also stated that “in bankruptcy it is generally the case that unsecured creditors will receive only a fraction of what they are owed and often nothing at all”: Campbell A., ‘Bank Insolvency and the Interests of Creditors’, (2006), 7 (1/2) J.B.R. 133, p. 139.

<sup>356</sup> This provides certainty and creditability to creditors before entering into a bargain with the debtor. Also, having a distribution scheme is necessary to substitute the “first come, first served” pre-bankruptcy distribution regime: O’kane D. & Bawlf P., above 355, pp. 133-134; see Rotem Y., ‘Pursuing Preservation of Pre-bankruptcy Entitlements: Corporate Bankruptcy Law’s Self-Executing Mechanisms’ (2008) 5 B.B.L.J. 79, p. 91.

since both the Commercial Code of 1990 and the Commercial Companies Law of 1974 do not offer clear guidance. As mentioned in the previous chapter,<sup>357</sup> in the bankruptcy of the debtor, various laws have granted priority to a certain player. For instance, while Oman's Labour Law of 2003 grants worker's wages priority over government debts, the law of Government Debts Recovery of 1994 grants priority to debts owed to the government, although they are not secured and were incurred later, and these debts must be paid before the payment of secured creditors. Furthermore, whereas the Social Insurance Law of 1991 grants preference, after paying government debts and judicial expenses, to unpaid pension contributions, the Personal Affairs Law of 1997 grants top priority to the amounts of Alimony over all debts. Thus, under the current regime, pre-bankruptcy rights are not well-protected. Due to the uncertainty in the ranking of creditors, secured creditors do not know the exact kind of treatment that they will be offered in the event of bankruptcy. Also, because of this uncertainty it is impossible to state a precise order of the recognised priority rule under the current bankruptcy regime in Oman.

It is stated that the normal rule<sup>358</sup> in a corporate bankruptcy is that creditors with security over an asset of the debtor can pay themselves out of the assets to the extent of its value by realising it.<sup>359</sup> All unsecured creditors are treated on an equal footing and share in bankruptcy assets *pro rate* (the notion of *pari passu*)<sup>360</sup>

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<sup>357</sup> See above section 4.4 (C) & (G).

<sup>358</sup> See Wood P., above 177, p. 240; Finch V., *Corporate Insolvency Law: Perspectives and Principles*, (2<sup>nd</sup> edition, Cambridge University Press, 2009), pp. 74-75.

<sup>359</sup> Wood P., above 177, p. 240; Finch V., above 358, p. 75.

<sup>360</sup> Goode states that "the most fundamental principle of insolvency law is that of *pari passu* distribution, all creditors participating in the common pool in proportion to the size of their admitted claims": Goode R., above 329, p. 235.

according to their pre-bankruptcy entitlements<sup>361</sup> or sums they are owed.<sup>362</sup> Even though this is the normal rule of priority in a corporate bankruptcy, an empirical study demonstrated that many bankruptcy regimes deviate from this general rule.<sup>363</sup> According to this study,<sup>364</sup> the most important difference between bankruptcy regimes is the priority they assign to secured creditors, insolvency procedures expenses (i.e. court, expert, legal and administration costs), employee wage claims and post-bankruptcy financing. Based on this study, the only jurisdictions that place secured creditors first in the priority of payments are the UK,<sup>365</sup> Germany, Japan, Hong Kong, Singapore and Australia.<sup>366</sup> In many of these jurisdictions, the enforcement of security takes place separately from the distribution of assets according to the statutory priority of payments.<sup>367</sup> In addition, while jurisdictions such as France, Canada and Spain grant employees the highest priority in liquidation, the US grants limited employees' wage claims priority over secured claims. Moreover, the jurisdictions that place the expenses of bankruptcy procedures first are Canada, Greece, Italy and Ireland.<sup>368</sup> In these jurisdictions the

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<sup>361</sup> Pre-bankruptcy entitlements can be determined by referring to contracts made by the firm with its claimants.

<sup>362</sup> Finch V., above 358, pp. 74 & 75.

<sup>363</sup> O'kane D. & Bawlf P., above 355.

<sup>364</sup> Ibid, p. 146.

<sup>365</sup> It is worth noting that the preferential status of taxes and social security contributions was abolished by the Enterprise Act 2002, but certain employee claims are still granted preference, such as contributions to occupational pension schemes, unpaid holiday pay and unpaid wages for employees within a particular period of insolvency and subject to a maximum amount per employee retain preferential status over floating charge collateral: see section 176 of the Insolvency Act 1986; Wood P., above 177, p. 255.

<sup>366</sup> O'kane D. & Bawlf P., above 355, p. 146.

<sup>367</sup> Ibid.

<sup>368</sup> Ibid.

recovery of secured creditors and all subordinate creditors are exposed to the fees and expenses of liquidation procedures.<sup>369</sup> This thesis argues that it is not clear how the difference between these jurisdictions in the priority ranking may have an effect on investment decisions.<sup>370</sup> However, it is argued that the quality of the laws and regulation may be a useful signal to foreign investors of the overall quality of the business environment<sup>371</sup> and in making their investment decisions, investors are becoming more prudent since the risk of facing bankruptcy has increased considerably.<sup>372</sup>

Further, another study provided a comparative summary of various insolvency regimes in the MENA region.<sup>373</sup> This study demonstrated that all bankruptcy regimes in MENA countries grant a number of claims priority over pre-bankruptcy rights of creditors.<sup>374</sup> According to this study,<sup>375</sup> Morocco, Jordan, Egypt, Qatar and Kuwait grant priority to the public policy exception (i.e. costs of court, taxes, costs of the estate and employee wages) over creditors' rights. Saudi Arabia only grants priority to liquidation costs, employee wages, rent and wife's dowry. Egypt also

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<sup>369</sup> Ibid.

<sup>370</sup> The researcher cannot find a specific empirical study in regard to the consequences or the implications of this difference.

<sup>371</sup> See Hornberger K., Battat J. & Kusek P., above 238; Perry A., above 239, p. 779; 'World Bank Doing Business Report: 2013', above 242, p. 47.

<sup>372</sup> Moskván D. & Vrbova V., above 243, p. 50.

<sup>373</sup> The MENA Region includes: Algeria, Bahrain, Djibouti, Egypt, Iran, Iraq, Israel, Jordan, Kuwait, Lebanon, Libya, Malta, Morocco, Oman, Qatar, Saudi Arabia, Syria, Tunisia, United Arab Emirates, West Bank and Gaza and Yemen.

<sup>374</sup> See Uttamchandani M., 'No Way Out: The Lack of Efficient Insolvency Regimes in the MENA Region', (March 2011), Policy Research Working Paper 5609, the World Bank, available at: [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=1794914](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1794914). accessed on 21/01/2014.

<sup>375</sup> Ibid.

gives rent a priority. Nevertheless, in Saudi Arabia secured creditors' rights are not subordinate to the public policy exceptions and the fund from secured creditors' collateral is held in trust by the bankruptcy trustee and paid to the secured creditors after the collateral is sold.<sup>376</sup> Although the issue of priority in Oman is not mentioned in this study, this thesis argues that clarity of priority rights is also a problem in Oman since, as stated above,<sup>377</sup> a number of different laws address the priority of payment. Further, the Omani Commercial Code grants limited employee wages claims priority over other creditors.<sup>378</sup>

It is clearly demonstrated by the above-mentioned studies that bankruptcy laws worldwide often grant priority rights to certain claims by adjusting and modifying pre-bankruptcy entitlements through having redistribution<sup>379</sup> provisions.<sup>380</sup> However, it is worth noting that whether or not bankruptcy law should be viewed as having a redistributive role is subject to controversial debate.<sup>381</sup> As discussed in

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<sup>376</sup> See also McNally R., 'Insolvency Regimes in the MENA Region', available at: [http://www.menacitylawyers.com/uploaded/publication\\_5feb3dd1-39ef-47bc-ad7d-4716d880dce5\\_.pdf](http://www.menacitylawyers.com/uploaded/publication_5feb3dd1-39ef-47bc-ad7d-4716d880dce5_.pdf). as of 15/08/2013.

<sup>377</sup> See above pp 192-193.

<sup>378</sup> Article 628 of the CC.

<sup>379</sup> Redistribution is generally defined as any modification of pre-bankruptcy entitlements held by an agent- i.e., formation of a new bankruptcy entitlement or destruction of a pre-bankruptcy entitlement- that occurs once the firm enters a formal collective bankruptcy procedure. In this regard, a provision of bankruptcy law is called redistributive as long as it creates a bankruptcy entitlement or destroys a pre-bankruptcy entitlement: see Rotem Y., above 356, pp. 90-91.

<sup>380</sup> Readjustment and modification of pre-bankruptcy entitlement is normally based on public interest or on the recognition of established legitimate policy such as to promote the rescue culture: see Finch V., above 358, pp. 600-601.

<sup>381</sup> See Jackson T., above 300, p. 861; Baird D., above 326, p. 817; Warren E., 'Bankruptcy Policy', (1987) 54 (3) U.C.L.R. 755.

Chapter Two,<sup>382</sup> on one side of the debate, the supporters of the creditors' bargain theory view bankruptcy law as a system that should be designed to mirror the agreement one would expect the creditors to reach among themselves (*ex ante*).<sup>383</sup> Thus, the supporters of this theory would argue that it is not the objective of bankruptcy laws to redistribute losses in bankruptcy, but rather the same rule that distributes losses outside bankruptcy should be applied.<sup>384</sup> However, on the other side of the debate, the supporters of the multiple values approach view bankruptcy law as having a redistributive role.<sup>385</sup> Warren, for instance, argues that one of the proper functions of the bankruptcy law should be to allocate losses that arise by virtue of the bankruptcy and in doing so bankruptcy law should contain wealth redistribution provisions whereby protection should be given to certain claimants who are least able to bear the costs of such a failure.<sup>386</sup> In supporting Warren's view, Korobkin argues that bankruptcy law is not merely a response to the problem of debt collection but rather it is also a distinct system for responding to the problem of financial distress.<sup>387</sup> As a consequence, in dealing with financial distress, bankruptcy law should and must modify rights recognised under substantive non-bankruptcy law.<sup>388</sup> However, Baird argues that if social policy rationally favours employees, legislation could favour employees in all businesses, not just those that are unable to meet their debt obligation or find themselves in

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<sup>382</sup> See above pp. 49-50.

<sup>383</sup> Jackson T., above 300, p. 860.

<sup>384</sup> Baird D., above 326, p. 822.

<sup>385</sup> Warren E., above 381; Korobkin D., 'Rehabilitating Values: A Jurisprudence of Bankruptcy', (1991) 91 R.C.L. 717.

<sup>386</sup> Warren E., above 381, p. 811

<sup>387</sup> Korobkin D., above 385, p. 766.

<sup>388</sup> *Ibid*, p. 766.

bankruptcy for some other reason.<sup>389</sup> If some interests are in need of such protection, it is better to tackle this problem and provide protection within the whole legal system in order to provide a uniform and certain protection.<sup>390</sup> Nevertheless, Goode argues that some claimants (i.e. employees in regard to their wages) arise by virtue of the bankruptcy of the debtor, and, as a result, there is no sense in prescribing priority for those claimants except in the context of bankruptcy law.<sup>391</sup> Further, Cantlie states that bankruptcy of the debtor automatically introduces a flaw into the bargaining process because a number of claimants are competing for a share of a limited pool of assets, and that means that there will not be enough to satisfy all claims.<sup>392</sup> Thus, there is a need to relieve certain creditors of the costs of default by the debtor.<sup>393</sup>

This thesis supports the idea that bankruptcy law should be designed in a way that allows pre-bankruptcy entitlements to be adjusted and modified in order to pursue a legitimate or public policy (a policy encouraging reorganisation of the business of the distressed debtor) and in a way that, also, provides protection to pre-bankruptcy creditors.<sup>394</sup> In this regard, in order to avoid such uncertainty and provide a level of predictability, the view of this thesis is that future bankruptcy law should have a clear priority rule. Within the context of this rule, the rights and

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<sup>389</sup> Baird D., above 326, p. 822.

<sup>390</sup> For more discussion: see above section 2.2.1; see also Baird D. & Jackson T., 'Corporate Reorganization and the Treatment of Divers Ownership Interests: A Comment on Adequate Protection of Secured Creditors in Bankruptcy', (1984) U.C.L.R. 97, pp. 102-103.

<sup>391</sup> See Goode R., above 329, pp. 73-74.

<sup>392</sup> See Cantlie S., 'Preferred Priority in Bankruptcy', in Ziegel J., *Current Developments in International Corporate Insolvency Law*, (Oxford, Clarendon Press, 1994), p. 421.

<sup>393</sup> Ibid.

<sup>394</sup> See below pp. 337-339.

priorities of creditors established prior to the bankruptcy of the trader should be upheld in insolvency cases in order to preserve the legitimate expectations of creditors and encourage greater predictability in commercial relationships.<sup>395</sup> In this regard, it is important for the holders of collateral (security) to be able to determine with certainty, at the time it agrees to provide credit, the ranking and the priority of its security right.<sup>396</sup> Thus, because of the importance of providing credit, future bankruptcy law should protect pre-bankruptcy secured entitlements. For instance, as discussed in Chapter Three,<sup>397</sup> even though the bankruptcy laws of both England and the US adopt the concept of moratorium, both countries allow secured creditors to apply to the court in order to have the stay lifted.<sup>398</sup> In the US, for the stay to be imposed on the holder of priority rights, the debtor has to prove that the creditor is comfortably over-secured (this is called 'equity cushion') or by showing that one of the criteria mentioned in the statute is met.<sup>399</sup> Also, in England, the court is given the discretion to decide whether to lift the stay or not based on the facts of each case.<sup>400</sup> Further, as explained in Chapter Three,<sup>401</sup> in the US, the

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<sup>395</sup> See Goode R., above 329, pp. 93-94; see also The World Bank Principles, above 337, p. 41.

<sup>396</sup> See United Nations Commission on International Trade Law, 'UNCITRAL Legislative Guide on Secured Transactions', (2010), p. 21, available at:

[http://www.uncitral.org/pdf/english/texts/security-ig/e/09-82670\\_Ebook-Guide\\_09-04-10English.pdf](http://www.uncitral.org/pdf/english/texts/security-ig/e/09-82670_Ebook-Guide_09-04-10English.pdf).

accessed on 20/02/2014; United Nations Commission on International Trade Law, 'Legislative Guide on Insolvency Law', (2004), p. 267, available at:

[http://www.uncitral.org/pdf/english/texts/insolven/05-80722\\_Ebook.pdf](http://www.uncitral.org/pdf/english/texts/insolven/05-80722_Ebook.pdf). accessed on 20/02/2014.

<sup>397</sup> See above section 3.4.2.

<sup>398</sup> However, as it is stated in Chapter three, lifting the stay is subject to a number of conditions that must be met: see above pp. 152-154.

<sup>399</sup> See Westbrook J., 'Chapter 11 Reorganisation in the United States', in Rajak H., *Insolvency Law: Theory & Practice*, (London, Sweet & Maxwell, 1993), p. 351; see also above p. 153.

<sup>400</sup> For further discussion: see above pp. 149-151.

<sup>401</sup> See above pp. 159-160.

status of super priority will not be granted to the new lender unless it is established that there is adequate value in the collateral to protect fully both old and new lenders.<sup>402</sup> Thus, when proposing the concept of moratorium and the notion of post-petition financing for the Omani legislator, this study will take these issues into account.<sup>403</sup>

It is worth noting that the *pari passu* distribution is one of the principles of the law of bankruptcy concerned ensuring an equitable distribution of the company's estate among its creditors.<sup>404</sup> It means that, in winding up a business, "unsecured creditors shall share proportionately in those assets of the insolvent company that are available for residual distribution".<sup>405</sup> However, as stated above, certain unsecured creditors' claims are granted preference over other unsecured claims.<sup>406</sup> These preferential debts are unsecured debts which by force of law fall to be paid in a winding up in priority over all other unsecured debts.<sup>407</sup> For instance, this is the case in Oman where priorities are granted to limited employees' wage claims,<sup>408</sup>

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<sup>402</sup> Smiley E. & Ekvall L., *Bankruptcy for Businesses: Benefits, Pitfalls and Alternatives*, (Entrepreneur Press, 2007), pp. 101-102.

<sup>403</sup> See below section 5.4.4.3 & section 5.4.4.4.

<sup>404</sup> For the importance, application, impact and exception of this principle: see Goode R., above 329, pp. 235-257; Finch V., above 358, pp. 599-627; Keay A. & Walton P., *Insolvency Law: Corporate and Personal*, (Longman, 2003), pp. 505-510.

<sup>405</sup> Finch V., above 358, p. 599.

<sup>406</sup> As stated above, some countries grant priority to certain claims, such as employees' wage claims, taxes, and rent of the property. It is argued that bankruptcy, by its nature, is a public and collective process that will involve the imposition of public policy priorities on what were previously private transactions. A country that privileges the private sector with favourable tax treatment may wish to make up for the lack of public funds available to support unemployed workers by privileging such workers in insolvency: see Uttamchandani M., above 1704, p. 7; see above pp. 330-332.

<sup>407</sup> Finch V., above 358, p. 604.

<sup>408</sup> Article 628 of the CC.

and government debts.<sup>409</sup> However, it is argued that the existence of preferential debts frustrates the distribution based on the notion of *pari passu*<sup>410</sup> and, as a result, it is submitted that the number of preferential claims should be kept to a minimum.<sup>411</sup> In this regard, the researcher's view is that, unlike the case under the current regime, tax claims should not be granted preferential treatment. However, preferential treatment should be given to employees in regard to some of their entitlements. The government is considered as a strong party in most dealings and, as a consequence, protection of the weak parties, such as employees, is advisable. Also, employees usually rely on their salaries as the main source of their income, whereas, the government has various sources and means of increasing its income. It is also argued that employees normally depend for their livelihood on the uninterrupted receipt of their salary; they cannot diversify away the risk posed by the bankruptcy of their employers.<sup>412</sup> Nevertheless, the government is widely diversified and its revenues are drawn from a vast cross-section of society.<sup>413</sup>

Based on what has been discussed, this thesis argues that in designing a priority rule, it is important to grant special protection to secured creditors since they are the main providers of credit necessary for running the business. Lenders may refrain from providing capital if they know in advance that their securities will not be respected in the event of bankruptcy. Therefore, it is essential to offer them priority and such priority is limited to specific collaterals that are held by secured

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<sup>409</sup> The law of Government Debts Recovery of 1994.

<sup>410</sup> Finch V., above 358, p. 604;

<sup>411</sup> See the World Bank Principles, above 337, p. 44.

<sup>412</sup> See Cantlie S., above 392, p. 414; Cleig B., 'Unpaid Wages in Bankruptcy', (1987) 21 U.B.C.L.R. 61.

<sup>413</sup> Cantlie S., above 392, p. 414.

creditors. However, the Omani legislator should also prescribe a super priority status to be given to any lender who provides financing that is necessary to run the business during the restructuring process. Offering such a super priority status is important, as otherwise lenders will be frustrated from extending the required funding. Moreover, the costs of administering bankruptcy proceedings should be taken into account and, as a result, priority should be given to administrators' wages and administration expenses. It is worth mentioning that due to religious and moral ground, preferential priority should also be given to the amount of alimony. Thus, this thesis proposes the following distribution rule<sup>414</sup> to be adopted by the Omani legislator:<sup>415</sup>

- Super priority claims that result from providing funding during restructuring processes.
- Secured creditors' claims to the extent of the value of their security.<sup>416</sup>
- Preferential creditors' claims, this includes employees' wages, alimony and administration expenses/ liquidation costs.<sup>417</sup>

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<sup>414</sup> As it appears, this thesis deviates from the *pari passu* distribution role; for the reasons discussed above, this thesis proposes the grant of preference to certain unsecured creditors' claims: see above p. 337.

<sup>415</sup> It is worth noting that the ranking of priorities differs from one jurisdiction to another. As stated above, in this regard, in England, for instance, no priority status is given to lenders who provide financing during the restructuring processes. However, in the US, a super priority status is granted to lenders who provide funding during the US Chapter 11.

<sup>416</sup> As stated above, secured creditors are ranked as unsecured creditors with regard to any shortfall between the size of the claim and the proceeds of selling the security asset.

<sup>417</sup> These include costs of operating the company, for instance, legal fees and rent of the properties that are necessary for the administrator/ liquidator to perform his or her functions.

- General unsecured creditors.<sup>418</sup>

To conclude, this thesis places emphasis on the fact that it is essential to prescribe a priority rule within Oman's future bankruptcy law. This enables any stakeholder to have a sense of certainty and predictability before entering into a bargain with the debtor. Also, prescribing such a ranking helps in avoiding any dispute that might be raised by one of the participants. However, it is worth noting that including a distribution priority rule in bankruptcy law does not indicate that every group will be paid at the end of the bankruptcy process. Rather, due to the bankruptcy of the company, some groups might be targeted and receive nothing. In this regard, all stakeholders should acknowledge the fact that this is the norm during the bankruptcy of traders.

### **5.5.3 Types of Desired Bankruptcy Procedures**

Currently, there are three available procedures in Oman, namely bankruptcy proceedings, preventive composition procedures and liquidation procedures. However, none of these proceedings is geared towards rescuing the business of enterprises. As stated in the previous chapter,<sup>419</sup> while the aim of the bankruptcy procedure is to declare the bankruptcy of a distressed debtor, release him from his debts and liabilities and distribute his assets, the aim of the liquidation proceeding is to liquidate the assets of the distressed company and to make distribution to creditors. The purpose of the preventive composition proceeding is to allow the

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<sup>418</sup> This is the vast majority of creditors and may include financial creditors who are either not secured or are under-secured. It also includes suppliers and non-preferred employee claims: see O'kane D. & Bawlf P., above 355, p. 37.

<sup>419</sup> See above p. 185.

trader to escape the consequences of the declaration of bankruptcy.<sup>420</sup> Thus, the aim of this proceeding is not to rescue the business of the enterprise, but rather it is merely to give the trader the opportunity to escape bankruptcy proceedings.

Furthermore, as stated above,<sup>421</sup> one of the main deficiencies of the current bankruptcy regime in Oman is that it is outdated and inconsistent with today's business requirements since rescuing the business of enterprises is not recognised. Hence, in order to modernise the Omani bankruptcy regime, it is important to take lessons from the experience of both England and the US. However, as argued above,<sup>422</sup> this does not mean to say that the Omani legislator should transplant all bankruptcy proceedings that are available in England and the US. In fact, there is a need for careful consideration since it is not appropriate to transplant all insolvency proceedings from these jurisdictions. As discussed above, in proposing foreign rules or principles it is necessary to take into account the differences between infrastructures in importing and exporting jurisdictions.<sup>423</sup> To clarify, the researcher does not support the idea of transplanting all insolvency proceedings that are available for distressed enterprises in England. As stated in Chapter Three,<sup>424</sup> there are five insolvency proceedings in England: administration, receivership, CVAs, schemes of arrangement and winding up proceedings. In this regard, this thesis argues that it is not sufficient for Oman to transplant the receivership procedure because the aim of this procedure is not to rehabilitate the

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<sup>420</sup> See *ibid* & p. 227.

<sup>421</sup> See above section 4.8.

<sup>422</sup> See above pp. 261-262 & pp. 273-275.

<sup>423</sup> More discussion on this point: see above pp. 273-275.

<sup>424</sup> See above section 3.2.

business of the debtor, but rather it is a tool for a floating charge holder to enforce his security by appointing a receiver whose main responsibility is to protect the interests of his appointer. Also, unlike the case in England, the notion of a 'floating charge' over all assets of the company is not recognised in Oman and any secured creditor is granted a security over a specifically designated asset. Hence, the importation of this particular regime is not appropriate, since creditors in Oman are not given security over all the assets of an enterprise, and since this regime does not support the idea of a 'rescue culture', the appointed administrative receiver is not obliged to restore the business of the debtor to a profitable status.<sup>425</sup> This does not mean to ignore the importance of a floating charge security in obtaining credit. Pennington, for instance, argued that a floating charge security meets the needs of companies, since in raising money they are allowed to grant a creditor security over all fixed and unfixed assets.<sup>426</sup> However, this type of security has been criticised from a number of angles.<sup>427</sup> For example, Finch argued that since floating charges usually take over the trader's entire undertaking,<sup>428</sup> monitoring in order to identify misbehaviour or analyse risks could involve scrutinising the whole business<sup>429</sup> and as a consequence, this type of charge offers 'a relatively

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<sup>425</sup> See above section 3.2.2.

<sup>426</sup> He stated that "the greater part of a company's assets would usually comprise raw materials, manufactured and semi-manufactured goods, stock in trade and trade debts payable to it, and its land, buildings and fixed equipment would often form a mere fraction of the value of its undertaking": Pennington R., 'The Genesis of the Floating Charge', (1960) 26 (6) M.L.R. 630, p. 631.

<sup>427</sup> For in-depth criticism: see Finch V., above 358, pp. 95-120; Mokal R., 'The Floating Charger- An Elegy', in Worthington S., *Commercial Law and Commercial Practice*, (Oxford, Hart, 2003), p. 479.

<sup>428</sup> Finch V., above 358, pp. 97-98.

<sup>429</sup> Ibid.

expensive method of securing finance'.<sup>430</sup> Also, the floating charge is viewed as a device particularly favourable to the transfer of insolvency wealth from unsecured to secured creditors.<sup>431</sup> Unsecured creditors may not receive sufficient notice of the impact of the floating charge on their interests, since it might be difficult to inform the company charges' register of the amount secured by the floating chargers.<sup>432</sup> However, even if this type of security is introduced by the Omani legislator in future, this thesis argues that administrative receivership should not be adopted in Oman since, as stated in Chapter Three,<sup>433</sup> it is against the concept of the rescue culture.

Further, this thesis argues that there is no need to have in place various restructuring procedures in Oman, but rather it is enough to have a single bankruptcy regime that is designed for all types of companies, large, medium and small. However, SMEs represents more than 90 per cent of registered enterprises in Oman,<sup>434</sup> so that within this regime, it is important to have special procedures that are devoted to the rehabilitation of viable SMEs. This can be done, for instance, by establishing a rescue regime for SMEs, by the easing of access to the reorganisation proceedings and by setting a specific time limit whereby all procedures should be completed.<sup>435</sup> Hence, proposing wholesale transplantation of CVA and scheme of arrangement proceedings in England are not appropriate for Oman. Having a single bankruptcy regime provides consistency and predictability

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<sup>430</sup> Ibid, p. 105.

<sup>431</sup> For more critiques of floating charge security device: see Finch V., above 358, pp. 113-114; Mokal R., above 427, p. 480.

<sup>432</sup> *ibid.*

<sup>433</sup> See above section 3.2.2.

<sup>434</sup> AL-Shanfari D., AL-Said A., AL-Said F. & AL-Busaidi S., above 260, p. 1.

<sup>435</sup> See below section 5.5.4.

in the sense that all debtors and creditors would know the applicable procedures that would apply in the event of financial distress. Furthermore, as explained above,<sup>436</sup> one of the main drawbacks of the current bankruptcy regime in Oman is that bankruptcy trustees/ practitioners and judges are not required to obtain certain qualifications to deal with bankruptcy cases. As a result, proposing a single gateway rescue regime to be adopted by the Omani legislator would facilitate the practice in Oman. However, as will be discussed,<sup>437</sup> establishing a rescue regime without having qualified bankruptcy officers renders the law to be ineffectively implemented. In this regard, it is appropriate to follow the approach adopted by the US Chapter 11. Chapter 11 offers reorganisation rules in which special procedures available for small businesses vary from those designed for medium and large businesses.<sup>438</sup> However, this does not mean to ignore the fact that both the CVA and scheme of arrangements embody a number of crucial features that are necessary for any bankruptcy regime. As discussed in Chapter Three,<sup>439</sup> even though one of the weaknesses of both proceedings is that secured creditors' actions are not stayed during the proceedings, the concept of 'debtor-in-possession (DIP)' is a feature of both the CVA and the scheme of arrangement in England. This is also similar to the case in the US Chapter 11 where DIP is one of its main characteristics.<sup>440</sup>

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<sup>436</sup> See above section 4.4 (E).

<sup>437</sup> See below section 5.5.4.6.

<sup>438</sup> Bankruptcy Abuse Prevention and Consumer Protection Act of 2005; see above p. 137.

<sup>439</sup> See above sections 3.2.3 & 3.2.4.

<sup>440</sup> See above section 3.3.1.

### 5.5.4 Establishing a Rescue Regime

In previous chapters, the importance of promoting the concept of rescue culture has been emphasised. As discussed in Chapter Two, most theories recognised the impact of rehabilitating the business of the distressed debtor on maximising the interests of all stakeholders.<sup>441</sup> As is the case under the US Chapter 11, such rehabilitation can be achieved through negotiating a payment plan with creditors or through running the business as a going concern.<sup>442</sup> However, in Chapter Three,<sup>443</sup> an explanation is given of how rehabilitating the business during bankruptcy varies from one jurisdiction to another. For instance, whereas under administration proceedings in England displacement of the previous management is viewed as an important step in restructuring the business during the administration processes, during the US Chapter 11 management, in principle, retains their position and plays a role in completing the reorganisation processes. Also, while it is possible to give a super priority status to a new lender during the US Chapter 11, the new lender is not given such priority during administration proceedings. Thus, even though both jurisdictions recognise the importance of having in place a rescue regime, in regulating such a regime each country adopts a distinct approach.<sup>444</sup>

This thesis supports the idea that future bankruptcy law should have a mechanism whereby it is possible to rehabilitate viable distressed enterprises

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<sup>441</sup> Examples of these theories are the multiple values theory and the explicit value theory: see above sections 2.6.1 & 2.7.1.

<sup>442</sup> Dahl H., 'USA: Bankruptcy under Chapter 11', (1992) 5 I.B.L.J. 555, p. 555; McCormack G., above 293, p. 162.

<sup>443</sup> See above section 3.4.

<sup>444</sup> See above section 3.4.

instead of liquidating them. However, it is affirmed by Tolmie<sup>445</sup> that there are a number of requirements for having a successful rescue regime. Ease of access to the process, encouraging debtors to apply for the process as early as possible, staying creditors' claims, regulating the post-financing and cramming-down dissenting creditors, are all examples of such requirements. In this regard, this thesis argues that in establishing a rescue regime, it is important for Oman to take lessons from the experience of both England and the US. As will be discussed below,<sup>446</sup> such lessons include facilitating access to the restructuring process, introducing a statutory mechanism whereby the rescue plan is imposed on objecting creditors, allowing creditors to have the stay lifted, and having qualified bankruptcy practitioners. As a consequence, transplanting some principles from England and the US will facilitate the establishment of modern restructuring procedures. However, as explained above,<sup>447</sup> in transplanting such principles care should be taken since some principles need to be modified in a way that suits Oman.<sup>448</sup> For instance, it will be demonstrated below, that it is not appropriate to propose the adoption of the administration regime where management is displaced and an insolvency practitioner is appointed, since this requires bankruptcy practitioners who are qualified to deal with bankruptcy cases. The aim of this part is to emphasise the importance of taking into account a number of issues in designing a future rescue regime.

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<sup>445</sup> Tolmie F., above 22, p. 64; for further explanations of these requirements: see above section 3.4.

<sup>446</sup> See below sections 5.5.4.

<sup>447</sup> See above pp. 261-262 & pp. 273-275.

<sup>448</sup> See the below discussions.

#### 5.5.4.1 Easing the Access to the Restructuring Process

Future bankruptcy law in Oman should provide easy access to reorganisation proceedings. Such access can be facilitated by encouraging debtors to apply for the process as soon as they perceive a disturbance of their businesses. In this regard, debtors should be assured that access to restructuring processes in the event of financial distress is facilitated. As discussed in the previous chapter,<sup>449</sup> at present, for a preventive composition application to be approved by the court, the debtor must demonstrate that (i) the disturbance of business activities leads to the cessation of paying commercial debts; (ii) such disturbance is not a result of gross fault or fraud; (iii) the debtor traded uninterruptedly for two years.<sup>450</sup> Because of these requirements, old traders who suspend their trading and all new traders who trade for less than two years are not eligible to apply for a preventive composition scheme. Further, access to the preventive composition scheme is complicated, since creditors and courts are unable to apply for this scheme and the only person eligible to apply is the distressed debtor. In addition, access to rescue proceedings can be facilitated by allowing creditors or the court to file the application. As discussed,<sup>451</sup> under the current bankruptcy regime, an application for a preventive composition scheme cannot be made by one of the creditors. Thus, the only choice for the creditors is to apply for bankruptcy proceedings.<sup>452</sup> Hence, it is important to allow creditors to apply for rescue proceedings.

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<sup>449</sup> See above section 4.6.2.1.

<sup>450</sup> Ibid.

<sup>451</sup> Ibid.

<sup>452</sup> As stated above, applying for bankruptcy proceedings means that the court might make an order declaring the sole trader or a company bankrupt. In case of a company, if a firm is declared

Furthermore, offering debtors a number of incentives has an impact on encouraging directors to attempt a restructuring route instead of running the business during its financial trouble. As will be discussed below,<sup>453</sup> these incentives include allowing directors to retain their position during reorganisation proceedings as well as imposing a temporary stay over all creditors' actions. However, it is worth noting that even though this thesis encourages the idea that directors should have incentives in order to apply for the process once they sense financial distress, there should be statutory provisions to punish the company's directors who fail to apply at an early stage. In this case, a lesson can be learned from England. As stated in Chapter Three,<sup>454</sup> the UK Insolvency Act of 1986 provides company directors with incentives- 'sticks and carrots'- in order for them to take action once they sense the financial crisis.<sup>455</sup> Armour and Mokal argue that both 'wrongful trading'<sup>456</sup> and 'director disqualification'<sup>457</sup> provisions contain statutory sticks to encourage directors to file for an administration regime as soon as they become aware of trouble.<sup>458</sup> On the other hand, if directors acted at the "earliest appropriate moment", they "would have some hope of regaining control," since the administrator may opt for their stay.<sup>459</sup> It is worth pointing out that Article 695 of the Commercial Code grants a bankruptcy trustee the right to seek court sanction to

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bankrupt, all the general liability partners must be declared bankrupt; for the effects of bankruptcy on the debtor, creditors and contracts: see above section 4.5.4.

<sup>453</sup> See below sections 5.5.4.2 & 5.5.4.4.

<sup>454</sup> See above pp. 147-148.

<sup>455</sup> Moss G., above 87, p. 19; Armour J. & Mokal R., above 294, p. 32.

<sup>456</sup> Section 214 of the Insolvency Act 1986.

<sup>457</sup> Company Directors Disqualification Act 1986.

<sup>458</sup> Armour J. & Mokal R., above 294, p. 32.

<sup>459</sup> Ibid.

order all members of the Board of Directors or all the managers, or some of them jointly or severally to pay all or some of the debts of the company. However, in order to escape this liability, directors must establish that they have exercised the necessary care to avoid further loss.<sup>460</sup> Also, according to Article 301 of Oman's Penal Code of 1974, directors may incur criminal liability where it is demonstrated that the bankruptcy of the company has been caused by fraudulent action on their part. Nevertheless, the problem with these Articles is that they are not detailed, which renders them incomplete. For instance, the test to be used in demonstrating directors' liabilities is not clear. In this case, a lesson can be taken from England where "in determining whether there was a reasonable prospect of the company meeting its liabilities and, if not, whether the director ought to have known this, the test would be objective, namely that of the ordinary, reasonable man".<sup>461</sup> Thus, introducing statutory sticks of wrongful trading and disqualification proceedings if the company leaves it too late, could encourage directors to apply for bankruptcy proceedings as soon as they detect the disturbance of the business. However, in designing such provisions care should be taken. In this regard, it is rightly argued that "a too rigid approach to holding directors and senior management responsible will potentially have the effect of preventing people from undertaking such a role if it is perceived as being too hazardous".<sup>462</sup>

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<sup>460</sup> Article 695 of the CC.

<sup>461</sup> See Goode R., above 329, p. 663; see above section 3.4.1.2.

<sup>462</sup> Campbell A., above 355, p. 142.

#### **5.5.4.2 Adopting the Notion of Debtor-in-Possession (DIP)**

As stated above, in order to encourage the debtors to apply for restructuring processes as soon as they notice the problem, the incentive of retaining their position during the process should be offered. Hence, this researcher's view is that it is important for the Omani legislator to adopt the concept of DIP. Nonetheless, in proposing the concept of DIP for the Omani legislator caution should be taken because, in adopting such a concept, there are two divergent practices. The US practice is that during the US Chapter 11 bankruptcy the management retains their position and runs the company without any kind of supervision.<sup>463</sup> However, in England the practice is that under CVA the management runs the company under the supervision of one or more insolvency practitioners.<sup>464</sup> In this regard, our view is that it is not appropriate to propose that the practice of the US should be followed by the Omani legislator, but instead it is prudent to opt for the practice of England. This thesis argues that<sup>465</sup> the appropriateness of foreign principles can be judged by trying to assess the workability and functionality of the proposed principles in the importing country. Hence, in assessing the workability and functionality of adopting, or not, the notion of DIP by the Omani legislator, recourse should be made to the cultural view because, as is the case in most Arab countries, in Oman the debtor is not viewed as an economic actor who deserves protection in the event of financial distress, but is viewed as a wrongdoer who needs to be punished and the assets distributed among creditors. This is evident from the treatment of the bankrupt under the Commercial Code. Upon the day on

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<sup>463</sup> See above section 3.3.1.

<sup>464</sup> See above section 3.2.3.

<sup>465</sup> See above pp. 273-275.

which the judgment of bankruptcy is issued, the bankrupt will be prohibited from practicing a number of civil rights,<sup>466</sup> might not leave Oman unless he/she is given permission by the court, and it is possible that the court is given powers to place him/her under supervision.<sup>467</sup> Because of this cultural view, leaving the management to run the business without any kind of supervision is not desirable. Moreover, it may be that case that creditors may lack confidence in the debtor on account of the financial troubles of the company and this lack of confidence may frustrate a rescue process.<sup>468</sup> Further, it is argued that leaving directors in control may create a lack of trust between creditors and management and as a result the level of litigation will rise and the expenses of such litigations will be paid from the debtor's resources.<sup>469</sup> It is also worth noting that this thesis does not support the idea of adopting the administration approach whereby upon the appointment of an administrator, the management will be displaced and the administrator will take control over any property belonging to the company.<sup>470</sup> Even though this approach coincides with the cultural view in Oman and the creditors might be in agreement, this approach is not appropriate for Oman due to an institutional factor. As stated above,<sup>471</sup> at present, bankruptcy trustees in Oman are not required to have qualifications and as a result it may be difficult for them to run the business of the company where knowledge and experience are highly recommended. Hence, the researcher argues that opting for the CVA is more practical, since it provides a

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<sup>466</sup> Article 604 of the CC.

<sup>467</sup> Ibid.

<sup>468</sup> See Legislative Guide on Insolvency Law, above 396, p. 163.

<sup>469</sup> Finch V., above 358, p. 284.

<sup>470</sup> However, as was explained, the administrator might opt for the stay of the management: see above p. 148.

<sup>471</sup> See above section 4.4 (E).

level of credibility and assurance for creditors. This also means that the management's decisions are overseen by the bankruptcy practitioner and the risk of over-investment could be minimised.

#### **5.5.4.3 Stay on Creditors' Actions**

Any future restructuring regime should have in place a mechanism whereby all creditors' claims are stayed. Imposing a stay on creditors' actions helps in facilitating the process of rehabilitating the business of the company. In the absence of such a mechanism, creditors will run to the court-house in order to be the first to enforce their securities.<sup>472</sup> This type of behaviour could hamper any attempt to rescue the company, particularly if the availability of such securities is necessary to complete the restructuring process successfully. In this regard, Goode rightly argued that if both secured and unsecured creditors are left free to pursue their claims, the assets of the company will be destroyed and the purpose of the rescue regime will be frustrated.<sup>473</sup>

As discussed in the previous chapter,<sup>474</sup> one of the main deficiencies of the current bankruptcy regime in Oman is that even though unsecured creditors' claims are stayed during bankruptcy processes, secured creditors' actions are not. As a consequence, bankruptcy trustees have to use some of the debtor's resources to defend secured creditors' actions before the court. This deficiency will be overcome if the debtor opts for the preventive composition scheme. Under this scheme, all claims, whether secured or unsecured, are stayed during the

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<sup>472</sup> Jackson T., above 302, pp. 14-16.

<sup>473</sup> Goode R., above 329, pp. 64-65.

<sup>474</sup> See above section 4.4 (D).

proceedings and, as a result, the assets of the company are protected from the demands of creditors until the end of the process. However, the aim of this scheme is not to rescue the business of the company, but rather it is a statutory alternative to escape the consequences of bankruptcy declaration.<sup>475</sup> Thus, at present, there is no statutory regime designed to rescue the business of distressed traders.

Hence, in designing a rescue regime, imposing a stay on secured and unsecured creditors' claims should be one of the main features. Certainly, it would be unlikely that the business of the debtor could be successfully reorganised if there was not a comprehensive stay imposed over all creditors' actions. However, in imposing a stay, caution should be taken since secured creditors are those most particularly burdened by the imposition of such a stay. In this case, there should be a mechanism whereby secured creditors are given the necessary legal right to seek the lifting of the stay. As explained in Chapter Three,<sup>476</sup> this type of mechanism is available under both England and the US bankruptcy laws. However, the difference between these two jurisdictions is that while in England lifting the stay is left to the discretion of the court, in the US the stay will not be lifted unless it is proven that the statutory requirements of 'adequate protection' are met.<sup>477</sup> In this regard, this thesis argues that it is crucial for Oman's future bankruptcy regime to deal with this issue and in this case it is advisable to adopt the experience of both England and the US. Hence, it is better for the Omani legislator to include a number of statutory requirements and to give judges the discretion to decide whether to lift the stay or not based on the facts of each case.

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<sup>475</sup> Article 753 of the CC; see above section 4.6.2.

<sup>476</sup> See above pp. 152-154.

<sup>477</sup> Section 361 of the US Bankruptcy Code.

To clarify, it is appropriate to stipulate that for the stay to be imposed on secured creditors, the debtor must demonstrate that a periodic cash payment will be made to the secured creditors or an additional or replacement lien equal to the decrease in the value of such entity's interests in the property.<sup>478</sup> Further, it is necessary to give courts the discretion to decide based on the facts of each case. For instance, the court should order the stay to be lifted if secured creditor's collateral is not necessary for the success of the reorganisation. Also, as is the case in England, a number of factors play a role in determining whether, or not, a stay has to be lifted.<sup>479</sup> These factors include the length of the stay and the impact of lifting the stay on other creditors.

Furthermore, one of the important issues that should be taken into account by the Omani legislator is to identify clearly those actions, if any, which are excluded from the stay. For instance, as stated in Chapter Three,<sup>480</sup> one of the substantial dissimilarities between the US and England insolvency proceedings is that while suppliers and customers are allowed to exercise contractual termination rights in insolvency in England, the US Chapter 11 moratorium prevents suppliers and customers from terminating their contracts with a company on grounds of insolvency alone.<sup>481</sup> In Oman, a stay will be imposed on all contracts and, as a result, suppliers will be prevented from exercising their contractual rights. As is the case in the US, Oman's Commercial Code invalidates what is called an '*ipso facto*

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<sup>478</sup> 'Adequate Protection': section 361 of the US Bankruptcy Code.

<sup>479</sup> Ian F., *The Law of Insolvency*, (Sweet & Maxwell, 2011), p. 543; *Re Paramount airways* [1990] Ch 744.

<sup>480</sup> See above pp. 151-152.

<sup>481</sup> Szekely A., Richardson F. & Gallagher A., 'Chapter 11 One Size Fits All', (2008) 23 (9) B.J.I.B.F.L. 457, p. 458.

*clause*'.<sup>482</sup> Inserting this clause means that the counterparty is able to cancel the contract in the insolvency of the other.<sup>483</sup> In this regard, this thesis argues that the approach taken by both the US and Omani law is better than that of England. This is due to that fact that not staying these types of contracts during the proceedings and allowing the suppliers to terminate their contracts on grounds of insolvency alone may impede any attempt to rescue the business of the company, particularly if such goods or services are necessary for the success of the rescue.<sup>484</sup> In addressing this issue Goode stated that the *ipso factor clause* triggered concern between insolvency practitioners, who view such clauses to be detrimental to the administration procedure' and, as a consequence, they should be annulled as being contrary to public interest.<sup>485</sup> Further, as is the case in both England and the US,<sup>486</sup> Oman's Commercial Code gives courts the right to approve any setting-off arrangement if it is satisfied that the rights and obligations of the parties are associated.<sup>487</sup> It is clearly stated that the rights and obligations of the parties are considered to be associated if they result from a 'single cause' or are included in a 'current account'.<sup>488</sup> If the conditions of the setting-off arrangement have been met, such an arrangement will be exempt from the stay. As a result, to provide certainty and predictability, in designing future bankruptcy regime, it is important to state clearly the actions that might be excluded from the stay.

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<sup>482</sup> Article 630 of the CC.

<sup>483</sup> Wood P., above 177, p. 429.

<sup>484</sup> In this regard see Milman D., above 336, p. 3.

<sup>485</sup> Goode R., above 329, p. 361.

<sup>486</sup> See above section 4.5.6.

<sup>487</sup> Article 607 of the CC.

<sup>488</sup> Ibid.

#### 5.5.4.4 Allowing Post-Financing

Besides adopting the notions of DIP and staying creditors' actions, it is crucial for the Omani legislator to facilitate a troubled debtor's access to new funding during the reorganisation phase. This is due to the fact that in the event of financial distress, the debtor would not be able to continue its operation unless sufficient funding is available.<sup>489</sup> However, in order to encourage existing lenders or a new lender to provide the required money, it is necessary for bankruptcy law to offer them a sufficient guarantee that they will be paid.<sup>490</sup> As discussed in Chapter Three,<sup>491</sup> this is the case under the US Chapter 11 where a post-petition lender is granted super priority status. Nonetheless, such status will not be granted to the new lender unless it is proven that there is adequate value in the collateral to protect pre-petition secured creditors.<sup>492</sup> In this regard, the US Bankruptcy Act imposes three requirements for authorising post-petition financing: the debtor must demonstrate that it is not possible to obtain a loan without granting a super priority status, there is adequate protection<sup>493</sup> of the interests of the pre-petition secured creditors, and that in any court hearing the onus of proving the necessity of new finance and the test of 'adequate protection' is on the debtor.<sup>494</sup> Further, it is worth

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<sup>489</sup> Henoch B., 'Post-Petition Financing: Is There Life after Debt?', (1991) 8 B.D.J. 575, p. 576.

<sup>490</sup> McCormack G., 'Super-Priority New Financing and Corporate Rescue', (2007) J.B.L. 701, p. 714.

<sup>491</sup> See above section 3.4.3.

<sup>492</sup> Triantis G., 'A Theory of the Regulation of Debtor-in-Possession Financing', (1993) 46 V.L.R. 901, p. 902.

<sup>493</sup> In this regard, the debtor must demonstrate that a periodic cash payment will be made to the secured creditor or an additional or replacement lien equals to the decrease in the value of such entity's interests in such property: see 11 USC 361 of the US Bankruptcy Act.

<sup>494</sup> 11 USC & 346 of US Bankruptcy Act; see Broude R., 'How the Rescue Culture Came to the US and the Myths That Surround Chapter 11', (2000) 16 (5) I.L.P. 194, p. 197.

noting that even though it was proposed in the House of Lords, the UK Enterprise Act of 2002 contains no specific provision for super priority new financing.<sup>495</sup> It was maintained that the decision whether to lend in times of trouble was a commercial one and was best left to the commercial judgment of the lending market, and that it would be wrong to offer a guaranteed return to super priority investor whether or not the rescue proposals had satisfied the market.<sup>496</sup> However, in recognition of the importance of such finance, in David Cameron's proposals for reform in July 2008, it was clearly affirmed that the Conservative Party would provide a priority status for a financier willing to provide ongoing funding post-petition.<sup>497</sup>

Currently, the concept of 'post-petition financing' is not recognized since there is no rescue regime in Oman. Hence, this thesis encourages the initiation of a rescue regime that facilitates the supply of new funding through offering the necessary incentives. Such incentives include granting a super priority status to the new lender. It is crucial to offer the debtor access to post-petition funds to enable the company to continue to pay for the supplies of goods and services, such as employees' salaries, insurance, rent of the property, maintenance of contracts and other operating expenses.<sup>498</sup> However, this does not mean to prejudice the interests of pre-petition secured creditors. This thesis argues that<sup>499</sup> in order to

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<sup>495</sup> McKnight A., 'The Reform of Corporate Insolvency Law in Great Britain- The Enterprise Bill 2002', (2002) 17 J.I.B.L. 324, p. 327; see also HL Official Report (Enterprise Bill), cols 786-789, (July 29, 2002).

<sup>496</sup> For more discussion see Finch V., above 358, pp. 408-409; McCormack G., above 490, p. 713.

<sup>497</sup> Available at [http://www.conservatives.com/News/Speeches/2008/07/David\\_Cameron\\_Speech\\_to\\_the\\_CBI.aspx](http://www.conservatives.com/News/Speeches/2008/07/David_Cameron_Speech_to_the_CBI.aspx).

as of 15/11/2013.

<sup>498</sup> Legislative Guide on Insolvency Law, above 396, pp. 113-114.

<sup>499</sup> See above pp. 334-336.

pursue a legitimate public policy,<sup>500</sup> bankruptcy law should be designed in a way that allows pre-bankruptcy entitlements to be adjusted and modified without prejudicing the interests of pre-bankruptcy creditors.<sup>501</sup> Thus, it is essential to reassure them that they are adequately protected against loss. In this regard, a lesson can be learned from the experience of the US, where the status of super priority is not granted unless the court establishes that the position of pre-petition secured creditors at the time of bankruptcy filing is not harmed and they are sufficiently protected. The sufficiency of such protection can be achieved by compelling the debtor to make a periodic cash payment to secured creditors or to provide supplementary collateral equal to the decrease in the value of the effected security.<sup>502</sup> In this regard, this thesis places emphasis on the fact that in order to avoid uncertainty and provide a level of predictability in commercial relationships, future bankruptcy law should have clear provisions for post-petition new financing. Within the context of these provisions, the requirements for sanctioning post-petition financing arrangements are made clear and pre-bankruptcy creditors are adequately protected.

#### **5.5.4.5 Creditors' Participation and the Approval of the Restructuring Plan**

Once a bankruptcy process is initiated, a rescue plan should be proposed by the debtor after seeking advice from a bankruptcy practitioner in order to be discussed, modified and approved by the creditors. In this regard, all creditors should be entitled to vote 'for' or 'against' the plan and raise any objections in

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<sup>500</sup> For example, rescuing the business of the company.

<sup>501</sup> However, this is against the view of the creditors' bargain theory: see above sections 2.2.1.

<sup>502</sup> This is the case in the US: see section 361 of the US Bankruptcy Act.

court, unlike the case under the current preventive composition scheme where secured creditors are not allowed to vote unless they relinquish their securities. Under both England and the US bankruptcy regimes, secured creditors are normally entitled to vote on the restructuring plan. The researcher's view is that secured creditors should be given the right to participate in voting on the plan. In reorganisation, for instance, secured creditors have a direct interest in where their rights might be adjusted or affected by the rescue plan or where the encumbered assets will be essential to the successful implementation of the proposed plan.<sup>503</sup> However, for voting purposes, whether to divide creditors into different classes or to treat all creditors as a single class is an issue that needs to be addressed by the Omani legislator. As discussed in Chapter Three,<sup>504</sup> under both the US Chapter 11 and the scheme of arrangement in England, voting on the plan is done by dividing creditors into a number of classes. However, they differ in the criteria that are used in determining these classes. Under the US Chapter 11, for instance, equity is always placed in a separate class, and each secured creditor usually placed in a single class.<sup>505</sup> Under the scheme of arrangement in England, the test of determining the number of classes is that a class must be limited to individuals whose rights are not so dissimilar as to make it impossible for them to consult together with a view to their common interests.<sup>506</sup> However, Milman argued that having such an arrangement in place generated a persistent problem in

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<sup>503</sup> Legislative Guide on Insolvency Law, above 396, p. 194.

<sup>504</sup> See above section 3.4.4.

<sup>505</sup> Franks J. & Torous W., 'Lessons from A Comparison of US and UK Insolvency Code', (1992) 8 (3), O.R.E.P. 70, p. 76.

<sup>506</sup> O'Dea G., 'Craving a Cram-Down: Why English Insolvency Law Needs Reforming', available at: <http://www.weil.com/files/Publication/8db63e8a-49b6-4712-90ac>. accessed on 25/11/2013.

determining what a “class” of creditors is since the more classes that are recognized, the more challenging it becomes to get the proposed plan approved by the requisite majorities in each class.<sup>507</sup> Furthermore, it is submitted that classification can increase the complexity and costs of insolvency proceedings, depending upon how many different classes are identified.<sup>508</sup> It is worth mentioning that, unlike the case under both the US Chapter 11 and the scheme of arrangement in England, the CVA opted for simplicity by treating all creditors as constituting a single class for voting purposes, with individual voting powers measured by the financial value of each creditor’s claim.<sup>509</sup> Thus, it is crucial for Oman’s future bankruptcy law to address the issue of classification and in doing so a lesson should be taken from the experience of both England and the US.

In addition, it is important for the bankruptcy law to have rules addressing the issue of cramming-down dissenting creditors. Even though it has not been approved by every class of creditors, both England and the US bankruptcy laws empowered the court to impose the restructuring plan over the wishes of objecting creditors.<sup>510</sup> However, it is worth noting that imposing the plan over the wishes of dissenting creditors does not mean to prejudice their interests and leave them without protection. Rather, besides giving the court discretion, bankruptcy law should contain a number of requirements that must be met before imposing the

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<sup>507</sup> Milman D., ‘Arrangement and Reconstructions: Recent Development in UK Company Law’, (2006) C.L.N. 1, p. 2.

<sup>508</sup> Legislative Guide on Insolvency Law, above 396, p. 218.

<sup>509</sup> Fletcher F., ‘UK Corporate Rescue: Recent Development- Changes to Administrative Receivership, Administration, and Company Voluntary Arrangements- the Insolvency Act 2000, the White Paper 2001, and the Enterprise Act 2002’, (2004) 5 (1) E.B.O.L.R. 120-15, p. 127.

<sup>510</sup> See above section 3.4.4.

rescue plan over objecting creditors. This can be done by taking lessons from Section 1129 (b) of the US Bankruptcy Code. This section details a number of requirements that must be met before the approval of the plan. In this regard, the court must be satisfied with the fact that objecting creditors must receive at least as much under the plan as they would if the company using the 'best interest test'; and the debtor company must be able to implement its commitments as stated in the plan 'feasibility test'. However, the case in England differs since there are no specific conditions for approving a restructuring plan and the court is given full discretion in determining whether a rescue plan should be approved or not. In designing bankruptcy law, this thesis supports the idea that it is better for the Omani legislator to combine the experience of both the US and England, that is to say, detailing in bankruptcy law a number of requirements that must be met and giving courts discretion to determine whether or not to approve the plan based on the facts of each case.

#### **5.5.4.6 Having Qualified Bankruptcy Practitioners**

As this thesis proposed above,<sup>511</sup> it is better for the Omani legislator to allow the debtor to run the business during rescue proceedings under the supervision of one or more bankruptcy trustees. However, at present, bankruptcy trustees are not required to be qualified or have enough training. Having a proper bankruptcy regime without having qualified bankruptcy practitioners renders the law to be ineffectively implemented. In affirming this point, it is rightly stated that "corporate insolvency processes are not mere bodies of rules: they are elaborate procedures

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<sup>511</sup> See above section 5.5.4.2.

in which legal and administrative, formal and informal rules, policies and practices are put into effect by different actors”.<sup>512</sup> It is the role of bankruptcy practitioners to administer bankruptcy processes from the day of filing until bringing the process to conclusion. These practitioners should be equipped with the necessary skills in order for them to control the process successfully. As stated in the previous chapter,<sup>513</sup> persons administering bankruptcy procedures in Oman are not required to have any particular training. Hence, in this particular area, it is important to benefit from the experience of England and the US. This can be done through inviting foreign bankruptcy practitioners to train a number of specialists or through sending Omani lawyers and accountants to England or the US in order to get the required training. This thesis argues that having qualified bankruptcy practitioners would help in improving the ranking of Oman on the ease of resolving insolvency. According to the World Bank Doing Business Report, Oman stands at 72 in the ranking of 189 economies: resolving insolvency cases in Oman takes 4 years on average compared to less than two years in many other countries.<sup>514</sup> This is due to the fact that, at present, there is no exact time frame within which bankruptcy procedures should be accomplished. As shown in the previous chapter,<sup>515</sup> during bankruptcy procedures, Article 665 of the Commercial Code states that the bankruptcy trustee, within thirty days of the date of his appointment, should present to the court a statement containing the reasons behind the cessation of payments; however, the court can extend this period at its own discretion. Also, Article 669 of

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<sup>512</sup> Finch V., above 358, p. 178.

<sup>513</sup> See above section 4.4 (E).

<sup>514</sup> Resolving insolvency takes only 6 months in Japan, a year in the UK, 1.5 years in the USA and 1.9 years in France: see World Bank Report: Oman, above 237.

<sup>515</sup> See above pp. 245-246.

the same Code states that once the debts have been verified, the bankruptcy trustee, within sixty days of this verification, should deposit to the court a list containing the names of secured creditors and the amounts of their collateral; however, the court also has the power to extend this period. Hence, in both articles the court is given the power to extend the period without setting a maximum period. Thus, it is important to prescribe a time-limit for the completion of all bankruptcy processes. However, it is essential to have qualified bankruptcy practitioners in order to complete all bankruptcy procedures within the stipulated time-limit. In this regard, it is asserted that if bankruptcy officers (judges, practitioners) are not able to respond to the demands placed upon them in a timely manner, it is important to take this into account when prescribing a certain time-limit in bankruptcy law.<sup>516</sup> The competence of the legal infrastructure and the proficiency of bankruptcy practitioners may have a significant influence on deciding the length of the time required for handling bankruptcy proceedings.<sup>517</sup>

In addition, in recognising the importance of the tasks that are carried out by the insolvency practitioners, Finch stated that their duties impinge on the public interests as they affect the lives and deaths of enterprises and include decisions about the livelihoods of both creditors and debtors.<sup>518</sup> The functions of these practitioners, also, have importance for private rights since pre-bankruptcy securities can be stayed and creditors' efforts to enforce their legal rights can be affected.<sup>519</sup> Hence, insolvency practitioners should have the capacity and skills to

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<sup>516</sup> Legislative Guide on Insolvency Law, above 396, p. 35.

<sup>517</sup> Ibid.

<sup>518</sup> Finch V., 'Insolvency Practitioners: Regulation and Reform', (1998) J.B.L. 334, p. 339.

<sup>519</sup> Ibid, p. 339; Legislative Guide on Insolvency Law, above 396, p. 175.

strike a balance between both public and private interests. Moreover, it is submitted that a robust insolvency system seeks to achieve a balance between rehabilitation and liquidation.<sup>520</sup> As a result, the role, powers and the nature of bankruptcy practitioners have an impact on determining whether or not it is viable to restructure an enterprise.

Further, it is worth noting that cramming down dissenting creditors is a difficult task since all statutory requirements<sup>521</sup> must be met- starting from procedural requirements, such as the composition of classes, and ending with the fairness of the terms of the rescue plan itself. This causes a scholar to state that “the cram-down standards appear to be simple, but the appearance is deceiving”.<sup>522</sup> Hence, this thesis emphasises that reforming the conduct and practice of bankruptcy practitioners in Oman is of high importance. This is due to the fact that the complexity of bankruptcy cases requires having in place persons who are able to deal with them in an orderly manner. As is recommended, the regulation of bankruptcy practitioners can be achieved either through statutory professional bodies or by a specially mandated department of government.<sup>523</sup> By its nature, regulatory oversight of the bankruptcy profession restricts entry to those who have

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<sup>520</sup> Sanderson R. & Batra S., ‘The Import of the Insolvency Professional’, in Hawkamah/ World Bank/ OECD/ INSOL International, ‘Study on Insolvency Systems in the Middle East and North Africa’, p. 7, available at: <http://www.oecd.org/daf/ca/corporategovernanceprinciples/44375185.pdf>.

<sup>521</sup> *Re Alabama, New Orleans, Texas and Pacific Junction Railway Co* [1891] 1 Ch 212, 239.

<sup>522</sup> Klee K., ‘All You Ever Wanted to Know About Cram Down Under the New Bankruptcy Code’, (1979) 53 A.B.L.J. 133, p. 156. In this article Klee examined the provisions of cram down under the US Bankruptcy Code by providing fourteen examples showing the complexity of such a concept in reality.

<sup>523</sup> Sanderson R. & Batra S., above 519, p. 8.

the necessary qualifications and attributes.<sup>524</sup> In designing the regulation of bankruptcy practitioners, it is appropriate to seek advice from some international organisations (i.e. the World Bank, UNCITRAL, and INSOL International) and to learn from the experience of both England and the US.

## **5.6 Reviewing Mechanism**

This chapter proposed the introduction of future bankruptcy reform in Oman by outlining its necessity. In designing a bankruptcy law, this thesis encouraged the adoption of some of the principles that are found under both England and the US bankruptcy laws. Examples of these principles are the notion of debtor-in-possession, the concept of post-petition financing, and the notion of cramming down dissenting creditors. Further, offering distressed debtors an alternative procedure other than liquidation is important to encourage the rehabilitation of viable enterprises. As stated above, having in place qualified bankruptcy practitioners and a developed institutional framework is crucial for the implementation and administration of bankruptcy processes in a timely manner.<sup>525</sup> However, in order to assess the impact of adopting bankruptcy principles and the impact of establishing a rescue regime, it is essential to continuously review the implementation of the law. This can be done by organising a government symposium every five years in order to evaluate the impact of the reform and to ensure that the law is being implemented in accordance with the policies and objectives of its design. Also, the aim of this symposium should be to propose

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<sup>524</sup> Ibid.

<sup>525</sup> For the importance of a well-developed institutional framework for administration of the law: see Legislative Guide on Insolvency Law, above 396, p. 33.

solutions that deal with any unintended consequences that might result from reforming bankruptcy law.

## 5.7 Conclusion

This chapter has called for future reform of the current bankruptcy regime in Oman. It is argued that in reforming bankruptcy law, countries tend to observe the experience of other developed jurisdictions.<sup>526</sup> However, in doing that caution should be taken since wholesale transplantation is not applicable. This chapter started by highlighting various approaches underpinning legal transplantations.<sup>527</sup> These approaches can be divided into two groups.<sup>528</sup> The first group took the view that legal transplantations are impossible.<sup>529</sup> This is due to the fact that, according to this group, legal rules are normally encumbered by historical and cultural aspects and these rules mirror the needs of the societies in which they have developed. Thus, legal rules cannot travel from one society to another and, as a result, legal transplantation cannot happen. The view of the second group was that legal transplants are not merely possible; but actually quite essential in the path of legal development.<sup>530</sup> However, the supporters of this group disagreed on the scope of such transplantations.<sup>531</sup> While some of them support the idea that legal transplantation is possible without the need for knowledge of the political and social

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<sup>526</sup> Berkowitz D., Pistor K. & Richard J., above 90, p. 163; Costa J., Jorge O. & Cardinal P., above 126, p. 84; Gillespie J., above 35, p. 641.

<sup>527</sup> See above section 5.3 (A).

<sup>528</sup> Ibid.

<sup>529</sup> See for example, Legrand P., above 36, p. 57; Montesquieu C., above 34, p. 7.

<sup>530</sup> See for example, Watson A., above 47, p. 95; Kahn- Freund, above 42, pp. 3-4.

<sup>531</sup> See above section 5.3 (A).

conditions in the donor jurisdictions,<sup>532</sup> others argued that to avoid the risk of rejection, it is necessary to have enough knowledge of such conditions.<sup>533</sup> As mentioned above,<sup>534</sup> notwithstanding the dissimilarity of social, political and legal systems, this thesis favoured the view that legal transplantation is possible and it is applicable as long as it serves the needs of the importing country.<sup>535</sup> Then, this chapter dealt with the issue of transplant effects and how these effects can have an impact on the receiving systems.<sup>536</sup> After that, this chapter questioned the possibility of measuring the success of legal transplantation.<sup>537</sup> In this regard, scholars had various opinions concerning the criteria that can be used to measure the extent of such success.<sup>538</sup> However, as discussed above, scholars failed in defining the notion of success and, as a result, it was proposed that the success of legal transplants can be assessed on a case by case basis. Further, transplantation within the area of bankruptcy laws was discussed and it was demonstrated that new reforms of bankruptcy laws did not mirror the societies of the importing countries.<sup>539</sup> Rather, these reforms were transplanted from other jurisdictions despite divergences in culture between the exporting and receiving systems.

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<sup>532</sup> Watson A., above 48, p. 79.

<sup>533</sup> Kahn- Freund, above 42, pp. 3-4.

<sup>534</sup> See above pp. 273-275.

<sup>535</sup> This is the view of Xanthaki: see Xanthaki H., above 83, p. 662.

<sup>536</sup> See above section 5.3 (B).

<sup>537</sup> See above section 5.3 (C).

<sup>538</sup> See Dupré C., above 27, pp. 60-61; Neiken D., above 118, p. 362.

<sup>539</sup> See above section 5.3.1.

In addition, this chapter explored the experience of Oman in acting as an importing country.<sup>540</sup> Since the start of the legislation path in 1973, Oman relied heavily on the experience of other jurisdictions, mainly western laws. As explained above,<sup>541</sup> the Omani Commercial Code of 1990, Oman's Penal Law of 1974, and Commercial Companies Law of 1974 all abandoned a number of Sharia laws and incorporated, instead, western principles. For instance, even though one of the fundamental principles of Sharia is the prohibition of *riba*, this principle is allowed under both Oman's Commercial Code and Commercial Companies Law. Hence, in reforming laws, Oman usually does not start from the very beginning, but rather learning from the experience of others has been the main source of legal development.

Further, this chapter questioned the reasons for the lack of interest in Islamic principles, particularly in regard to bankruptcy. Desires to meet the requirements of today's business, attracting foreign investment, and the irrelevance of Sharia bankruptcy principles, all are reasons behind the lack of interest in Islamic principles.<sup>542</sup> Hence, this thesis supports the idea that in reforming bankruptcy law, Oman should transplant the principles of modern bankruptcy law from developed jurisdictions.<sup>543</sup> In this regard, this thesis highlighted the importance of taking lessons from the experience of both England and the US. Based on a number of justifications, this thesis demonstrated that the importation of some western

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<sup>540</sup> See above section 5.3.2.

<sup>541</sup> Ibid.

<sup>542</sup> See above pp. 291-294.

<sup>543</sup> For the view of this thesis see above p. 273-275.

bankruptcy concepts will be accepted in Oman, despite the differences in cultural views and legal institutions between Oman and these jurisdictions.<sup>544</sup>

This chapter, furthermore, underscored the necessity for bankruptcy reform in Oman.<sup>545</sup> Such necessity emerges from the government's desire to attract foreign direct investment and by formulating this desire to be one of the main pillars of Oman's 2020 economic vision.<sup>546</sup> Also, the role played by SMEs in promoting the national economy necessitates the introduction of bankruptcy reform in Oman.<sup>547</sup> Having acknowledged the importance of modernising Oman's bankruptcy regimes, this chapter proposed a map for future bankruptcy reform.<sup>548</sup> As discussed, this map includes having a clear statutory mandate,<sup>549</sup> making bankruptcy law certain and predictable,<sup>550</sup> and establishing a bankruptcy regime that encourages the rehabilitation of viable enterprises instead of liquidating them.<sup>551</sup> However, due to the complexities of bankruptcy cases, having in place qualified practitioners is highly important.<sup>552</sup> Further, this chapter highlighted the importance of reviewing the implementation and administration of bankruptcy law in order to deal with any unintended consequences.<sup>553</sup>

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<sup>544</sup> See above, pp. 294-297.

<sup>545</sup> See above section 5.4.

<sup>546</sup> See above section 5.4 (A).

<sup>547</sup> See above section 5.4 (B).

<sup>548</sup> See above section 5.5.

<sup>549</sup> See above section 5.5.1.

<sup>550</sup> See above section 5.5.2.

<sup>551</sup> See above sections 5.5.3 & 5.5.4.

<sup>552</sup> See above section 5.5.4.6

<sup>553</sup> See above section 5.6.

## Chapter Six: Conclusions

### 6.1 Introduction

Each country has its own legal rules that are designed to deal with the bankruptcy of companies;<sup>1</sup> however, these legal rules vary from one jurisdiction to another.<sup>2</sup> On the one hand, bankruptcy rules in some countries are designed merely to wind up distressed enterprises without giving them a chance to rehabilitate their businesses.<sup>3</sup> This is the case in almost all Arab States where the philosophy of a rescue culture has not yet been adopted. On the other hand, some countries have set up their bankruptcy laws in a way that encourages the rehabilitation of viable enterprises instead of liquidating them.<sup>4</sup> This is the case, for example, in the United States, the United Kingdom and more recently France.<sup>5</sup>

This study set out to examine the current bankruptcy regime in Oman. As a consequence, a number of questions were considered, for examples what types of

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<sup>1</sup> See above Chapter Four, footnotes 1 & 2.

<sup>2</sup> See O'kane D. & Bawlf P., 'Global Guide to Corporate Bankruptcy: A Comprehensive Guide to Corporate Bankruptcy and a Survey of Global Corporate Bankruptcy Regimes', (Nomura International, July 2010), pp. 45-79, available at:

<http://www.scribd.com/doc/59845050/Bankruptcy-Guide>. accessed on 10/03/2014.

<sup>3</sup> Uttamchandani M., 'No Way Out: The Lack of Efficient Insolvency Regimes in the MENA Region', (March 2011), Policy Research Working Paper 5609, the World Bank, available at:

<http://elibrary.worldbank.org/doi/book/10.1596/1813-9450-5609>. accessed on 19/02/2014; Also,

McNally R., 'Insolvency Regimes in the MENA Region', available at:

[http://www.menacitylawyers.com/uploaded/publication\\_5feb3dd1-39ef-47bc-ad7d-4716d880dce5\\_.pdf](http://www.menacitylawyers.com/uploaded/publication_5feb3dd1-39ef-47bc-ad7d-4716d880dce5_.pdf). accessed on 10/03/2014.

<sup>4</sup> O'kane D. & Bawlf P., above 2.

<sup>5</sup> Ibid.

bankruptcy proceedings are currently available for distressed debtors in Oman and how effective are they? Does Oman encourage the rehabilitation of viable enterprises or not? Are there special proceedings available for small and medium enterprises? To what extent can Oman take lessons from the experience of both England and the US? And what kind of values should be protected by bankruptcy law?

These questions and others have been explored in this thesis. Thus, the aim of this overall conclusion is to reveal the original contribution made by this thesis. Also, this chapter will restate the research undertaken and the approach made by this thesis. Furthermore, based on what has already been discussed, this chapter offers suggestions for further development and research.

The central theme of this study was to examine the efficiency of the bankruptcy regime in Oman. Based on this examination, it was demonstrated that Oman's current bankruptcy regime is insufficient and inconsistent with the requirements of today's business environment.<sup>6</sup> This has been proven by identifying the main reasons behind its inefficiency.<sup>7</sup> However, this thesis held the view that it was inappropriate to examine the effectiveness of Oman's bankruptcy regime unless proper recourse were made to more developed bankruptcy regimes.<sup>8</sup> Such recourse is important in order to discover areas of weaknesses and to propose means to overcome them. Also, it was felt that starting this thesis by exploring a number of the theories underpinning the bankruptcy system is of great

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<sup>6</sup> See also above section 4.8.

<sup>7</sup> See above pp. 311-313.

<sup>8</sup> See above pp. 24-27.

importance.<sup>9</sup> Hence, apart from Chapter One (the introduction) and Chapter Six (the overall conclusion), this study is divided into four main chapters.

This study gained its importance from examining the current bankruptcy regimes in Oman. In this regard, it is worth noting that even though this thesis expressed the researcher's own views in regard to a number of issues discussed in Chapter Two<sup>10</sup> and Chapter Three,<sup>11</sup> the original contributions of this thesis can be found in both Chapter Four and Chapter Five. In Chapter Four, this thesis critically examined various bankruptcy procedures in Oman in an attempt to identify the main deficiencies.<sup>12</sup> This examination took into account bankruptcy principles that are adopted by both England and the US (for instance, the notion of DIP, staying creditors' actions, cramming-down dissenting creditors) and the ranking of Oman in resolving bankruptcy cases based on the 2014 World Bank Doing Business Report. This thesis demonstrated that the current bankruptcy regime in Oman is not sufficiently regulated, as well as being outdated and inconsistent with the needs of today's business.

The original contribution of this study can also be found in Chapter Five. A number of factors which necessitate the importance of introducing bankruptcy reform in Oman have been stated, for examples are (i) the significant roles that are played by SMEs; (ii) the desire of the Omani Government to attract foreign investment; and (iii) the inconsistency of the current bankruptcy regime in Oman with the needs of today's business. Furthermore, this thesis made a number of

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<sup>9</sup> See above section 1.4.

<sup>10</sup> See above section 2.8.

<sup>11</sup> See above section 3.5.

<sup>12</sup> See above sections 4.3, 4.5, 4.6, 4.7 & 4.8.

proposals that the Omani legislator should take into consideration while designing future bankruptcy law. Examples of these proposals are (i) setting a clear statutory mandate in regard to both reorganisation and liquidation proceedings; (ii) offering clarity and predictability in regard to both the meaning of the phrase ‘inability to pay debts’ and a priority entitlement rule; (iii) establishing a rescue regime that offers easy access to the process, provides incentives for directors to apply for the process as soon as they notice the problem, stays secured and unsecured creditors’ claims during bankruptcy proceedings, facilitates access to post-finance and crams-down dissenting creditors. Hence, the originality of this thesis lies in suggesting some means that might help in overcoming the deficiencies of the existing bankruptcy regimes in Oman. However, as was emphasised throughout this chapter, in taking lessons from the experience of England and the US, wholesale transplantation should be avoided since there is no one size which fits all.

## **6.2 Theories Underpinning Bankruptcy Law**

The second chapter of this thesis discussed some theories relating to the aims and philosophy behind bankruptcy laws, namely creditors’ bargain theory,<sup>13</sup> the bankruptcy choice theory,<sup>14</sup> the communitarian theory,<sup>15</sup> the forum theory,<sup>16</sup> the multiple values theory<sup>17</sup> and the explicit value theory.<sup>18</sup> The focus of the debate

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<sup>13</sup> See above section 2.2.

<sup>14</sup> See above section 2.3.

<sup>15</sup> See above section 2.4.

<sup>16</sup> See above section 2.5.

<sup>17</sup> See above section 2.6.

<sup>18</sup> See above section 2.7.

between these theories was what kind of values should be protected and recognised by bankruptcy law? The issue of whether bankruptcy laws should be designed to deal merely with the interests of creditors or other interests that deserve such protection is subject to debate.

Supporters<sup>19</sup> of the creditors' bargain theory view bankruptcy law as a system designed to maximise only the interests of creditors by having in place a compulsory collective system where all creditors' claims are stayed.<sup>20</sup> Staying creditors' claims is important in reducing the cost of debt collection, as well as in maximising the aggregate pool of assets and it is also administratively effective.<sup>21</sup> Thus, based on their view, it is not within the role of bankruptcy law to protect the interests of employees, customers and local community.<sup>22</sup> Rather, these values should be protected within the context of the general law.<sup>23</sup> In this regard, general law should prescribe priorities for employees or tort claimants and there is no scope for the bankruptcy law to prescribe such priorities.<sup>24</sup> Bankruptcy rules should deal only with the rights of creditors and, as a consequence, rescuing the business

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<sup>19</sup> See, Jackson T., *The Logic and Limits of Bankruptcy Law*, (Harvard University Press, 1986); Jackson T. & Scott R., 'On the Nature of Bankruptcy: An Essay on Bankruptcy Sharing and the Creditors' Bargain', (1989) 75 V.L.R. 155; Baird D. & Jackson T., 'Bargaining After the Fall and the Contours of the Absolute Priority Rule', (1988) 55 U.C.L.R. 738; Baird D., 'Loss Distribution, Forum Shopping, And Bankruptcy: A Reply to Warrant', (1987) 54 U.C.L.R. 815

<sup>20</sup> Jackson T., 'Bankruptcy, Non-Bankruptcy Entitlement, and the Creditors' Bargain', (1991) Y.L.J. 857, p. 862.

<sup>21</sup> *Ibid*, pp. 860-861; see above section 2.2.2.

<sup>22</sup> Baird D., 'Reply to Warren', above 19, p. 822.

<sup>23</sup> Baird D. & Jackson T., 'Corporate Reorganization and the Treatment of Divers Ownership Interests: A Comment on Adequate Protection of Secured Creditors in Bankruptcy', (1984) U.C.L.R. 97, pp. 102-103.

<sup>24</sup> *Ibid*.

of the company should not be attempted unless it is intended to maximise the interests of existing creditors' rights.<sup>25</sup> Even though this theory emphasises the importance of imposing a moratorium on the creditors' action, its scope has been criticised.<sup>26</sup> The promoters of the bankruptcy choice theory, for instance, expressed the view that all parties in society are affected by the bankruptcy of the company and, as a result, they should be given the opportunity to bargain *ex ante* and choose the principles that govern their relationship in the event of bankruptcy.<sup>27</sup> Nonetheless, this theory is criticised since it is not clear how agreement can be reached *ex ante* between various parties, since each party has distinct interests from the others.<sup>28</sup>

Furthermore, even though the communitarian, the forum, the multiple values and the explicit value theories oppose the view of the creditors' bargain theory, each of these theories has its own arguments.<sup>29</sup> The communitarian theory, for instance, argues that besides protecting the interests of creditors, bankruptcy law should take into account the interests of all stakeholders such as employees, suppliers, customers and local authority.<sup>30</sup> However, this theory leads to the problem of indeterminacy since there are so many community interests in each

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<sup>25</sup> Ibid.

<sup>26</sup> See above section 2.2.3.

<sup>27</sup> Korobkin D., 'Contractarianism and the Normative Foundations of Bankruptcy Law', (1993) 71 T.L.R. 541, p. 545; see above section 2.3.1.

<sup>28</sup> Goode R., *Principles of Corporate Insolvency Law*, (4<sup>th</sup> edition, Sweet & Maxwell, 2011), p. 78; Finch V., *Corporate Insolvency Law: Perspectives and Principles*, (2<sup>nd</sup> edition, Cambridge University Press, 2009), p. 40; see above section 2.3.2.

<sup>29</sup> See above sections 2.4.1, 2.5.1, 2.6.1 & 2.7.1.

<sup>30</sup> Gross K., 'Taking Community Interests into Account in Bankruptcy', (1994) 72 W.U.L.Q. 1031, p. 1031.

bankruptcy case.<sup>31</sup> Also, the forum theory argues that bankruptcy law should establish a mechanism whereby all interests affected by the failure of the business are recognised and heard through their representatives.<sup>32</sup> However, the promoters of this theory fail to provide clear guidelines for implementing their theory in reality.<sup>33</sup> In addition, the multiple values theory agreed with the creditors' bargain theory in that a stay should be imposed upon all creditors' claims.<sup>34</sup> However, the promoters of the multiple values theory propose the idea that it is the aim of the bankruptcy law to take into account the interests of all stakeholders.<sup>35</sup> Thus, this theory asserts that bankruptcy law should establish priorities between creditors, protect the interests of future interested claimants, by offering opportunities for continuation of the business, and thus serving the interests of those who have no formal rights but who have an interest in the continuation of the business.<sup>36</sup> This theory supports the philosophy of rescuing viable businesses because it plays a role in maximising the interests of all participants.<sup>37</sup> Nonetheless, the main criticism of this theory is that it lacks clear guidance for the policy-makers on the controlling of tensions and conflict between various values that are affected by the bankruptcy of debtors.<sup>38</sup>

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<sup>31</sup> Finch V., above 28, p. 42; see above section 2.4.2.

<sup>32</sup> Flessner A., 'Philosophies of Business Bankruptcy Law: An International Overview' in Ziegel J. (ed), *Current Developments in International and Comparative Corporate Insolvency Law* (Clarendon Press, 1994), p. 24

<sup>33</sup> Finch V., above 28, p. 44; see above section 2.5.2.

<sup>34</sup> Warren E., 'Bankruptcy Policymaking in an Imperfect World', (1993) 92 M.L.R. 336, p. 368.

<sup>35</sup> See above section 2.6.1.

<sup>36</sup> *Ibid.*

<sup>37</sup> McCormack G., *Corporate Rescue Law- An Anglo- American Perspective*, (Edward Elgar Publishing Limited, 2008), p. 34.

<sup>38</sup> Finch V., above 28, p. 47; Keay A. & Walton P., *Insolvency Law: Corporate and Personal*, (Longman, 2003), p. 29; see above section 2.6.2.

Moreover, despite the fact that the explicit value theory is of the opinion that bankruptcy law should take into account the interests of both private and public rights,<sup>39</sup> it is acknowledged that striking the right balance between various conflicting values is not an easy process<sup>40</sup> and requires a final political judgment.<sup>41</sup> However, based on this approach, in establishing the principles of bankruptcy law, reference should be made to the following four benchmarks:<sup>42</sup> *efficiency* (having a clear mandate), *expertise* (having qualified bankruptcy practitioners), *accountability* (controlling the bankruptcy processes by competent bodies), and *fairness* (having fair procedures that give due access for all affected parties).<sup>43</sup> Nonetheless, this approach was criticised since it did not offer a reasonable justification of the relationship between these benchmarks.<sup>44</sup>

This thesis concluded the second chapter by asserting that each of the discussed theories carries its own merits.<sup>45</sup> As a consequence, in designing bankruptcy laws it is worthwhile for legislators to have recourse to the issues posed by these theories. For instance, both the creditors' bargain theory and the multiple values theory recognise the importance of staying creditors' actions during bankruptcy processes, since such a stay has its impact on promoting the concept of collectivity. This is the case under both England and the US regimes where all creditors' claims are stayed during bankruptcy proceedings. However, this is one of

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<sup>39</sup> Finch V., above 28, p. 52.

<sup>40</sup> *Ibid*, p. 58.

<sup>41</sup> *Ibid*; see above section 2.7.1.

<sup>42</sup> Finch V., above 28, p. 56.

<sup>43</sup> *Ibid*.

<sup>44</sup> Mokal R., 'On Fairness and Efficiency', (2003) 66 M.L.R. 452; see above section 2.7.2.

<sup>45</sup> See above section 2.8.

the main deficiencies of the current bankruptcy regime in Oman since secured creditors' actions are not stayed during bankruptcy processes.<sup>46</sup> Hence, unlike the case in England and the US where the concept of collectivity is recognised, such a concept is not encouraged by Omani law.

### **6.3 Bankruptcy Proceedings in England and the US**

The aim of the third chapter was to explore the experience of both England and the US and to observe the similarities and differences between them. It was stated that both England and the US promotes the concept of rescue culture by offering distressed enterprises alternatives to liquidation.<sup>47</sup> In the US, for example, there is Chapter 11 which is designed to deal with the bankruptcy of distressed debtors.<sup>48</sup> Also, in the England, there are administration proceedings, CVAs and schemes of arrangement, all of which support the idea of rehabilitation. However, the principles adopted by England differ from those of the US.<sup>49</sup> Whereas the management of the company is displaced during administration proceedings in England, it remains in place without the supervision of licensed bankruptcy practitioners once the US Chapter 11 is initiated.<sup>50</sup> The case under the scheme of arrangement in England is similar to that of the US Chapter 11. However, although during CVA in England

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<sup>46</sup> See above section 4.4 (D).

<sup>47</sup> See above sections 3.2 & 3.3.

<sup>48</sup> Ibid.

<sup>49</sup> McCormack G., 'Apples & Oranges? Corporate Rescue and Functional Convergence in the US and UK', (2009) 18 (2) I.I.R. 109; Franks J. & Torous W., 'Lessons from A Comparison of US and UK Insolvency Code', (1992) 8 (3), O.R.E.P. 70; Westbrook J., 'A Comparison of Bankruptcy Reorganisation in the US with the Administration Procedure in the UK', (1990) 6 I.I.P. 86; see above section 3.4.

<sup>50</sup> See above section 3.4.1.

directors retain their position, they run the business under the supervision of insolvency practitioners. This is analogous to the case of Oman's preventive composition scheme where directors run the business under the supervision of bankruptcy practitioners.<sup>51</sup> In this regard, this thesis supports the idea that allowing directors to retain their position during the process encourages directors to apply for bankruptcy as soon as they perceive the disturbance of the business. However, it is important to appoint bankruptcy practitioners to supervise their conduct since this provides a level of credibility and assurance for creditors. Also, appointing bankruptcy practitioners helps in opposing any over-investment decisions that might be taken by the management during bankruptcy proceedings.

In addition, one of the main features of both the US Chapter 11 and administration regime in England is that creditors' actions, both secured and unsecured, are stayed during insolvency processes.<sup>52</sup> Lack of stay has an impact on wasting the assets of debtors since once bankruptcy procedures are initiated, creditors will run to the court-house in order to be first to obtain a court ruling against the debtor.<sup>53</sup> Thus, staying creditors' actions helps in avoiding this type of race between creditors.<sup>54</sup> Also, imposing a stay helps in maximising the returns of debtor's creditors.<sup>55</sup> As discussed in Chapter Three,<sup>56</sup> one of the main deficiencies of CVA and the scheme of arrangement is the lack of staying creditors' claims. This is also the problem under the current bankruptcy regime in Oman where secured

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<sup>51</sup> See above section 4.6.2.3.

<sup>52</sup> See above section 3.4.2.

<sup>53</sup> Goode R., above 28, pp. 64-65.

<sup>54</sup> Jackson T., above 20, p. 862.

<sup>55</sup> Ibid, p. 864; see also Jackson T., *Logic and Limits*, above 19, p 14-16; see above 2.2.2 (B).

<sup>56</sup> See above sections 3.2.3 & 3.2.4.

creditors are allowed to pursue their claims during bankruptcy proceedings and liquidation procedures.<sup>57</sup>

Moreover, the concept of post-financing was one of the principles discussed in Chapter Three.<sup>58</sup> During financial distress, troubled debtors are not normally able to continue their operations unless access to new funding is facilitated.<sup>59</sup> Such facilitation includes offering incentives to new lenders and sufficient guarantees to existing lenders. This is the case under the US Chapter 11 where distressed debtors are allowed to seek new financing during bankruptcy processes.<sup>60</sup> In this case and as an incentive, the new lender is granted a super priority status.<sup>61</sup> However, this status is not granted unless it is proven that pre-petition creditors are sufficiently protected.<sup>62</sup> The case in England differs, since no super priority status is granted to the new lender. Rather, post-petition fund is considered as administration expenses and the new lender will not supersede existing secured creditors.<sup>63</sup> In this regard, this researcher's view is that the approach adopted by the US is better than that of England.<sup>64</sup> Hence, it is essential to facilitate access to new financing during the reorganisation phase by granting a super priority status to

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<sup>57</sup> See above sections 4.5.4 (B) & 4.6.2.4.

<sup>58</sup> See above section 3.4.3.

<sup>59</sup> Henoeh B., 'Post-Petition Financing: Is There Life After Debt?', (1991) 8 B.D.J. 575, p. 576.

<sup>60</sup> Section 364 of the US Bankruptcy Code.

<sup>61</sup> See Henoeh B., above 59; McCormack G., 'Super-Priority New Financing and Corporate Rescue', (2007) J.B.L. 701, p. 714.

<sup>62</sup> See Triantis G., 'A Theory of the Regulation of Debtor-in-Possession Financing', (1993) 46 V.L.R. 901, p. 902; Broude R., 'How the Rescue Culture Came to the US and the Myths That Surround Chapter 11', (2000) 16 (5) I.L.P. 194, p. 197; Section 363 (c) (2) & 363 (e) of the US Bankruptcy Code.

<sup>63</sup> Sch.1 para 3 of the Insolvency Act 1986; See above p. 157.

<sup>64</sup> See above pp. 356-357.

the new lender. However, this should be done in a way that does not prejudice the interests of existing secured creditors.

Moreover, it is not possible to convince all parties to accept the reorganisation plan. Thus, there is a need for a statutory mechanism whereby the plan is enforced against the wishes of the dissenting creditors.<sup>65</sup> This mechanism is called 'cram-down'. As stated in Chapter Three,<sup>66</sup> both England and the US have in place measures for approving the rescue plan, even if it is rejected by a minority. However, such plan will not be approved unless it is proven that pre-bankruptcy creditors are sufficiently protected.<sup>67</sup> This is the case in the US, where there are a number of statutory conditions that have to be met in order to impose the plan against the wishes of objecting creditors. However, the case in England differs, as<sup>68</sup> there is no statutory requirement, but rather the court is given total discretion to decide whether to approve the rescue plan or not.<sup>69</sup> In this regard, the view of this thesis is that it is better to combine the experience of both England and the US.<sup>70</sup> Hence, besides giving the court discretion, it is better to detail a number of statutory requirements that have to be met.

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<sup>65</sup> See above section 3.4.4.

<sup>66</sup> *Ibid.*

<sup>67</sup> See O'Dea G., 'Craving a Cram-Down: Why English Insolvency Law Needs Reforming', available at: [http://www.weil.com/files/Publication/8db63e8a-49b6-4712-90ac0348746890a9/Presentation/PublicationAttachment/c196def8-cca3-49fd-a5ab071187e511c6/JIBFL\\_Nov\\_09.pdf](http://www.weil.com/files/Publication/8db63e8a-49b6-4712-90ac0348746890a9/Presentation/PublicationAttachment/c196def8-cca3-49fd-a5ab071187e511c6/JIBFL_Nov_09.pdf); see also sections 1129 (a) (7) (A) (ii) & 1129 (a) (10) (11) of the US Bankruptcy Code.

<sup>68</sup> O'Dea G., *ibid.*

<sup>69</sup> *Ibid.*

<sup>70</sup> See above pp. 359-360.

## 6.4 Examining the Current Bankruptcy Regime in Oman

Having explored some of the theories underpinning bankruptcy law and observed the experience of both England and the US, Chapter Four examined the current bankruptcy regime in Oman. This examination took into account the issues discussed in Chapters Two and Three. This chapter started by providing an overview of the statutory framework for bankruptcy in Oman.<sup>71</sup> It is clearly stated that unlike the case in England and the US, there is no separate bankruptcy law in Oman. Rather, both Oman's Commercial Code of 1990 and the Omani Commercial Companies Law of 1974 provide a statutory framework for the bankruptcy and liquidation of traders.

Chapter Four demonstrated that the current bankruptcy regime in Oman is ineffective and inconsistent with the needs of today's business.<sup>72</sup> This demonstration is based on a number of justifications.<sup>73</sup> Currently, rehabilitation of viable enterprises is not encouraged, since there are no statutory proceedings designed to facilitate the reorganisation of distressed businesses. Also, the tests used to determine the state of 'inability to pay debts' is not sufficiently regulated. It is unlike the case in England and the US where such status is determined by a reference to two bankruptcy tests, namely the 'cash flow test' and 'balance sheet test'.<sup>74</sup> In Oman it is unclear what sorts of tests are intended to be relied on.<sup>75</sup> Further, the bankrupt in Oman is considered as a wrongdoer and, as a

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<sup>71</sup> See above section 4.2.

<sup>72</sup> For the assessment of Oman's current bankruptcy regime: see above section 4.8.

<sup>73</sup> Ibid.

<sup>74</sup> See above section 4.4 (A).

<sup>75</sup> Ibid.

consequence, he will be deprived of a number of rights.<sup>76</sup> He is not viewed as an economic actor that deserves such protection. Moreover, there is no clarity in regard to the ranking of creditors.<sup>77</sup> This leads this thesis to argue that having a clear priority ranking provides a level of predictability and certainty within the context of bankruptcy law.<sup>78</sup> Also, one of the obstacles of the current bankruptcy regime in Oman is that bankruptcy trustees and liquidators are not required to hold a specific qualification or obtain specific training.<sup>79</sup>

The available bankruptcy procedures in Oman include bankruptcy proceedings, the preventive composition scheme and liquidation procedures.<sup>80</sup> Whereas the debtor himself, creditors, or the court can apply for bankruptcy proceedings,<sup>81</sup> only the debtor is able to apply for the preventive composition scheme.<sup>82</sup> Also, while the aim of the preventive composition scheme is to give the troubled trader the opportunity to escape the declaration of bankruptcy, the purpose of bankruptcy proceedings is to declare the bankruptcy of the distressed debtor and to release the bankrupt from his liabilities and debts.<sup>83</sup> Thus, rehabilitation of the business of the distressed debtor is not the aim of either bankruptcy or the preventive composition scheme. Furthermore, whereas liquidation procedures apply only to companies, both bankruptcy proceedings and the preventive composition scheme apply to all debtors whether an individual debtor or a company.

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<sup>76</sup> See above section 4.4 (B).

<sup>77</sup> See above section 4.4 (C).

<sup>78</sup> For this view see above section 5.5.2.2.

<sup>79</sup> See above section 4.4 (E).

<sup>80</sup> See above section 4.3.

<sup>81</sup> See above section 4.5.1.

<sup>82</sup> See above section 4.6.2.1.

<sup>83</sup> See above p. 185.

As explained in Chapter Four,<sup>84</sup> each of bankruptcy proceedings suffers from a number of problems. For instance, during both liquidation proceedings and bankruptcy procedure, secured creditors' actions are not stayed.<sup>85</sup> Thus, the assets of the debtor will be wasted during bankruptcy processes which will hinder any attempt to rescue the business of the distressed debtor. Also, even though secured creditors' claims are stayed during the preventive composition scheme, they are not allowed to participate in voting on the preventive composition's plan.<sup>86</sup> In addition, it is clearly stated that the problem with the bankruptcy regime in Oman is that, at present, there is no specific time limit wherein liquidation procedures, bankruptcy proceedings and the preventive composition scheme should be completed.<sup>87</sup>

Moreover, the main reasons behind the lower ranking of Oman based on the World Bank Doing Business Report of 2014 were discussed.<sup>88</sup> This ranking is judged by reference to three benchmarks: the cost of proceedings, length of the process and recovery rate for creditors.<sup>89</sup> Out of 189 economies, Oman's ranking is 72.<sup>90</sup> In this regard, this thesis gave a number of reasons that, based on the researcher's view, are associated with the lower ranking of Oman.<sup>91</sup> Lack of stay,

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<sup>84</sup> See above section 4.8.

<sup>85</sup> See above sections 4.5.4 (B) & 4.7.

<sup>86</sup> See above sections 4.6.2 & 4.8.3.

<sup>87</sup> See above section 4.8.3.

<sup>88</sup> See above pp. 244-246.

<sup>89</sup> The World Bank, 'Economy Profile: Oman', (Doing Business 2014), p. 90, available at: [http://www.doingbusiness.org/Reports/~/\\_media/GIAWB/Doing%20Business/Documents/Profiles/Country/OMN.pdf](http://www.doingbusiness.org/Reports/~/_media/GIAWB/Doing%20Business/Documents/Profiles/Country/OMN.pdf). accessed on 10/03/2014.

<sup>90</sup> Ibid.

<sup>91</sup> See above pp. 244-246.

not prescribing an exact time-limit and disqualification of bankruptcy persons, all are examples of such reasons. Also, this chapter demonstrated the researcher's point of view that the Omani bankruptcy regime, as it currently stands, can be categorised as a creditor-friendly regime.<sup>92</sup> This is due to a number of factors such as lack of appropriate reorganisation procedures, displacing directors during bankruptcy proceedings and allowing secured creditors to enforce their securities during bankruptcy processes.<sup>93</sup>

## **6.5 Proposals to Overcome the Current Problems**

Since Chapter Four critically examined the current bankruptcy regimes in Oman, the purpose of Chapter Five was an attempt to propose a map for future bankruptcy reform in Oman. Thus, Chapter Five proposed a number of means in order to overcome the problems of Oman's current bankruptcy regime. This proposal took into account some of the bankruptcy principles promoted by various theories discussed in the second chapter and the experience of both England and the US.

This thesis acknowledged the fact that it was not possible to transplant all bankruptcy principles that are adopted by both England and the US.<sup>94</sup> Rather, while proposing such principles caution was exercised. In this regard, this thesis believed that what was applicable in England and the US might not be applicable in Oman.<sup>95</sup> For instance, it is not advisable to follow the approach adopted by the US

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<sup>92</sup> See above section 4.8.2.

<sup>93</sup> Ibid.

<sup>94</sup> See above pp. 273-275.

<sup>95</sup> Ibid.

Chapter 11 where directors run the business of the company without any kind of supervision; rather, opting for the approach adopted by England during CVA proceedings is more suitable for Oman.<sup>96</sup> In this case, allowing directors to run the company under the supervision of the appointed bankruptcy practitioners is better. The rationale behind this view is that allowing directors to retain their position plays a role in encouraging them to file for bankruptcy procedures as soon as they become aware of the crisis and appointing bankruptcy practitioners to supervise their conduct provides a level of credibility and assurance for creditors.<sup>97</sup>

This chapter discussed the applicability of legal transplantations based on two conflicting views.<sup>98</sup> While one view argued that legal transplantation is possible,<sup>99</sup> the other view was that legal transplant is impossible.<sup>100</sup> Also, the experience of Oman in transplanting others countries' laws was dealt with.<sup>101</sup> In this regard, even though some principles are not found under Sharia Law, this thesis argued that it would be possible for Oman to transplant some of the bankruptcy principles that are adopted by both England and the US.<sup>102</sup> To support this belief, this thesis

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<sup>96</sup> For this view see above section 5.5.4.2.

<sup>97</sup> Ibid.

<sup>98</sup> See above section 5.3 (A).

<sup>99</sup> See, for example, Watson A., *Society & Legal Change*, (Scottish Academic Press, 1977), p. 95.; Watson A., 'Legal Transplants and European Private Law', (2000) 4 (4) E. J.C.P.L., available at: <http://www.ejcl.org/44/art44-2.html>; Kahn- Freund, 'On Uses and Misuses of Comparative Law', (1974) 37 (1) M.L.R. 1, pp. 3-4.

<sup>100</sup> See, for example, Legrand P., 'What 'Legal Transplants'?', in Nelken D. & Feest J., *Adopting Legal Culture*, (Hart Publisher, 2001), p. 57; Montesquieu C., *The Spirit of Laws*, (J. & M. Roberson, 1793), p. 7.

<sup>101</sup> See above section 5.3.2.

<sup>102</sup> Ibid.

provided a number of justifications.<sup>103</sup> For instance, the Omani legislator has already transplanted some of western principles and such principles have been accepted, even though they were against the concepts of Sharia. The prohibition of *riba* (usury) is one of the fundamental principles of Sharia. However, as stated in Chapter Five,<sup>104</sup> the *riba* was not prohibited under both the Omani Commercial Code of 1990 and the Commercial Companies Law of 1974. Also, Oman's membership in the World Trade Organisation in 2000 and Oman's Free Trade Agreement with the United States played an important role in fostering such transplantations.

After a critical examination of the bankruptcy regime in Oman had been made, it was clearly stated that the current bankruptcy regime in Oman is inefficient and inconsistent with the requirements of today's business. Hence, in Chapter Five, this thesis made the point that there are a number of factors that necessitate the introduction of bankruptcy reforms in Oman.<sup>105</sup> One of the factors discussed was that attracting foreign direct investment is one of the main pillars of Oman's 2020 economic vision. However, this researcher's view was that to attract such investment it is not sufficient merely for Oman to facilitate access to the market.<sup>106</sup> Rather, regulating a company's exit from the market in an orderly manner is also important in offering a tempting economic climate.<sup>107</sup> Also, the significant role played by small and medium enterprises in promoting Oman's national economy

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<sup>103</sup> See above pp. 294-297.

<sup>104</sup> Ibid.

<sup>105</sup> See above 5.4 (A), (B) & (C).

<sup>106</sup> See above section 5.4 (A).

<sup>107</sup> Ibid.

necessitates the establishment of a bankruptcy regime in a way that facilitates and encourages the rehabilitation of viable enterprises and quickly liquidates those which are unviable.<sup>108</sup> These two factors and others discussed in Chapter Five demonstrated the need for future bankruptcy reform in Oman.

Having stated the factors that demand the availability of a proper bankruptcy regime, the thesis proceeded by drawing a map for future reform.<sup>109</sup> This thesis, first of all, asserted that future bankruptcy law in Oman should have a clear statutory mandate concerning the aims of each bankruptcy proceedings.<sup>110</sup> This is similar to the case under administration proceedings in England where the purposes of such proceedings are clearly formulated in the Enterprise Act 2002.<sup>111</sup> Also, in determining the bankruptcy of the debtor, reference should be made to both the cash flow bankruptcy test and the balance sheet bankruptcy test.<sup>112</sup> Further, establishing a clear priority rule provides a level of certainty and credibility for creditors and other stakeholders.<sup>113</sup> Moreover, due to their importance and their contribution to the national economy in Oman, the researcher's view was that designing a special bankruptcy regime for SMEs is necessary.<sup>114</sup> Finally, this thesis highlighted the importance of establishing a rescue regime besides liquidation.<sup>115</sup> However, this thesis made the point that in designing a rescue regime, a number of

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<sup>108</sup> See above section 5.4 (B).

<sup>109</sup> See above section 5.5.

<sup>110</sup> See above section 5.5.1.

<sup>111</sup> Goode R., above 28, pp. 400-401; see the new Schedule B1 of Insolvency Act 1986, Para 3 (1) (a), (b) and (c).

<sup>112</sup> See above section 5.5.2.1.

<sup>113</sup> See above section 5.5.2.2.

<sup>114</sup> See above section 5.5.3.

<sup>115</sup> See above section 5.5.4.

requirements should be taken into account.<sup>116</sup> Examples of these requirements are easing the access to the rescue processes, staying creditors' claims, adopting the concept of debtor-in-possession, allowing access to new funding during restructuring proceedings and implementing the rescue plan in a way that does not prejudice the interests of objecting creditors. In considering these requirements, lessons should be taken from the experience of both England and the US. However, it was clearly explained that wholesale transplantations are not possible and care should be taken in importing such principles.

## **6.6 Areas for Future Research**

One of the issues discussed in this study is the relationship between attracting foreign direct investment and the quality of bankruptcy law. In Chapter Five, it is argued that the flows of foreign direct investment are determined by the quality of the legal system of the host country. However, it is statistically unclear how the lack of a proper bankruptcy law in Oman deters the attraction of such investments. Thus, this issue needs to be examined through questioning the determinants and deterrent of foreign investment in Oman to ascertain whether or not lack of sufficient bankruptcy regimes is one of the deterrents of such investment.

Further, this study proposed the initiation of future bankruptcy reform in Oman. Nevertheless, this has been done without examining the impact of such reform on particular sectors, such as banking, agricultural and industrial sectors. Thus, future empirical research needs to be undertaken in order to examine the impact of

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<sup>116</sup> Ibid.

reforming bankruptcy law on these sectors. However, this research needs to be done after the enactment of a new bankruptcy law.

## **6.7 Concluding Remarks**

Unlike the case in many jurisdictions, at present, Oman does not have a separate bankruptcy law. Rather, a number of bankruptcy provisions are incorporated in both the Commercial Code of 1990 and the Omani Commercial Companies Law of 1974. As explained in this thesis, there are three bankruptcy proceedings in Oman: bankruptcy proceedings, the preventive composition scheme and liquidation procedures. The main purpose of this thesis was to examine the efficiency of these proceedings and to propose means to overcome their deficiencies.

The aim of this concluding chapter was to provide a brief overall conclusion of all chapters. Firstly, the main contributions made by the researcher in this study were stated. Also, the main ideas that were discussed in this thesis have been highlighted. Finally, this study proposed areas that might be an appropriate subject for future research.

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