Chapter 7

The Road Towards Good Bankruptcy Governance: A Comparative Law and Economics Perspective

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1 Introduction

The words "*towards*" and "*good*" in the title of this paper suggest a highly normative account of the topic "*bankruptcy governance*". First, they denote that *good* bankruptcy governance, in contrast to *bad* bankruptcy governance will be discussed. Second, they hint that the reader of this paper will find the law as it should be (*de lege ferenda)*, contrasted with the law as it is (*de lege lata*).

In order to be able to discuss *good* bankruptcy governance, the question "*what is good and… what is bad?*" must be tackled. This implies that certain normative statements or assumptions must be made, which (since one does not have a God's eye view) can be heavily criticized (2). Next, it will briefly be discussed how to efficiently ensure that a system of good bankruptcy governance is in place, by explaining the key concepts and theories that exist in the already extensive corporate governance doctrine (3). As to the law as it should be, the content of this paper will stay rather modest and only identify some shortcomings that can be found in the law as it is (*de lege lata*) by applying the aforementioned corporate governance

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theories and concepts to the existing deficient bankruptcy governance model. In this regard, the focus will be on the remuneration and personal civil liability of insolvency trustees in liquidation proceedings from a comparative law and economics perspective (4).

2 Defining *Good* Bankruptcy Governance

First things first: bankruptcy governance is nothing more, but also nothing less, than corporate governance in financially distressed firms. As Bon Jovi would put it: "it is the same damn song with a different melody".[2] Once acknowledged that an insolvency estate is very similar to a "forced" corporation, with a management ("bankruptcy trustee/liquidator" or "debtor-in-possession") and shareholders ("creditors"), a functional equivalent governance structure is discovered, with its own agency conflicts: (i) between the creditors and the trustee, (ii) between the secured creditors and the unsecured creditors, and (iii) between the creditors in the estate and the estate creditors.[3] One can observe a similar, although a bit more controversial, governance structure in companies in reorganization.[4] The following table contains these agency conflicts:

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[2] Based on Bon Jovi's song "*The More Things Change*".

[3] See J Vananroye, 'De civielrechtelijke aansprakelijkheid van een curator: tanden zonder tijger?' in I Samoy (ed), *Professionele aansprakelijkheid* (Jura Falconis Libri, Intersentia 2015) 139, 140-141; J Vananroye, *Organisatierecht: Werfbezoek aan een onvoltooide piramide* (Acta Falconis VII, Intersentia 2015) 35-38.

[4] On the importance of this kind of research, see D Baird and T Jackson, 'Bargaining After the Fall and the Contours of the Absolute Priority Rule' (1988) 55 U Chi L Rev 738, 775: "The law of corporate reorganizations should focus on identifying the residual owner, limiting agency problems in representing the residual owner, and making sure that the residual owner has control over the negotiations that the firm must make while it is restructuring."

Corporate governance	Bankruptcy governance	
	Reorganization proceedings (e.g. collective agreement)	Liquidation proceedings
Shareholders – Management	Pre-bankruptcy creditors – Management (DIP)	Creditors in the estate – Insolvency trustee
Majority – Minority shareholders	Secured – Unsecured creditors	Secured – Unsecured creditors
Shareholders – Creditors	Pre-bankruptcy – Post-bankruptcy creditors	Creditors in the estate – Estate creditors

This paper will focus exclusively on the agency conflict between the creditors in the estate and the insolvency trustee in liquidation proceedings. Although this conflict is arguably the least controversial of the six bankruptcy governance has to deal with, its underlying assumption is still heavily criticized today.

The underlying assumption comes down to the following question: "In whose interest should the management of a corporation or insolvency estate act?". This is a particularly normative question, on which reasonable minds can differ.[5] In Belgium, the *Cour de Cassation* has ruled that the interest of the corporation equals the interest of the present and future shareholders. According to the prevailing view, this means that the management of a corporation should pursue shareholder wealth maximization in the long term (in contrast to shareholder wealth maximization in the short term). Non-shareholder interests, such as those of employees, are only indirectly protected by the corporate interest. So those are solely taken into account in so far as this would ultimately benefit the shareholders (i.e. the enlightened shareholder value).[6] In the United Kingdom[7] and

[5] See generally J Armour, H Hansmann, R Kraakman and M Pargendler, 'What is Corporate Law' in R Kraakman, J Armour, P Davies, L Enriques *et al* (eds), *The Anatomy of Corporate Law. A Comparative and Functional Approach* (Oxford University Press 2017) 1, 22-24; F De Leo, 'Het vennootschaps- en boedelbelang in de queeste van Dionysos: naar nieuwe wijn in oude zakken' [2018] TPR 465.

[6] Cass 28 november 2013 [2014] TRV 287: "Het belang van een vennootschap wordt bepaald door het collectief winstbelang van haar huidige en toekomstige aandeelhouders". In this regard, see D Van Gerven, 'Kroniek Vennootschapsrecht 2013-2014' [2014] TRV 555, 578; A François, 'Eng is niet steeds eng: het

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the United States[8], similar views prevail. In Germany[9] and in the Netherlands[10], the predominating view is substantially different: the corporate interest encompasses the interests of *all* stakeholders, *including* those of shareholders. The consequences of this *stakeholder* orientation (in contrast to a shareholder orientation) can be considerable, as seen in the recent Dutch AkzoNobel case: the court has ruled that the management of a corporation is sometimes

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vennootschapsbelang eindelijk gedefinieerd!' in E Alofs, H Casman and A Van Den Bossche (eds), *Liber amicorum André Michielsens* (Wolters Kluwer 2015) 343, 348.

[7] A Keay, *The Enlightened Shareholder Value Principle and Corporate Governance* (Routledge 2013) 15.

[8] Supreme Court of Michigan (US) 7 February 1919, *Dodge et al / Ford Motor Co et al*, 170 NW 668 <h2o.law.harvard.edu/cases/3965> accessed 28 August 2018; A Berle, 'For Whom Corporate Managers are Trustees: A Note' (1932) 45 Harvard L Rev 1365; A Berle and G Means, *The Modern Corporation and Private Property* (MacMillan Press 1932) 113-114; M Friedman, 'The Social Responsibility of Business is to Increase its Profits' New York Times (New York, 13 September 1970) 32; F Easterbrook and D Fishel, 'Voting in Corporate Law' (1983) 26 Journal of Law and Economics 395, 403; F Easterbrook and D Fishel, *The Economic Structure of Corporate Law* (Harvard University Press 1991) 67; S Bainbridge, 'In Defence of the Shareholder Wealth Maximization Norm: A Reply to Professor Green' (1993) 50 Wash & Lee L Rev 1423; J Fisch, 'Measuring Efficiency in Corporate Law: The Role of Shareholder Primacy' (2006) 31 The Journal of Corporation Law 637, 646-647.

[9] K Hopt, 'Labor Representation on Corporate Boards: Impacts and Problems for Corporate Governance and Economic Integration in Europe' (1994) 14 International Review of Law and Economics 203, 208-209; Kommission Mitbestimmung, *Mitbestimmung und neue Unternehmenskulturen – Bilanz und Perspektiven* (Berstelsmann Stiftung 1998); F Fitzroy and K Kraft, *Co-Determination, Efficiency, and Productivity* (IZA Discussion Paper no 1442, 2004) <ftp.iza.org/dp1442.pdf> accessed 29 August 2018.

[10] Principle 1.1 of the Dutch Corporate Governance Code 2016 <www.mccg.nl/de-code>: "[…] Het bestuur richt zich op de lange termijn waardecreatie van de vennootschap en de met haar verbonden onderneming en weegt daartoe de in aanmerking komende belangen van de stakeholders. […]"; Hoge Raad 13 July 2007, *ABN AMRO*, para 4.5 <uitspraken.rechtspraak.nl/inziendocument?id=ECLI:NL:HR:2007:BA7972> accessed 25 August 2018: "[…] de belangen van alle betrokkenen, waaronder die van de aandeelhouders".

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allowed to pursue the interests of employees *instead* of long term shareholder wealth maximization.[11]

The same song, although with another melody, can be heard when discussing the liquidator in a liquidation proceeding. In Belgium, a liquidator ("*curateur*") has to act in the interests of the creditors and the debtor (the so-called Janus Face).[12] A similar melody accompanies an English liquidator[13] and an American Chapter 7 trustee[14]. In the Netherlands, however, a liquidator ("*curator*") has to take into account the interests of the broader society as a whole (cf. a Many-Faced God). In practice, this means that creditors can be obliged to incur the (risk of) costs caused by investigations that potentially benefit the society, although the creditors themselves cannot reap the benefits thereof (e.g. "*oorzakenonderzoek"*). This can be the case if, for instance, enough liquid assets are available in the insolvency estate to pay all creditors in full.[15]

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[11] Gerechtshof Amsterdam (Ondernemingskamer) 29 May 2017, *Elliot International, LP / AkzoNobel NV* <uitspraken.rechtspraak.nl/inziendocument?id=ECLI:NL:GHAMS:2017:1965> accessed 25 August 2018, para 3.34: "Om dezelfde reden is evenzeer denkbaar dat de doelvennootschap besluit een voorstel voor een potentiële bieder niet te steunen terwijl aannemelijk is dat een stand alone scenario minder aandeelhouderswaarde genereert (op lange termijn) dan het overnamevoorstel (op korte termijn)"; T Vos, 'The AkzoNobel Case: An Activist Shareholder's Battle against the Backdrop of the Shareholder Rights Directive' (2017) 14 European Company Law Journal 238.

[12] C Resteau, *Traité des sociétés anonymes* (Librairie judiciaire 1933) 181; L Fredericq, *Traité de droit commercial belge VII* (Fecheyr 1949) 175; J Van Ryn and J Heenen, *Principes de droit commercial IV* (Emile Bruylant 1965) 247; E Dirix-, 'De bewindvoerder in het insolventierecht' in *Liber Amicorum Walter Van Gerven* (Kluwer 2000) 521, 524; P Deseyne, L Vandenbroucke, J Declercq and B De Fleur, *Vademecum voor de rechter-commissaris* (UGA 2012) 285.

[13] See generally §172(3) Companies Act 2006; *West Mercia Safetywear Ltd v Dodd* [1988] BCLC 250, [1988] BCC 30; *Kuwait Asia Bank EC v National Mutual Life Nominees Ltd* [1991] AC 187 (PC).

[14] See generally *North American Catholic Education Programming Foundation, Inc v Gheewalla*, 930 A 2d 92 (Del 2007); *Quadrant Structured Products Co v Vertin*, 2015 WL 2062115 (Del Ch May 4, 2015).

[15] This was the case in Rotterdam 21 June 2017, *Stichting Bedrijvencentrum Drechtsteden*, no C/10/522025/ HARK 17-172 <uitspraken.rechtspraak.nl/inziendocument?id=ECLI:NL:RBROT:2017:4902> accessed 25 August 2018. See also Kamerstukken II 2014/15, 34253, 3,

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When using the external comparative method in answering the abovementioned question ("In whose interest should the management of a corporation or insolvency estate act?"), one can, in sum, only agree to disagree. However, some room for common ground can be found by turning to an economic analysis of law. Each legal system accepts that a shift in duties occurs once the company enters financial distress. The reason for this is that as long as the company is financially sound, the shareholders (incl. the creditors since they are, in an economic sense, the future shareholders) are the residual owners or the residual risk bearers of the company. Once the company enters financial distress, the residual ownership shifts from the shareholders to the creditors (incl. the shareholders as structural subordinated creditors). According to this line of thought, the interest of the corporation or insolvency estate is limited to the interest of the residual owners or residual risk bearers. The attentive reader will notice that this is an outcome which closely resembles the enlightened shareholder value principle.[16]

Adherence to the residual owner principle implies that, cf. the enlightened shareholder value principle, the "non-debt" interests of stakeholders other than shareholders or creditors are not directly

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<www.tweedekamer.nl/kamerstukken/verslagen/detail?id=2016D48663&did=2016 D48663> accessed 25 August 2018; R Vriesendorp, '[**]it happens; then and now' [2017] Tijdschrift voor Insolventierecht 148, 153.

[16] It is admitted, though, that this line of thought can be criticized as well (think about the team production theory and the debate concerning corporate social responsibility). In a previous article we have extensively argued why we think that these theories do not hold up. See F De Leo, 'Het vennootschaps- en boedelbelang in de queeste van Dionysos' (n 5) See also D Baird, 'The Initiation Problem in Bankruptcy' (1991) 11(2) International Review of Law and Economics 223, 228-229; J Armour and M Whincop, 'The Proprietary Foundations of Corporate Law' (2007) 27 Oxford Journal of Legal Studies 429, 440; J Armour, G Hertig and H Kanda, 'Transactions with Creditors' in R Kraakman, J Armour, P Davies, L Enriques, H Hansmann *et al* (eds), The Anatomy of Corporate Law (Oxford University Press 2007) 109; S Cools, *De bevoegdheidsverdeling tussen algemene vergadering en raad van bestuur in de NV* (Roularta 2015) 457-459; K Van Zwieten, 'Director Liability in Insolvency and Its Vicinity' (2018) 38 Oxford Journal of Legal Studies 382, 388-391.

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protected by the corporate or insolvency estate interest. This can be explained by the internal function of each branch of law, which should be respected as much as possible in order to have efficient legal protection mechanisms. To put it bluntly: corporate law should protect shareholders; insolvency law creditors; employment law and social security law employees; consumer law consumers; etc.[17]

Recent evolutions in European corporate and insolvency law seem to be consistent with this line of thought. Consider, for example, the European trend to abolish the (minimum) legal capital in corporate law: legal capital, with its very reason of existence creditor protection, is being removed from corporate law, that is, shareholder law.[18] At the same time, there is a shift away from the real seat doctrine towards the incorporation doctrine to determine the applicable corporate law. In other words, shareholders will encounter less practical hurdles in choosing a shareholder-friendly corporate law. Changing the statutory seat is, after all, more quick and cost-effective than changing the real seat of a corporation.[19] These

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[17] D Baird and T Jackson, 'Corporate Reorganizations and the Treatment of Diverse Ownership Interests: A Comment on Adequate Protection of Secured Creditors in Bankruptcy' (1984) 51 U Chi L Rev 97, 102-103; T Jackson, *The Logic and Limits of Bankruptcy Law* (Harvard University Press 1986) 25; F De Leo, 'De sterken en de zwakken in reorganisatieprocedures' in Q Cordier, X Miny, A Quintart and F Vanrykel (eds), *The Strong, the Weak and the Law* (Larcier 2018) 266. Cf N Luhmann, 'Zur Funktion der "subjektiven Rechte"' in R Lautmann, W Maihofer and H Schelsky (eds), *Jahrbuch für Rechtssoziologie und Rechtstheorie, Bd 1: Die Funktion des Rechts in der modernen Gesellschaft* (Bertelsmann Universitätsverl 1970) 321-330.

[18] For the recent legislative decision to abolish the notion of legal capital in Belgium, see Wetsontwerp tot invoering van het Wetboek van vennootschappen en verenigingen en houdende diverse bepalingen, *ParlSt Kamer* 2017-18, no 54-3119/001, 12-15, <www.dekamer.be/FLWB/PDF/54/3119/54K3119001.pdf> accessed 28 August 2018.

[19] ECJ 27 September 1988, ECLI:EU:C:1988:456 (*Daily Mail);* ECJ 9 March 1999, ECLI:EU:C:1999:126 (*Centros*); ECJ 5 November 2002, ECLI:EU:C:2002:632 (*Überseering*); ECJ 30 September 2003, ECLI:EU:C:2003:512 (*Inspire Art*); ECJ 16 December 2008, ECLI:EU:C:2008:723 (*Cartesio*); ECJ 12 July 2012, ECLI:EU:C:2012:440 (*Vale*); J-M Nelissen Grade and M Wauters, 'Reforming Legal capital: harmonisation or fragmentation of creditor protection' in K Geens and KJ Hopt (eds), *The European*

evolutions are all symptoms of the competition for corporate charters, which encourages (European member) states to make their company law as shareholder-friendly as feasible.[20]

This shift from the real seat doctrine to the incorporation doctrine could, however, be to the detriment of creditors, since shareholders can now more easily opt-out of creditor-friendly corporate laws (i.e. forum shopping). Legal systems try to solve this issue by focusing more on flexible remedies such as director liability, and by shifting these remedies from their corporate law to their insolvency law as the new company law for third parties (as one author rightly puts it)[21]. The reason behind all this is that the applicable insolvency law is determined by the Centre of Main Interests (COMI), which is a functional equivalent of the corporate real seat doctrine. Forum shopping will thus still be a problem for creditors, but it will not be any bigger than under the abandoned corporate real seat doctrine.[22]

Even in the Netherlands, which is a typical stakeholder-oriented legal system, a lenient reader can find anecdotal evidence to support this view. One can think, in particular, about the recent decision of the European Court of Justice in the *Smallsteps*-case. In that much debated case, the Court held that the Dutch pre-pack practice does not fall under the exception of art. 5(1) of the EU Directive 2001/23/EG, and the employees should therefore be protected according to art. 3 and 4 of the EU Directive. In Belgium, this judgement led to the (temporary) abolishment of the pre-pack liquidation in the new (draft) insolvency legislation (Book XX

Company Law Action Plan Revisited: Reassessment of the 2003 Priorities of the European Commission (Leuven University Press 2010) 47-50.

[20] K Maresceau, 'Belgium, Get Ready to Compete for Corporate Charters: een pleidooi voor de invoering van de statutaire zetelleer' in H Braeckmans, O Caprasse *et al* (eds), *De modernisering van het vennootschapsrecht* (Larcier 2014) 203.

[21] G Lindemans, 'The Walls Have Fallen, Run for the Keep: Insolvency Law as the New Company Law for Third Parties' (2016) 24 European Review of Private Law 877.

[22] See extensively on this topic: *ibid* 877; De Leo (n 5) 519-521.

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WER), since it was inspired on the Dutch pre-pack practice.[23] The Dutch Minister of Safety and Justice, S.A. Blok, however, decided that the Dutch draft *insolvency* legislation concerning the pre-pack (WCO I) does not need to be altered since the problem at hand concerns employee protection (in insolvency proceedings), which is *labor* law (i.e. employment law) and *not* insolvency law (i.e. creditor law).[24]

3 Building a Model

It is one thing to argue that the management of a corporation in financial distress, especially in a liquidation proceeding, should act in the interests of the creditors (incl. the structurally subordinated shareholders) as the new residual owners, it is another thing to have that management actually behave in the interest of the principal. Consequently, the next logical question is: “how can we efficiently ensure that the agent (liquidator) acts in the best interest of the principal (creditors)?”. Since reinventing the wheel is never cost-effective, the existing extensive corporate governance doctrine will be utilised when answering this question.

In their seminal paper entitled “Theory of the Firm” (1976), Jensen and Meckling point out that an agent will not automatically act in the interest of the principal. Instead, the agent will behave opportunistically in its own interest (the *homo economicus*).[25] The principal can react to this by using monitoring and bonding mechanisms to align the interest of the agent with those of the principal. One can think of the appointment, remuneration, liability

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[23] F De Leo, ‘De stille dood van het stil faillissement’, (29 June 2017) Trends <http://trends.knack.be/economie/bedrijven/de-stille-dood-van-het-stil-faillissement/article-opinion-872381.html> accessed 28 August 2018.

[24] S A Blok, *Brief van 28 september 2017*, <eerstekamer.nl/behandeling/20170928/brief_van_de_minister_van/document3/f=/vki0nrocvlr3.pdf> accessed 28 August 2018.

[25] M C Jensen and W H Meckling, ‘Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure’ (1976) 3 J Fin Econ 305. See already: A Smith, *The Wealth of Nations* (first published 1776, University of Chicago Press 1977) para I.2.2: “It is not from the benevolence of the butcher, the brewer, or the baker, that we expect our dinner, but from their regard to their own interest”.

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and dismissal of the agent as sticks and carrots to correctly incentivize him.[26]

$If\ principal\ control\ \uparrow, then\ agent\ conflict\ costs\ \downarrow$

Despite the use of bonding and monitoring mechanisms, there will always be residual losses. These losses exist because (i) the interest of the agent will never be *fully* aligned with that of the principal and (ii) the bonding and monitoring mechanisms themselves cost time and money. The sum of the bonding costs, monitoring costs and residual losses are called the agent conflict costs.

In a recent paper, Goshen and Squire introduce a more modern agency-principal costs theory by shifting the focus away from agent conflict costs to competence and conflict as well as agent and principal costs.[27] The interconnectedness of these costs can be illustrated as follows.

Assume that an agent is completely loyal to the principal, that is, that the agent conflict costs = 0. In that hypothetical case[28], the agent can still make honest mistakes, resulting in agent competence costs.[29] So one could argue that to decrease the agent competence and conflict costs, a shift of control rights from the agent to the principal, which could ultimately even remove the entire agency relationship, should occur. The sole fact that in a certain corporation an agent has been appointed by the principal, however, is already proof that the principal believes, rightly or wrongly, that the agent is more competent than the principal in managing the firm on a daily basis. The agent competence costs of a specialized management will indeed often be lower than the principal competence costs of a group of shareholders or creditors who lack the necessary management or

[26] Jensen and Meckling (n 25) 305.
[27] Z Goshen and R Squire, 'Principal Costs: a New Theory for Corporate Law and Governance' (2017) 117 Columbia L Rev 767.
[28] This, however, will never be the case due to the existence of residual losses. See generally Jensen and Meckling (n 25) 305.
[29] Cf J Vananroye and G Lindemans, 'Het einde van de wereld die we kennen is nabij' [2015] TRV 701, 702: "Aansprakelijkheidsvorderingen (welke ook hun aanknopingspunt) blijven virtueel, tenzij de curator ze wil én kan instellen. Zowel het willen als het kunnen schieten in België tekort […]".

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technical skills. Since in reality the principal consists of a heterogeneous group of stockholders or creditors (in contrast to a centralized manager), coordination and transaction costs (i.e. principal conflict costs) exist as well. Each individual creditor will wonder why he should invest in monitoring the firm if that investment results in just him bearing the monitoring costs while the entire group of creditors reaps the potential benefits? Accordingly, two things can happen. First, individual sophisticated creditors (e.g. banks) might decide to monitor the firm to maximize their personal benefits, potentially causing negative externalities to third-party, mainly non-adjusting, creditors (problem of moral hazard).[30] Second, individual (often smaller) creditors may abstain from investing (rational apathy) and try to free-ride on the investments of their fellow principals (delegated monitoring).[31] However, if each individual creditor thinks and acts this way, this will result in underinvestment in bonding and monitoring, which will eventually be to the detriment of the group of creditors (i.e. a collective action problem).[32]

The main takeaway of this more modern account of agency and principal costs for this paper is that a shift of control rights from the agent to the principal is (Kaldor-Hicks) efficient if the agent costs decrease more than the principal costs increase:

$$If\ principal\ control\ \uparrow, then\ agent\ costs\ \downarrow + principal\ costs\ \uparrow$$

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[30] See generally D Matri, *Covenants and Third-Party Creditors. Empirical and Law & Economics Insights into a Common Pool Problem* (Springer 2017) 87ff.

[31] H Leland and D Pyle, 'Informational asymmetries, financial structure, and financial intermediation' (1977) 32 Journal of Finance 371; J Campbell and W Kracaw, 'Information production, market signaling, and the theory of financial intermediation' (1980) 35 Journal of Finance 863; D Diamond, 'Financial intermediation and delegated monitoring' (1984) 51 Review of Economic Studies 393.

[32] See generally Matri (n 30) 147ff; R Parry, *Transaction Avoidance In Insolvencies* (Oxford University Press 2001) 532; F De Leo and D Cardinaels, 'Remuneratie curator. Het bureau voor rechtsbijstand is geen insolventieverzekeraar, maar wie dan wel?' [2017] NjW 566, 573.

$$If\ agent\ costs\ \downarrow > principal\ costs\ \uparrow, then\ principal\ control\ \uparrow = (Kaldor - Hicks) efficient$$

$$If\ agent\ costs\ \downarrow < principal\ costs\ \uparrow, then\ principal\ control\ \uparrow \neq (Kaldor - Hicks) efficient$$

Or; a decrease in principal control is efficient if the principal costs decrease more than the agent costs increase:

$$If\ principal\ control\ \downarrow, then\ agent\ costs\ \uparrow + principal\ costs\ \downarrow$$

$$If\ agent\ costs\ \uparrow < principal\ costs\ \downarrow, then\ principal\ control\ \downarrow = (Kaldor - Hicks) efficient$$

$$If\ agent\ costs\ \uparrow > principal\ costs\ \downarrow, then\ principal\ control\ \downarrow \neq (Kaldor - Hicks) efficient$$

This, of course, sounds great in theory, but how can this theoretical model be used to gain valuable practical insights for the law as it should be (*de lege ferenda*)? Two complicating factors deserve our attention.

A first complicating issue is that the different competence and conflict costs are firm specific. Indeed, some firms have a more competent or loyal management than others (i.e. low agent competence or conflict costs). In other firms, shareholders will have a hard time judging the competence or loyalty of the present management (i.e. high principal competence costs). The latter will often be the case in high tech startups due to a large information asymmetry between the principal, who mainly possesses investment knowledge, and the agent, who mainly possesses specialized technical knowledge.[33] Goshen and Squire solve this issue by arguing

[33] In this regard, see R Daines, S Li and C Wang, 'Can Staggered Boards Improve Value? Evidence from the Massachusetts Natural Experiment' (Harvard Business School Accounting & Management Unit Working Paper No 16-105, Stanford Law and Economics Online Working Paper No 498, European Corporate Governance Institute (ECGI) – Finance Working Paper No 499/2017, 2017),

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that corporate law should consist of one or more set(s) of default rules.[34] Corporate law is therefore merely a technique to reduce transaction costs.[35] Each firm – in continental Europe often controlled by majority shareholders[36] – should be able to decide for itself if it wants to deviate from a certain corporate rule. After all, the firm itself is best placed to make a firm specific cost-benefit analysis.[37] If the previously defended normative assumption that corporate law is shareholder(-friendly) law is accepted, more say for shareholders indeed makes a lot of sense.

In this paper, however, a model for good bankruptcy governance is being built, i.e. insolvency or creditor law. If during its existence a firm (read: (majority) shareholders) could simply opt out from every creditor protection mechanism that can be found in (default) insolvency law, there would be no real third party protection at all. Creditors, and especially weak non-adjusting creditors (e.g. tort victims, tax authorities, consumers or small suppliers), would not be able to adequately protect themselves due to a severe problem of contract failure. As Ayres and Gertner put it:

> "There is surprising consensus among academics at an abstract level on two normative bases for immutability. Put most simply, immutable rules are justifiable if society wants to protect (1) parties within the contract, or (2) parties outside the contract. The former justification turns on parentalism; the latter on externalities. Immutable rules displace freedom of

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<https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2836463> accessed 29 August 2018.

[34] Goshen and Squire (n 27) 827-828.

[35] About transaction costs generally, see: R Coase, 'The Nature of the Firm' (1937) 4 Economica 386; R Coase, 'The Problem of Social Cost' (1960) 3 Journal of Law and Economics 1; R Coase, 'The Nature of the Firm: Influence' (1988) 4 Journal of Law, Economics and Organization 33.

[36] C Van Der Elst, *Shareholders as Stewards: Evidence from Belgian General Meetings* (Financial Law Institute Working Paper 2013-05, 2013), <SSRN: dx.doi.org/10.2139/ssrn.2270938> accessed 30 August 2018; R La Porta, F Lopez-de-Silanes and A Shleifer, 'Corporate Ownership Around the World' (1999) 54 Journal of Finance 471.

[37] Goshen and Squire (n 27) 827-828.

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> contract. Immutability is justified only if unregulated contracting would be socially deleterious because parties internal or external to the contract cannot adequately protect themselves".[38]

In other terms, a strong case can be made for not (exclusively) relying on default insolvency or bankruptcy governance rules.

Promoting mandatory rules implies accepting inefficiencies: some creditors would be better off if it were possible to deviate from certain existing/proposed bankruptcy governance rules (for instance, due to the presence of an extremely loyal and competent management in high-tech startups). This, however, is not an insurmountable problem as long as the goal of this paper is clearly stated, that is, to achieve a *Kaldor-Hicks* efficient bankruptcy governance model. This means that a model that tries to minimize the total control costs in the majority of insolvency proceedings is being built.

A second issue that deserves our attention is the existence of different kinds of creditor control rights. On the one hand, there are principal-empowering or discretionary control rights (e.g. appointment and dismissal rights) with limited to no judicial intervention. These are able to adequately reduce agent competence and conflict costs, but are in principle afflicted with high principal costs (coordination costs, duplicative efforts, collective action problems, etc.). On the other hand, there are agent-constraining or duty-enforcement control rights that legally limit the power of the agent in a predefined manner. Since a judge will usually intervene when these agent-constraining control rights are exercised (for instance, when bringing a liability claim against the agent for a breach of its duty of loyalty), the principal costs resulting from their exercise are normally lower than

[38] I Ayres and R Gertner, 'Filling Gaps in Incomplete Contracts: An Economic Theory of Default Rules' (1989) 99 The Yale LJ 87, 88. See further: J Armour, H Hansmann, R Kraakman and M Pargendler, 'What is Corporate Law' (n 5) 19; G Calabresi and AD Melamed, 'Property Rules, Liability Rules, and Inalienability: One View of the Cathedral' (1972) 85 Harv L Rev. 1089; Easterbrook and Fischel, *The Economic Structure of Corporate Law* (n 8) 21-30; J Vananroye and G Lindemans, 'Schuldeisersbescherming tegen misbruik van rechtspersonen: het insolventierecht geeft en het vennootschapsrecht neemt?' [2017] 123 DAOR 4, 14.

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those of principal-empowering control rights. Blatant mistakes one or more creditors were willingly or unwillingly going to make, are halted in a timely fashion by the judge, causing a decrease in principal costs.[39]

The disadvantage of judicial intervention, however, is that the control costs are being shifted from the principal to the legislator (*ex-ante*)[40] and judicial organs (*ex-post*).[41][42] Furthermore, it eliminates a large

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[39] In general, see: J Armour, H Hansmann and R Kraakman, 'Agency Problems and Legal Strategies' in R Kraakman, J Armour, P Davies, L Enriques, H Hansmann *et al* (eds), *The Anatomy of Corporate Law. A Comparative and Functional Approach* (Oxford University Press 2017) 29, 31.

[40] C Diver, 'The Optimal Precision of Administrative Rules' (1983) 93 *The Yale LJ* 65; D North, *Institutions, Institutional Change and Economic Performance* (Cambridge University Press 2004) 21; M Taylor, 'Formal versus Informal Incentive Structures and Legislator Behavior: Evidence from Costa Rica' (1992) 54 The Journal of Politics 1055.

[41] About competence costs on the part of the judge, see generally: B Bouckaert, *Hoe gemotiveerd is Cassatie? Pleidooi voor een waarachtig precedentenhof en een hernieuwde motiveringscultuur* (Gandaius Thorbecke 21, Kluwer 1997); R Van Den Bergh, *Averechts Recht* (Intersentia 2000); MV Antokolskaia, 'Opkomst van empirical legal studies: een vloek, een zegen of allebei?' [2016] TPR 423-432; E Dirix, 'Gezocht: een statisticus voor het Grondwettelijk Hof' (2017) 81 RW 522. About conflict costs on the part of the judge, see generally: E Elhauge, 'Does Interest Group Theory Justify More Intrusive Judicial Review?' (1991) 101 Yale LJ 31; J Macey, 'The Internal and External Costs and Benefits of Stare Decisis' (1989) 65 Chicago-Kent L Rev 93; R Posner, 'What Do Judges and Justices Maximize? (The Same Thing Everyone Else Does)' (1993) 3 Supreme Court Economic Rev 1; S Bainbridge and G Gulati, 'How do Judges Maximize? (The Same Way Everybody Else Does – Boundedly): Rules of Thumb in Securities Fraud Opinions' (2002) 51 Emory LJ 83; D Langevoort, 'Seeking Sunlight in Santa Fe's Shadow: The SEC's Strategic Pursuit of Managerial Accountability' (2001) 79 Wash U LQ 449; E Rasmussen, 'A Theory of Trustees, and other Thoughts, with a Postscript' (2000), <www.rasmusen.org/published/Rasmusen_98.BOOK.trustees.NEW.pdf> accessed 30 August 2018 (Pride, Policy, Place, Power and Principle are the guiding principles for judges); F Schauer, 'Incentives, Reputation, and the Inglorious Determinants of Judicial Behavior' (2000) 68 U Cinn L Rev 615 ("judges have an impact for the sake of having an impact"). Critical, see L Stout, 'Judges as altruistic hierarchs' 2002 (43) William and Marry L Rev 1605.

[42] See generally: Armour, Hansmann and Kraakman, 'Agency Problems and Legal Strategies' (n 39) 31; Goshen and Squire (n 27) 800; M Safavian and S Sharma,

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part of the positive effect of agent-constraining control rights on the existing agent competence costs. A judge will rarely rule that an agent (e.g. a liquidator) has made honest mistakes, for which he has to be held liable. Some of the reasons for this are the judgement business rule, the fear of ruling in hindsight bias and the limited managerial experience of judges (especially in Continental European countries).[43]

Accordingly a healthy mix of agent-constraining and principal-empowering control rights is needed in order to obtain a Kaldor-Hicks efficient bankruptcy governance structure.

4 Applying the Model

Applying the afore-described agency-principal costs model in bankruptcy law allows us to discover some inefficiencies in the current bankruptcy governance system (*de lege lata*). While the residual risk in companies in financial distress shifts from the shareholders to the creditors, not all governance rights shift correspondingly. Although some of these standstills can be explained by principal competence or principal conflict costs, others cannot. In what follows, the focus will be on the remuneration and personal civil liability of liquidators, both agent-constraining control rights.

'When do Creditor Rights Work?' (2007) 35 Journal of Comparative Economics 484; K Ayotte and H Yun, 'Matching Bankruptcy Laws to Legal Environments' (2009) 25 Journal of Law, Economics & Organization 2; B C Iverson, J Madsen, W Wang and Q Xu, 'Practice Makes Perfect: Judge Experience and Bankruptcy Outcomes' (2018), <https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3084318> accessed 30 August 2018; I Ehrlich and R Posner, 'An Economic Analysis of Legal Rulemaking' (1974) 3 The Journal of Legal Studies 257, 258; L Kaplow, 'Rules versus Standards: An Economic Analysis' (1992) 42 Duke LJ 557.

[43] W T Allen, J B Jacobs and L E Strine, 'Realigning the Standard of Review of Director Due Care with Delaware Public Policy: A Critique of Van Gorkom and its Progeny as a Standard of Review Problem' (2002) 96 Nw U L Rev 449, 454-455; M Roe, 'Corporate Law's Limits' (2002) 31 Journal of Legal Studies 233, 235; Goshen and Squire (n 27) 799.

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4.1 Personal Civil Liability of the Liquidator

The personal civil liability of a Belgian liquidator is a clear example of an inefficiently modelled bankruptcy governance enforcement mechanism, essentially belonging to the rules and standards strategy. This has everything to do with the concept of "collective damage".

When a liquidator, as an agent of the general body of creditors, makes honest mistakes (agent competence costs) or acts opportunistically in his own interest (agent conflict costs), the insolvency estate is usually damaged. This damage is directly suffered by the insolvency estate, i.e. the joint creditors, and not by the individual creditors. The individual creditors only suffer indirect damage, since their claims in the insolvency estate decrease in value precisely because the insolvency estate suffers direct damage.[44] Hence, only (the representative of) the insolvency estate has standing to sue the liquidator in his personal capacity for his (dis)honest mistakes, and to claim damages for the losses the insolvency estate suffered. This means that the liquidator is expected to monitor himself and to sue himself for his own improper conduct (so-called "inherent conflicts"). *Spoiler*: such lawsuits are non-existent:[45]

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[44] Cass 12 February 1981 [1980-81] *Arr Cass* 662; Cass 2 March 1995 [1995] *JLMB* 1195, note C Parmentier; Cass 24 October 2002 [2002] *Arr Cass* 2266; Cass 29 October 2004 [2004] *Rev prat soc* 152, note W Derijcke, [2005] *TRV* 554, note J Vananroye. Cf Cass 23 February 2012 [2011-12] *RW* 1658, note F Parrein, [2012] *TRV* 319, note J Vananroye, [2013] TBH 876, note D Willermain.
Conversely, where the actions of the IP have directly (personally) harmed a creditor, it is the creditor (and not the estate) that is able to sue the IP. Individual creditors suffer direct (personal) harm if it is not derivative of that suffered by the estate. One example is an individual creditor who has been misled by the liquidator into granting credit to the firm in financial distress and thereby suffers personal harm. Furthermore, one action can simultaneously cause harm to the estate and individual stakeholders. One particular example is the personal guarantor who suffers direct/personal harm due to the harm suffered by the estate. This is the case where an individual creditor exercises recourse against the personal guarantor precisely because the insolvency estate suffered losses, thereby limiting the assets to pay the individual creditors in full.

[45] J Vananroye, 'De civielrechtelijke aansprakelijkheid van een curator: tanden zonder tijger?' (n 3) 158; E Hoogmartens, 'Interne aansprakelijkheidsvordering tegen de curator voor afgeleide schade' [2017] Jura Falconis 754; F De Leo,

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$$R_{result} = A_{being\ able}\ x\ W_{willing}$$

$$If\ W_{willing} = 0, then\ R_{result} = 0$$

Unlike in corporate law, where the (minority) shareholders can bring an *actio mandati* or *actio pro socio* against the management[46], creditors cannot bring a derivative lawsuit against the liquidator. Accordingly, creditors are left out in the cold, all the more so since there are no real alternatives[47].

Suing the liquidator in his professional capacity (*qualitate qua*), for instance, would not be helpful since damages that are awarded to the insolvency estate have to be paid out of the same insolvency estate that suffered these losses in the first place. Meanwhile, the personal assets of the liquidator remain unaffected. The potential risk of creditors suing the liquidator *qualitate qua* will thus not *ex-ante* (adequately) incentivize the liquidator to act in the interest of the agent. *Ex-post* the principal will not be truly compensated for the losses he suffered, since the damages are paid out of the damaged insolvency estate itself, i.e. the collateral of the joint creditors.[48]

Trying to replace the liquidator, on the other hand, is a precarious, time-consuming and costly process. It involves not only the direct costs of the replacement process itself, but also indirect costs, such as the time needed for the liquidator to familiarize himself with the insolvency estate. Even if creditors succeed in replacing the liquidator, they can only hope that the new court-appointed liquidator

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'Economics Trumps Politics. De valkuil van democratische besluitvoering bij vennootschappen en insolventieprocedures' (2017-18) 81 RW 1243, 1254.

[46] Art 5:103-105 and 7:156-159 Wetboek Vennootschappen en Verenigingen.

[47] At least not until the closing meeting of the liquidation proceeding, when the creditors have a possibility to contest certain actions undertaken by the liquidator (art XX.170 and 171 Wetboek Economisch Recht). This practice, however, is questionable on grounds of procedural economy. See also Vananroye (n 3) 165.

[48] E Dirix, 'De bewindvoerder in het insolventierecht' in X, *Liber amicorum Walter van Gerven* (Kluwer 2000) 534; A De Wilde, *Boedelschulden in het insolventierecht* (Intersentia 2005) 346-349; Vananroye (n 3) 143; Beslagr Hasselt 4 maart 1997 [2002-03] *RW* 669; C Berckmans, 'Schuldeisers en stilzitten curator: het monopolie doorbroken?' [2013] 478 *NjW* 492-493.

will actually bring a liability claim against the former liquidator. Collegiality and the principle of reciprocity ("*das Gesetz des Wiedersehens*"[49]) will most often prevent these liability law suits from happening.[50]

How then can this problem of underinvestment in liquidator liability law suits be solved? This can only be done by shifting the control right to sue the liquidator from the agent (the liquidator) to the principal (the creditors). Such a shift, resulting in the introduction of a possibility for creditors to bring a derivative lawsuit against the liquidator, would substantially reduce agent conflict costs in the broad sense.

First, the risk of being held liable would *ex-ante* incentivize the liquidator to do his utmost best and to act loyal. Second, natural selection would occur: the very incompetent or disloyal liquidators would stop accepting appointments in insolvency proceedings for fear of being held liable. In other words, such a shift would potentially address the concerns expressed in the Belgian doctrine that there are too many occasional liquidators who lack the necessary experience in administering insolvency proceedings. The system with many occasional liquidators would be transformed into a system with a smaller amount of professional liquidators.[51] Third, the creditors

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[49] N Luhmann, *Vertrauen – Ein Mechanismus der Reduktion sozialer Komplexität* (Enke 1973) 39.

[50] Vananroye (n 3) 143; Beslagr Hasselt 4 maart 1997 [2002-03] *RW* 669; Berckmans (n 45) 492ff. *Cf* K Davis, 'Structural Bias, Special Litigation Committees, and the Vagaries of Director Independence' (2005) 90 Iowa L Rev 1305, 1307 and 1317-1335; J Cox and H Munsinger, 'Bias in the Boardroom: Psychological Foundations and Legal Implications of Corporate Cohesion' (1985) 48 Law and Contemporary Problems 83, 91-108; M Underberg, 'The Business Judgement Rule in Derivative Suits Against Directors' (1980) 65 Cornell L Rev 600, 619-622.

[51] V Verlaeckt, 'Professionele of occasionele curatoren: een essentiële keuze' [2017] 349 *De Juristenkrant* 12; Addendum van de Orde van Vlaamse Balies van 21 maart 2016 bij het standpunt over het wetsvoorstel 18 juni 2015 tot wijziging van de faillissementswet van 8 augustus 1997 wat het aanwijzen van curatoren betreft, *Parl St* Kamer, no 54-1191/001: "[…] anno 2016 staan er momenteel 70 advocaten op de lijst van curatoren voor de afdeling Oudenaarde van de rechtbank van koophandel Gent, waartegenover 170 faillissementen staan. Behoudens

would be able to obtain real compensation for the damage the insolvency estate suffered due to the improper conduct of the liquidator (*ex-post* remedy).

However, an increase in principal control inevitably also causes an increase in principal costs:

$$If\ principal\ control\ \uparrow, then\ agent\ costs\ \downarrow + principal\ costs\ \uparrow.$$

The liquidator is, for instance, better informed of the mistakes he made while administering the insolvency estate than the creditors (information asymmetry). Accordingly, the principal competence costs will indeed often be higher than the agent competence costs. Furthermore, creditors suffer from a collective action problem (and the corresponding rational apathy) and will try to free-ride on the investments of others. Nonetheless, the principal conflict costs of bringing a derivative liquidator liability lawsuit will always be lower than the agent conflict costs of bringing such a claim; a rational liquidator will certainly never want to sue himself.

Taking into account the idea that $if\ W_{willing} = 0, then\ R_{result} = 0$ and acknowledging the impossibility to efficiently increase the willingness of a liquidator to sue himself (inherent conflict), the only logical conclusion would be that a transfer of the control right to sue the liquidator from the agent to the principal is efficient since the corresponding increase in principal costs is in any event less than the pre-existing agent costs. In this respect, the United States and the United Kingdom can serve as an example.

In the US, courts allow individual creditors to pursue claims belonging to the insolvency estate in certain situations, such as where the proposed defendant in the action is the insolvency trustee or where the trustee is abusing its discretion in not pursuing a third party. To limit the increase of principal costs created by an increase of principal control, the individual creditor(s) must obtain express bankruptcy court approval before commencing such an action and

afwijkende beslissing door de voorzitter van de rechtbank van koophandel Gent zou dat bij aanvaarding van het wetsvoorstel neerkomen op een toewijzing van amper drie faillissementen per curator".

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must accept that any recovery will be distributed through the estate, so that creditors can participate in accordance with the priority scheme set forth in the Bankruptcy Code.[52]

A functionally equivalent remedy can be found in the United Kingdom. In the UK, individual creditors can sue the liquidator who has misapplied, retained, or become accountable for any money or other property of the company, or been guilty of any misfeasance or breach of any fiduciary or other duty in relation to the company or in connection with the carrying out of his functions as liquidator of the company (Insolvency Act 1986, s 212). If the claim is successful, the court will compel the liquidator to repay, restore or account for the money or property (with interest), or to contribute such sum to the insolvency estate's assets as it thinks just. The relief is therefore given to the insolvency estate rather than to the individual creditor.[53]

In addition, the increase in principal conflict costs (caused, for instance, by rational apathy and freeriding) can be limited by providing incentives for individual creditors to sue the liquidator. One example of potential incentives is to accord the creditor, who brings a liability lawsuit against the liquidator and thus bears the financial risk thereof, a privilege on the damages that are awarded to the insolvency estate. Another method to decrease the principal conflict costs is to introduce a creditors' committee that represents the general body of creditors and that can intervene when needed to bring a liquidator liability lawsuit.

4.2 Remuneration of the Liquidator

The question of the personal civil liability of the liquidator could be answered quickly, mainly on the basis of a law and economics analysis. The remuneration of the liquidator is less straightforward and will require a more extended comparative law and economics analysis.

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[52] *DiStefano v Stern (In re JFD Enters.)* 223 BR 610 (Bankr D Mass 1998); *San Juan Hotel Corp* 847 F2d (1st Cir 1988); *Barnett v Stern* 93 BR 962 (NDI111988).
[53] Eg *Top Brands Ltd v Sharma* [2015] 1 BCLC 546; *Hedger v Adams* [2015] EWHC 2540 (Ch); *McGuire v Rose* [2013] EWCA Civ 429.

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In most jurisdictions, the (general assembly of) shareholders can in principle freely choose how to remunerate the management of their firm, at least as long as the firm is solvent and the shareholders are the residual owners of the company. The shareholders are the first ones to feel the positive or negative effects of a change in the remuneration of their agent (the management), through an uplift or downfall in the share price.[54] Things change, however, once the firm enters a liquidation proceeding. The residual ownership shifts from the shareholders to the creditors and the management is replaced by a professional liquidator.[55] One would expect that the creditors as the new residual owners of the company (now: insolvency estate) would be able to freely determine the method of remuneration of the liquidator. The creditor involvement in the remuneration process differs, however, substantially from jurisdiction to jurisdiction.

In Belgium, the pay of a liquidator is determined in accordance with the Royal Decree of 26 April 2018. This Royal Decree determines that the remuneration is established on the basis of percentages of realized assets (realization scales). The result is sometimes multiplied by a correction coefficient (varying from 0,6 to 1,4), taking into account, inter alia, the complexity of the case and the time spent on the case. The liquidator himself makes the calculation and subsequently submits it to a judge ("*juge-commissaire*"), who acts as a trustee of the general body of creditors. The *juge-commissaire* (and eventually the companies court) then verifies whether the calculation as submitted by the liquidator has been made in accordance with the

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[54] Former Reflection Group on the Future of EU Company Law, 'Response to the European Commission's Action Plan on Company Law and Corporate Governance' [2013] *ECFR* 304, 314; Cools (n 16) 286 and 297; W Slagter, *Compendium van het ondernemingsrecht* (Kluwer 2005) 365; P Wauwermans, *Manuel pratique des sociétés anonymes* (Bruylant 1924) 198; B Tilleman, *Bestuur van vennootschappen* (die Keure 2005) 454; H-U Vogt, *Aktionärsdemokratie* (Dike 2012) 50.

[55] Baird (n 16) 228-229: "The managers' loyalty needs to change when there is a change in the residual owner, the person who gains or losses from any change in the fortune of the firm. Such a change takes place when the firm becomes insolvent and creditors cannot be paid in full"; De Leo (n 5).

Royal Decree and finally approves or modifies the remuneration proposal.[56]

A similar method of calculation is used in the United States. The U.S. Code determines that the court may allow reasonable compensation for the trustee's services, not to exceed

> "25 percent on the first $5,000 or less, 10 percent on any amount in excess of $5,000 but not in excess of $50,000, 5 percent on any amount in excess of $50,000 but not in excess of $1,000,000, and reasonable compensation not to exceed 3 percent of such moneys in excess of $1,000,000, upon all moneys disbursed or turned over in the case by the trustee to parties in interest, excluding the debtor, but including holders of secured claims".[57]

It is important to note that these are maximum percentages. In determining the amount of reasonable compensation to be awarded to the trustee, the court, as a trustee of the joint creditors, takes into account various factors, including the time spent by the trustee on his services.[58]

At first glance, the method of remuneration in the Netherlands seems entirely different from that in the two jurisdictions previously discussed. In the Netherlands, the remuneration of the liquidator consists of an hourly rate: a base rate annually determined by Recofa ("*Landelijk overlegorgaan van rechters-commissaris in faillissementen en surseances van betaling*") (in 2018, the base rate was set at 212 EUR) and corrected by an "experience" factor (varying from 0,6 to 1,3) and "estate" factor (varying from 1,0 to 1,2).[59] Despite this substantial ideological difference in the calculation base in these three jurisdictions (an hourly rate in the Netherlands vs. percentages of realized/distributed assets in Belgium and the United

[56] F De Leo, R Verheyden and D Cardinaels, 'Hernieuwde remuneratieregeling curatoren' [2018] 372 De Juristenkrant 6.
[57] 11 US Code, §326(a).
[58] 11 US Code, §330(a)(3) and (4).
[59] Art 6 Recofa-richtlijnen voor faillissementen en surseances van betaling (hereafter referred to as the "Recofa guidelines").

Proof

States), the methods of calculation are convergently functionally equivalent.[60] In Belgium and the United States, judges take into account the time the liquidator/trustee has spent on realizing the assets when determining the percentages and/or correction coefficients.[61] In the Netherlands, the estate factor (depending on the realized assets in the insolvency estate) and the experience factor (requiring a cost-effective allocation of the work to be carried out between the different insolvency staff members) (in)directly influence the hourly rate.[62] A Dutch liquidator makes a calculation according to the Recofa guidelines and a "*rechter-commissaris*" (and eventually the companies court) checks whether the calculation is correct; this is similar to what their Belgian and US counterparts do.[63]

Summarily, all these jurisdictions have in common that the liquidator makes the calculation on the basis of a (semi-)legislative document and that a judge, as a trustee of the general body of creditors, monitors the liquidator (by verifying the correctness of the calculation). The principals, i.e. the creditors, have no control whatsoever over determining the remuneration of their agent, i.e. the liquidator. So these jurisdictions have all chosen to decrease the principal control in the remuneration process to the absolute minimum. The result is a decrease in principal costs and a corresponding increase in control costs on the part of the legislators

[60] The incentive structure of these two methods of remuneration is not entirely the same, though. A correction coefficient only has effect when the first multiplier, i.e. realized assets or time spent, $\neq 0$. A liquidator can directly influence the time he spends on a case (the risk of this multiplier being 0 against his will is non-existent), but *not* the realized assets (to put it bluntly, a court decides on this multiplier). Consequently, the method applied in Belgium and the United States causes a risk of underinvestment in director liability lawsuits on the part of the liquidator; in contrast, the method applied in the Netherlands causes a risk of overinvestment. In this regard, see generally M Kroeze, *Bange bestuurders* (Kluwer 2005) (Netherlands); Vananroye and Lindemans (n 29) 701 (Belgium).

[61] In this regard, see Verslag aan de Koning bij het KB 26 April 2018, *BS* 27 April 2018, 36930: "De coëfficiënten moeten als 'incentives' voor de curatoren worden beschouwd".

[62] Art 6.7 Recofa guidelines.

[63] Art 65 and 71 Faillissementswet; art 6.3(a) and (b) Recofa guidelines.

Proof

(*ex-ante*) and judges (*ex-post*). Whether this shift of control rights from the principal to the legislative and judicial organs is (*Kaldor-Hicks*) efficient can only be measured by empirical research, which falls outside the scope of this paper.

Interesting in this regard, though, is the approach taken in the United Kingdom in the remuneration process of the liquidator. In the United Kingdom it is, in a creditors' voluntary winding up or in a winding up by the court, in principle for the committee of creditors to determine the basis of remuneration. If the committee fails to determine the basis of remuneration or there is no committee, then the basis of remuneration may be fixed by a decision of the creditors by a decision procedure.[64] In fixing the basis of the remuneration, the creditors have the freedom of choice. The basis can be fixed as (a combination of) percentages of the assets which are realized, distributed or both realized and distributed by the liquidator, by reference to the time properly given by the liquidator and the liquidator's staff in attending to matters arising in the winding up or as a set amount.[65] Creditors could, for instance, determine that when bringing a liability claim against the former management, the liquidator is being paid according to a pay-out ratio, according to which the hourly rate is being increased together with the pay-out for the non-secured creditors.[66]

This approach in the United Kingdom is consistent with the approach that is generally accepted in the traditional corporate governance doctrine: the residual owners (shareholders or creditors) have the best interest in aligning the interest of the management (liquidator) with their own and should therefore be able to determine the remuneration of the agent. In other terms, an increase in principal control would reduce the agent conflict costs.

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[64] Insolvency Rules 2016, s 18.20(1)-(3) (hereafter referred to as the "IR2016").
[65] IR2016, s 18.16(2).
[66] Insolad, *Rapport beloning curatoren* (Wolters Kluwer 2008) 28-30; De Leo and Cardinaels (n 32) 571.

It has been noted (*supra*), however, that an increase in principal control not only reduces agent costs, but also increases principal costs.

$$if\ principal\ control\ \uparrow, then\ agent\ costs\ \downarrow + principal\ costs\ \uparrow$$

As a result, an increase in principal control is only (Kaldor-Hicks) efficient if the decrease in agent costs outweighs the increase in principal costs.

$$if\ agent\ costs\ \uparrow < principal\ costs\ \downarrow, then\ principal\ control\ \downarrow = (Kaldor - Hicks) efficient$$

Without declaring ourselves in favor for more or less principal control in the remuneration process of a liquidator, it is submitted that in the United Kingdom mechanisms exist to limit this increase in principal costs.

First, where a liquidator proposes to take all or any part of the remuneration at an hourly rate, the liquidator must, prior to the determination of which of the bases of remuneration are to be fixed, deliver to the creditors a fees estimate and details of the expenses the liquidator considers will be, or are likely to be, incurred.[67] The liquidator is not allowed to draw remuneration in excess of the total amount set out in the fees estimate without approval of the creditors or, in certain circumstances, the court.[68] This rule partially solves the information asymmetry between the liquidator and creditors as well as the aforementioned collective action problem of creditors. In other words, the increase in principal costs is being limited. More efficient principal control leads, for instance, to a larger decrease in the risk of overinvestment (such as bringing excessively long and costly director liability claims) on the part of the liquidator who, after all, in this hypothesis is being paid an hourly rate.[69]

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[67] IR2016, s 18.16(4).

[68] IR2016, s 18.30.

[69] In this regard, see the Shakespeare Martineau presentation at INSOL Europe Academic Forum 2017: C Fitzgerald and T Clench, 'Insolvency Office Holders' Qualification, Regulation, and Remuneration in the UK' in Jennifer L. L. Gant, *Harmonisation of European Insolvency Law* (INSOL Europe 2017) 151, 154-156. See also: E Kempson, 'Review of Insolvency Practitioner Fees' (Report to the

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Second, a series of exceptions exist in case the increase in principal costs (following an increase in principal control) is disproportionally high. The following provisions illustrate this:

- If creditors fail to fix the remuneration in a winding up by the court, that is, the liquidator has requested the creditors to fix the basis of remuneration and the creditors have not done so, or in any event if the basis of remuneration is not fixed by the creditors within 18 months after the date of the liquidator's appointment, Schedule 11 Insolvency Rules 2016 applies. In that case, the remuneration is determined by the court, as a trustee of the general body of creditors, on the basis of percentages of realized or distributed assets (scales).[70] A similar rule exists for the remuneration of liquidators in charge of a voluntary winding up;[71]

- A liquidator who considers the rate or amount of remuneration fixed to be insufficient or the basis fixed to be inappropriate may request the creditors to increase the rate or amount or change the basis or, in certain circumstances (cf. *ultimum remedium*) apply to the court for an order increasing the rate or amount or changing the basis.[72] A similar option to modify the basis is available when there is a material and substantial change in the circumstances which were taken into account in fixing the liquidator's remuneration;[73]

- A secured creditor or an unsecured creditor with either (i) the concurrence of at least 10% in value of the unsecured creditors (including that creditor), or (ii) the permission of the court, may apply to the court on grounds that the remuneration or expenses of the liquidator are excessive;[74]

Insolvency Service, July 2013) <www.bristol.ac.uk/media-library/sites/geography/migrated/documents/pfrc1316.pdf> accessed 4 September 2018.

[70] IR2016, s 18.22.

[71] IR2016, s 18.23.

[72] IR2016, s 18.24-18.28.

[73] IR2016, s 18.29.

[74] IR2016, s 18.34.

Proof

- A special exception exists for administrators whose remuneration has been determined by the committee of creditors and who have applied for an increase in the rate or amount of the remuneration or a change in the basis and subsequently became a liquidator. In that case, the request (by the freshly appointed liquidator) for an increase in the rate or amount of remuneration or a change in the basis may only be made by application to the court.[75]

The United Kingdom's approach demonstrates that the trusteeship strategy in the remuneration process of liquidators as applied in Belgium, the Netherlands and the United States is not the only valid option. Instead, this strategy can be used in combination with principal-empowering strategies. Using the trusteeship strategy as a last resort, that is, when the principal-empowering strategies fail, can possibly contribute to certain efficiency gains. One could think of lower agent conflict costs (since the interest of the agent would normally be better aligned with those of the principal) and lower control costs on the part of the legislators (*ex-ante*) and judges (*ex-post*).

5 Conclusion

Unlike corporate governance, bankruptcy governance is a largely unexplored area. This paper seeks to start the discussion on the topic of good bankruptcy governance and to inspire idealistic researchers to involve in this discussion. Three key aspects of good bankruptcy governance have been dealt with in this paper.

First, an attempt was made to define the concept of "good bankruptcy governance". The view was defended that the internal function of a legal system implementing good bankruptcy governance is to ensure that the management of a financially distressed company, such as a liquidator of an insolvency estate, acts in the best interest of the present and future creditors, including the interest of the structural subordinated shareholders, as the (new) residual owners of that

[75] IR2016, s 18.27.

Proof

firm/insolvency estate. Anecdotal evidence was presented that can be found in recent European legislative evolutions to support this view.

Second, a theoretical model was built, based on the agency-principal costs theory from Goshen and Squire, to identify shortcomings in the current bankruptcy governance system (*de lege lata*). In contrast to Goshen and Squire (whose research primarily focused on corporate law), it was argued that rules implementing a system of good bankruptcy governance should sometimes be mandatory, due to severe contract failures on the part of the (non-adjusting) creditors. Furthermore, the argument was presented that both agent-constraining and principal-empowering control rights are needed to achieve a Kaldor-Hicks efficient bankruptcy governance system.

Third, the model was applied ~~model~~ to the current bankruptcy governance system (*de lege late*), in particular to the personal civil liability and remuneration of the liquidator.

We found that the current Belgian rules concerning liquidators' personal civil liability are inefficient. A liquidator suffers an inherent conflict, that is, extremely high agent conflict costs, when deciding whether to sue himself for mistakes he made during the administration of the insolvency estate. A transfer of the control right to bring liquidator liability lawsuits from the agent to the principal (i.e. creditors) should occur.

The cost-benefit analysis of the rules concerning the remuneration of the liquidator is less clear. Although two different approaches were identified in the level of principal control (trusteeship and principal-empowering strategy) in the four scrutinized legal systems (Belgium, the Netherlands, the United States and the United Kingdom), comprehensive research of the various interconnected bankruptcy governance mechanisms is necessary in order to be able to call one approach superior to the other.

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