



INSOL
EUROPE



Academic Conference
AMSTERDAM
11-12 October 2023

MAIN SPONSOR

EdwinCoeLLP
LAW FIRM


Absolute priority rule dilemmas - case of Slovenia

Jaka Cepec

School of Economics and Business, University of Ljubljana



Academic Conference
AMSTERDAM
11-12 October 2023

MAIN SPONSOR



*The absolute priority rule (APR) is a fundamental rule in corporate bankruptcy law which determines that, in the event of bankruptcy proceeding, all creditors **must be fully satisfied** before **shareholders retain any positions** in the reorganized debtor or are entitled to any payment in liquidation. The rule also states that all senior creditors must be fully satisfied before subordinate any junior creditors can collect outstanding claims.*



Academic Conference
AMSTERDAM
11-12 October 2023

MAIN SPONSOR



APR in

- 1) bankruptcy liquidation;
- 2) financial reorganization of insolvent firms;
- 3) in pre- insolvency (formal) procedures;



Academic Conference
AMSTERDAM
11-12 October 2023

MAIN SPONSOR



- Exemptions from APR as an incentive for prompt initiation of procedures (**Hart, 1999**)
- Different approaches for different kinds (sizes) of firms in need (**Agion et al 1994**;
- Modern scholarship on the absolute priority rule neglects the question of who controls the assets during the reorganization. It also fails to take account of the role that existing manager/shareholders will play in firms that possess going concern value and cannot be resold in the market (**Baird and Rasmussen, 2001**)
- Creditors have the right to be paid from debtor's assets, not debtor's shareholders shares; exceptions from APR are a „price“ to pay for the premium they all get (**Blazy, Chopard; Madus 2021**)
- Exemptions improve risk distribution, reduces moral hazard, reduces pre-insolvency disposal of assets etc. (**Stiglitz, 2001**)
- Deviations have positive *ex ante* effects but negative *ex post effects*. The magnitude is hard to measure. (**Bebchuk, 2002**)
- Economics reality in US favours deviations due to negotiation positions; pre-packs are getting more important; full APR is inconsistent with CH 11 or any sensible system of reorganization (**Baird, Bernstein, 2006**)
- Reorganization is not liquidation. It requires different rules; in reality is fundamentally inconsistent with heartfelt fondness for a strict absolute priority rule (**Luben, 2015**)
- **Classics**: Baird and Jackson (1988); Adler (1992); Skeel Jr (1992), Warren (1992); Aghion (1994); Schwartz, (1994); Adler (1994),
- **and many, many more....**



Academic Conference
AMSTERDAM
11-12 October 2023

MAIN SPONSOR



Different comparative approaches

- US, Germany, England...
 - APR rule (specially for cram – down)
 - „**contractual exemptions**“ (majority within the class of creditors is sufficient)
 - APR not used in small Business reorganizations (subchapter V. of Ch11)
- On the other hand... many EU jurisdictions still have not provided for the ability of a restructuring plan in proceedings of insolvency companies to infringe shareholders rights.



Academic Conference
AMSTERDAM
11-12 October 2023

MAIN SPONSOR



Case of Slovenia

Institutional background

- Upon insolvency, insolvent firm can either attempt reorganization or pursue liquidation
- Creditors cannot force the debtor into liquidation
- Reorganization proceedings typically initiated by the debtor
- Any insolvency filing triggers the automatic stay rule
- Conventional reorganization plan: the reduction and/or the postponement of repayment of debt held by **ordinary unsecured** creditors; Equity holder position remains untouched.



INSOL
EUROPE



Academic Conference
AMSTERDAM
11-12 October 2023

MAIN SPONSOR



- The 2011 reform
 - Minimum payment requirements for debtor in the reorganization plan
- The 2014 reform
 - introducing a mandatory APR rule and a „mandatory“ DtoE conversion
 - Splitting the under secured part of secured claims
 - a possibility of postponing payments for secured creditors and lower the interest rates
 - Enabling creditor-initiated insolvency reorganizations



INSOL
EUROPE

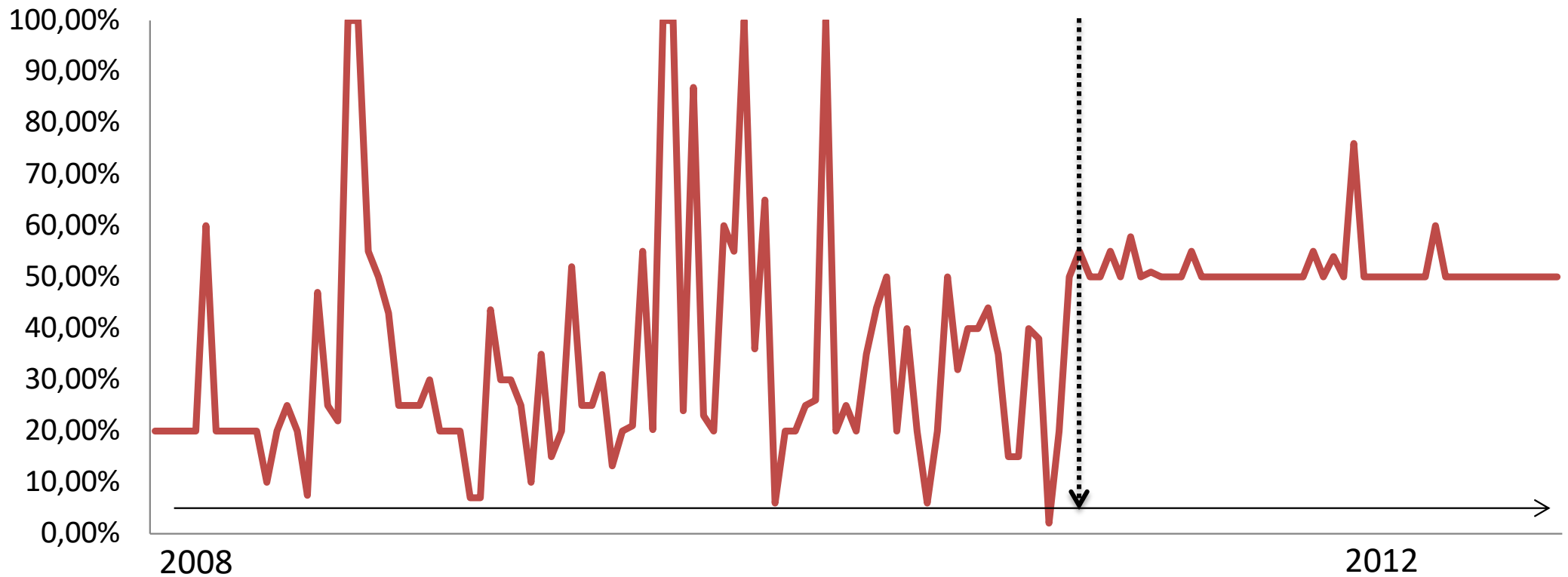


Academic Conference
AMSTERDAM
11-12 October 2023

MAIN SPONSOR



Case 1: Consequence of minimum repayment requirements





INSOL
EUROPE



Academic Conference
AMSTERDAM
11-12 October 2023

MAIN SPONSOR



APR

	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
stečajni	595	941	1302	1154	1228	1316	1155	1110	950	902	859
PP	40	45	39	15	11	12	9	11	11	6	2
PPP	3	99	105	108	100	38	26	35	27	26	16
v %	7%	13%	10%	10%	8%	4%	3%	4%	4%	3%	2%

ZFPPIP- G

On the other hand... (Cepec, Grajzl, 2020):

Out of 250 analyzed firms (2008 to 2018):

- 143 got a confirmed plan, only 54 survived until 2019
- In summary: 185 out of 250 firms were not successful (75 %)
- DtoE swap is associated with reduced prospects of post – bankruptcy failure)

Explanatory variable	(1)	(2)	(3)	(4)	(5)	(6)
Debt-to-equity conversion	0.443***	0.459***	0.442***	0.438**	0.436**	0.449**
Controls						
Joint-stock company		1.129	1.106	1.080	1.079	1.418
Firm age (in years)		0.997	0.996	0.997	0.997	0.988
Foreign owned		0.914	0.921	0.959	0.936	0.865
Ownership concentration		1.484	1.501	1.436	1.432	1.355
Log assets			1.012	1.093	1.094	1.074
Leverage			1.074	1.090	1.094	1.152*
Liquidity			1.092	1.180	1.176	1.283
Return on assets			0.994	0.991	0.996	1.047
Creditor initiated proceedings				0.758	0.746	1.306
Log unsecured ordinary claims				0.981	0.976	1.001
Log unsecured priority claims				0.978	0.977	0.973
Log secured claims				1.004	1.005	1.001
Log excluded claims				1.018	1.018	1.018
Log number of creditors				0.974	0.964	0.986
Proposed percent repayment of ordinary unsecured creditors				1.000	1.000	1.009
Proposed months for repayment of ordinary unsecured creditors				1.024*	1.025*	1.029*
Estimated percent repayment of ordinary unsecured creditors if liquidation				0.980**	0.980**	0.978**
Length of proceedings (in months)				0.972	0.971	0.961
Management turnover before proceedings					1.044	0.874
Management turnover during proceedings					1.202	1.135
Fixed effects						
Industry FE	No	No	No	No	No	Yes
Size classification FE	No	No	No	No	No	Yes
Court FE	No	No	No	No	No	Yes
Trustee proceeding FE	No	No	No	No	No	Yes
Year of filing FE	No	No	No	No	No	Yes
Failures	152	152	152	152	152	152
Observations	206	206	206	206	206	206
Log pseudolikelihood	-713.2	-712.1	-710.9	-702.7	-702.5	-688.7



Academic Conference
AMSTERDAM
11-12 October 2023

MAIN SPONSOR



Conclusion

- The debate about pro&cons of APR rule is by far not over yet
- Many countries have still different understandings of how to implement the APR rule
- The EU Directive on restructuring and insolvency has opened additional questions and interests in the APR rule
- (Wrong) adoption of the APR rule can have very adverse results.