
Bankruptcy Law Severity for Debtors: Comparative Analysis Among Selected Countries*

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Abstract:

Purpose: The objective of this paper is to propose the new indicator of bankruptcy law severity for debtors (BLSI-Bankruptcy Law Severity Index). On the basis of this index we conducted comparative analysis of debtor/creditor friendliness of bankruptcy laws among 27 selected countries.

Design/Methodology/Approach: In the research the following methods were used: analysis of legal acts, literature review and expert method.

Findings: The empirical results show that the most debtor-friendly bankruptcy and restructuring laws are those of the USA, Ireland and Canada. At the opposite pole were Slovenia, Australia and Austria. It can also be noted that many EU countries have a similar level of BLSI measure, which is most likely a consequence of harmonisation activities undertaken within the Community.

Practical Implications: The conducted research enables us to propose the direction of changes in bankruptcy and restructuring laws in the next stage.

Originality/value: On the basis of proposed BLSI, we will be able to examine the relationship between the severity of bankruptcy law and innovation, entrepreneurship and the level of development of financial markets in the studied countries.

Keywords: Bankruptcy, Law & Economics, law severity, institutional economics.

JEL classification: G33, K22

Paper Type: Research study.

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1. Introduction

Failure to conduct business activity is a mechanism permanently inscribed in the functioning of market economies. One can even say that it is their distinctive feature. According to Schumpeter's concept (Schumpeter, 1942; 1982) called creative destruction, it is even a desirable and normal element. They influence the development of entrepreneurship and innovation. Moreover, the previous research also shows that entrepreneurs who previously declared bankruptcy acquire certain experience, start up again and run businesses successfully (Stam, Audretsch and Meijaard, 2008). It is a form of learning through the acquisition of knowledge and experience. However, it is important to be aware that the stigmatisation of unsuccessful entrepreneurs leads to limiting their returns to entrepreneurial activities and the setting up of new businesses by them (Simmons, Wiklund and Levie, 2014).

The institution of bankruptcy plays a very important role in the process of entrepreneurs' insolvency. Due to the often large number of stakeholders representing different interests, it is difficult in many cases to conduct bankruptcy proceedings on market terms. Therefore, for many years now, such proceedings have been regulated by law and are often judicial in nature. There is also an ongoing discussion as to whether the models of bankruptcy law should be more or less restrictive towards the so-called honest debtors who were unsuccessful in business. In our opinion, the type of bankruptcy law model, as well as the efficiency of the judiciary system in the area of bankruptcy and restructuring proceedings through the barriers blocking market entry and exit, have a significant impact on the level of entrepreneurship and innovation. For example, in the United States, where bankruptcy law is considered to be one of the best in the world (Jackson and Skeel, 2013), the level of acceptance of failure, and consequently, of willingness to take risk is much higher than in European countries. This is related, among other things, to the bankruptcy law, which is less restrictive for debtors, and which enables a second chance policy. As a result, entrepreneurs are less afraid of failure and can start a new business relatively quickly after bankruptcy proceedings. Such a model also serves innovation more effectively, as entrepreneurs get more opportunities to create new ideas and solutions. Financial failure when introducing new ideas to the market does not disqualify them for years. It is often only a transitional stage at which they acquire experience and knowledge, and this in many cases contributes to the business success achieved at a later stage.

Based on i.a. American solutions the European Commission started to promote and implement activities aimed at implementing second chance policies and increasing the effectiveness of bankruptcy proceedings in member states in the 21st century. These proposals were reflected in the following documents and legal acts: *Overcoming the stigma of business failure - for a second chance policy. Implementing the Lisbon Partnership for Growth and Jobs (2007); Think Small First. A Small Business Act for Europe (2008); Business Dynamics: Start-ups, Business Transfers and Bankruptcy. The economic impact of legal and*



administrative procedures for licensing, business transfers and bankruptcy on entrepreneurship in Europe (2011); Report of the Expert Group: A Second Chance for Entrepreneurs: Prevention of Bankruptcy, Simplification of Bankruptcy Procedures and Support for a Fresh Start (2011); Commission Recommendation of 12 March 2014 on a new approach to business failure and insolvency (2014); Entrepreneurship 2020. Action Plan. Reigniting the entrepreneurial spirit in Europe (2013); Directive (EU) 2019/1023 of the European Parliament and of the Council of 20 June 2019 on preventive restructuring frameworks, on discharge of debt and disqualifications, and on measures to increase the efficiency of procedures concerning restructuring, insolvency and discharge of debt (2019).

This shows how important and valid this socio-economic problem is. To broaden our knowledge in this area, which is part of the Law and Economics research, we proposed to build a Bankruptcy Law Severity Index for Debtors, based on which the friendliness of bankruptcy law towards debtors can be assessed. Compared to several previous attempts to classify legal systems as more or less debtor-friendly, this measure contains more criteria and is quantifiable. Moreover, over time, bankruptcy laws evolve, mainly towards more debtor-friendly ones, therefore it is necessary to update this type of research. At the next stage, we conducted a comparative analysis of the value of this index in the selected EU countries as well as in the USA, Canada and Australia, which was the main objective of the research. The example of the United States was used as the basic benchmark for EU countries, and two other developed countries with extensive experience in the field of bankruptcy law, Canada and Australia, were also selected to enrich the analysis. The following research methods were used: analysis of legal acts, literature review and expert method. In addition to the introduction, the article contains an analysis of the literature; description and results of the research and conclusions.

2. Literature Review

Legal solutions for insolvent debtors date back many years B.C. and were originally very restrictive and even draconian for them. In many cases, prison sentences, slavery and even the death penalty were practised. It was unimportant whether the debtor fell into debt as a result of fraud or it was a consequence of business failures or random incidents. Over time, the approach to legal solutions related to insolvent persons has changed. The enforcement was carried out not against the person of the debtor but against his or her property. Moreover, following the example of the current bankruptcy proceedings, they began to have a collective character, i.e. one bankruptcy proceeding replaced several individual enforcement proceedings (Levinthal, 1918; White, 1977). As a result of the evolution of bankruptcy law, it has increasingly become more debtor-friendly. For example, in the UK, early in the 18th century, regulations that enabled debt reduction for debtors cooperating with the court, were introduced. This was due to a change in the approach to insolvency. Insolvency began to be treated as a condition that could result from the debtor's ineptitude and not as a crime.

On the other hand, however, the penalties for those debtors who refused to cooperate with the court were increased. Lack of cooperation was even punishable by the death penalty (Di Maritino, 2006). In the United States, which is often cited as an example of a country with one of the most efficient and debtor-friendly bankruptcy systems in the world, the first bankruptcy law was officially enacted in 1800 and was practically a copy of the regulation then in force in the United Kingdom (Tabb, 1995). Subsequent legal acts amending the previous ones were adopted in 1841, 1867 and 1898 respectively. The bankruptcy law of 1841 was a breakthrough since for the first time it was a voluntary procedure in which the debtor himself/herself could apply for bankruptcy proceedings.

Moreover, the law provided for the possibility to reduce some part of the debt. The legal act of 1867 was the first in the world to provide for the declaration of bankruptcy of enterprises, while the bankruptcy law of 1898 introduced an arrangement procedure enabling reorganisation of enterprises (Delaney, 1998). Modern bankruptcy law was formed in the 19th and early 20th century. In addition to the above-mentioned solutions, Piasecki (1999) gives a special role to three acts regulating the issue of bankruptcy, namely the French Commercial Code, the Reich Insolvency Ordinance of 1877 and the Austrian Insolvency Ordinance of 1914. In addition to the countries mentioned above, significant changes in the shaping of insolvency law took place in other countries, such as Belgium, Scotland, Ireland, Canada, Australia, Denmark, Finland, Hungary, Italy, the Netherlands, Norway, Portugal, Russia, Spain, Sweden, Switzerland (Sgard, 2006; Brown, 1900). With the evolution of the bankruptcy law, the following directions of changes can be observed:

1. Lenient treatment of debtors and enabling them to start again and allow them to set up a new business.
2. Limitation or lack of penalties for debtors cooperating with the court.
3. The occurrence of a voluntary application for the introduction of arrangement or recovery proceedings in many countries. This voluntariness provides the debtor with the right to apply, on his/her initiative, for the opening of arrangement or recovery proceedings. As for the application for the opening of bankruptcy proceedings, however, it is usually forced.
4. Possibility of reducing part of the debt, paying in instalments or postponing the payment of the debt as a result of the approval of the agreement with the creditors.
5. In many countries, separation of the bankruptcy law regulating the bankruptcy of enterprises and the bankruptcy law concerning the insolvency of natural persons.
6. In addition to the general bankruptcy of enterprises, the insolvency law also provides for the regulation of specific activities such as banking and insurance activities, as well as the regulation concerning the bankruptcy of groups of companies and entities with assets in more than one country (the so-called cross-border bankruptcies).



7. Promoting activities aimed at keeping the debtor's business by reorganising it or selling it in its entirety, rather than ending the business by selling it in parts.
8. Enabling out-of-court bankruptcy proceedings, which usually take the form of an agreement between the creditors and the debtor. Depending on the country, these types of proceedings may or may not be controlled by the court.
9. Introduction of the so-called prepacked proceedings, i.e. out-of-court proceedings enabling the conclusion of an agreement between a debtor and creditors on the future of an insolvent company even before the commencement of judicial bankruptcy or restructuring proceedings.

Despite some universal directions of change, the bankruptcy laws of individual countries still show many different features. The main criterion differentiating them is the friendliness of regulations towards debtors and creditors. Therefore, in the subject literature, a distinction is made between legal systems that are more debtor- or creditor-friendly and the so-called hybrid systems. One of the first information and research aimed at separating bankruptcy systems friendly to debtors from those creditor-friendly was presented by P.R. Wood (1995), Q. Hussain and C. Wihlborg (1999), E. Berglöf, H. Rosenthal and E.L. von Thadden (2001), R.R. Bliss (2003), M. Falke (2003), G. Recasens (2004), S. Franken (2004), C. López-Gutiérrez, M. Olalla García and B. Torre Olmo (2005). In these publications, the authors both presented criteria that differentiate the two systems and attempted to qualify some countries as bankruptcy systems with regard to their friendliness to debtors and creditors. However, the classification of countries into individual bankruptcy regimes concerned a relatively small number of countries, apart from the research conducted by Z.R. Azar (2007), who proposed PDI (pro debtor index) and PCI (pro creditor index) and based on several criteria and data from 2003 assigned 50 countries to more or less debtor or creditor-friendly systems.

Based on the achievements so far, it is possible to distinguish the basic criteria differentiating the two types of systems. In debtor-friendly bankruptcy systems, the choice of reorganisation is more common than that of liquidation. These systems are often accused of treating creditors worse than debtors, and managers of an insolvent business unit are more often left in power after bankruptcy than in creditor-friendly systems. This is based on the assumption that managers know the problems of an insolvent company better and they should be left in charge. Therefore, the Absolute Priority Rule (APR) is often violated in this model. Importance in this approach is also attached to social issues, i.e. preserving jobs. An important criterion differentiating the two systems constitutes also the giving of preference to new sources of financing for a bankrupt debtor. This is to contribute to the maintenance of the activity within the business unit. Besides, R.R. Bliss (2003) points out to the fact that this system gives the possibility of protecting one's claims through the conclusion and implementation of the so-called ex-ante reciprocal agreements (e.g.



secured contracts, i.e. with collateral security and netting agreements - mutual compensation of claims with liabilities).

In opposition to the above concept, the system promoting creditor assumes the best possible protection of creditors, removal of existing managers from the management of the company because they are blamed for financial problems, liquidation of the company because reorganisations have little effect and it often happens that companies, after unsuccessful restructuring processes, return to the path of liquidation proceedings, which generates high costs. Other differences concern the regulation of the possibility of deciding to accept or reject the reorganisation plan, creditors' voting on the plan and the so-called automatic stay, which is connected with e.g. lack of charging penal interest on liabilities, suspension of court enforcement, etc. as a result of bankruptcy. This system usually ignores reciprocal agreements because they favour one creditor over another. On the other hand, however, it supports the creation of the so-called groups of privileged claims, which, after all, violate the division of claims established before the declaration of bankruptcy.

3. Empirical Evidence

3.1 Methodology

Based on the analysis of the literature, it was established that bankruptcy law plays a vital role in the economy. It constitutes one of the factors that influence, e.g. growth in entrepreneurship, innovativeness and thus, economic development. The issue connected to it was noticed in the EU countries and steps to implement the equal opportunities policy have been taken, this included, e.g. proposing directions for changes in national and EU bankruptcy laws. Therefore, it is crucial to evaluate and compare bankruptcy laws. For this reason, a comparative analysis of the friendliness/severity of bankruptcy law for debtors was assumed as the aim of this study. The research sample included EU countries (Austria, Croatia, Estonia, Finland, Greece, Lithuania, Latvia, Sweden, Germany, Bulgaria, the Czech Republic, France, Spain, Poland, Portugal, Romania, Slovakia, Slovenia, Hungary, Denmark, the Netherlands, Ireland, Italy), the United Kingdom (small EU countries and countries for which the authors were unable to obtain information about the bankruptcy law were not included) and the United States, Canada and Australia. The United States was assumed in this study as a benchmark, as this country is considered to have one of the best and most debtor-friendly bankruptcy laws in the world (Jackson and Skeel, 2013). Apart from the USA, the countries that rank high in the Resolving Insolvency ranking (Doing Business Report 2020), namely Australia and Canada were also included in the comparison. In Australia, similarly to the USA, common law is in force, while in Canada, both common and civil law is in force. The legal status of the end of 2019 was taken into account.



The comparative analysis was conducted using a quantitative method. To achieve the aim, a BLSI (Bankruptcy Law Severity Index for debtors) measure was developed, the value of which is between 0 and 1:

- 0 – debtor-friendly bankruptcy law,
- 1 – bankruptcy law severe (unfriendly) for debtors,

BLSI is the arithmetic average of grades of the individual criteria included in the index. The authors did not decide to weigh the grades, as this could disturb the comparison by including subjectivity. The criteria were established based on literature analysis, experience and knowledge of the authors of the study. The first group of criteria, for which the grade range is <0;3>. The general evaluation principle was adopted, i.e.:

- 0 – solutions very beneficial for the debtor,
- 1 – significant number of solutions beneficial for the debtor,
- 2 – a few solutions with no significance for the debtor,
- 3 – proposed solutions are unfavourable for the debtor or there are no beneficial solutions for the debtor in this area of regulations.

In order to implement these principles taking into account their specificity and objectivity, for each criterion, detailed rules have been proposed.

1. Any kind of sanctions concerning debtor on account of carrying out bankruptcy proceedings, e.g. for failure to file a bankruptcy petition in due time or for the debtor's lack of cooperation with the court (criminal, civil law, administrative). The more such sanctions are imposed and the more severe they are for the debtor, the more severe the law is for them. In some analysed countries, there is the obligation to file a bankruptcy petition and a due date set. The obligation to file a petition and to set a due date indicates the severity of the law for debtors. The sanctions imposed for failure to file a bankruptcy petition in due date aggravate unfriendliness of the law for debtors. The law in the countries, where there are only sanctions for a debtor's actions unrelated to the failure to comply with the due date for filing a bankruptcy petition, e.g. for failure to cooperate with the court, are to be considered less severe for debtors.

Detailed evaluation criteria:

- 0** – liability only for debtor's actions not related to not filing a bankruptcy petition, excluding criminal liability.
- 1** – liability only for debtor's actions not related to not filing a bankruptcy petition, including criminal liability,
- 2** – civil or criminal liability for damage arising from not filing a bankruptcy petition,
- 3** – civil and criminal liability for damage arising from not filing a bankruptcy petition.



2. Existence of different procedures for restructuring (concerning greater or lesser involvement of the court in restructuring proceedings). The more such procedures, the more debtor-friendly the law is. It is then possible to choose the most appropriate for the situation bankruptcy proceeding.

Detailed evaluation criteria:

0 – bankruptcy law separated from restructuring law. More than three restructuring procedures,

1 – bankruptcy law separated from restructuring law. One or two restructuring procedures,

2 – only one bankruptcy law including several restructuring procedures,

3 – only one bankruptcy law including one restructuring procedure.

3. Regulations on releasing from debt after the completion of bankruptcy or restructuring proceedings (period, conditions, type of entities to which possibility of realising from debt apply). The greater the chances of releasing from debt and the shorter the time that it might take to execute it, the more debtor-friendly the law is.

Detailed evaluation criteria:

0 – automatic releasing from debt, both for natural persons and entrepreneurs after completion of bankruptcy proceedings, with no additional conditions,

1 – automatic realising from debt for natural persons and/or entrepreneurs provided that specified in the law conditions are fulfilled,

2 – no automatic releasing from debt for either natural persons and entrepreneurs after the completion of bankruptcy proceedings. However, after fulfilling specified in the law conditions, automatic releasing from debt is possible for both natural and legal persons,

3 – no releasing from debt for either natural persons and entrepreneurs after the completion of bankruptcy proceedings.

4. Regulations concerning leaving the current management board or debtor-managed (understood as a person managing business activity) in the event of opening bankruptcy or restructuring proceedings (debtor in possession). The more favourable the regulations for leaving the current debtor on managing position, the less severe they are for them; and if they are to encourage the court or creditors to appoint a new management board, e.g. in the form of licensed receivers or managers, the more severe they are for the debtor.

Detailed evaluation criteria:

0 – concerning both bankruptcy and restructuring proceedings, the court leaves company management to the debtor,

1 – concerning bankruptcy proceedings, the court may leave the management to the debtor under supervision, and in restructuring proceedings, the court leaves the management to the debtor,

2 – concerning bankruptcy proceedings, the court takes the management away from the debtor, and in restructuring proceedings it leaves the management to the debtor under supervision,



- 3** – concerning both bankruptcy and restructuring proceedings, the court takes away from the debtor the right to manage the company and transfers it to other entities.
5. Rules of voting among creditors on a restructuring plan or arrangement and the occurrence of the so-called cramdown. The more restrictive, requiring a large majority of votes for the approval of restructuring proceedings or arrangement the law is, the more severe it is for the debtor. The occurrence of a cramdown, i.e. the possibility of accepting the arrangement or restructuring proceedings over the objection of some classes of creditors, including secured creditors, favours the debtor.

Detailed evaluation criteria:

0 – The voting majority (calculated based on the value of claims and/or the number of creditors) for the plan is 1/2 or less. In the case of voting in groups, there is a possibility of accepting the restructuring plan if some creditor groups have voted against the restructuring plan. There is a possibility of initiating a cramdown procedure,

1 – The voting majority (calculated based on the value of claims and/or the number of creditors) for the plan is 6/10. In the case of voting in groups, there is a possibility of accepting the restructuring plan if some creditor groups have voted against the restructuring plan, under certain conditions. There is a possibility of initiating a cramdown procedure,

2 – The voting majority (calculated based on the value of claims and/or the number of creditors) for the plan is at least 2/3. In the case of voting in groups, there is a possibility of accepting the restructuring plan if one group of creditors have voted against the restructuring plan, under certain conditions. There is a possibility of initiating a cramdown procedure to a limited extent,

3 – The voting majority (calculated based on the value of claims and/or the number of creditors) for the plan is at least 3/4. In the case of voting in groups, all groups have to secure a majority that allows accepting the restructuring plan. There is no possibility of initiating a cramdown procedure.

The second group of criteria, for which the grade range is <0;1>:

0 – regulations that favour debtors exist;

1 – no regulations that favour debtors.

1. Suspension of bankruptcy proceedings in the case of applying to open restructuring proceedings. The existence of this ground is debtor-friendly, i.e. the law is less severe for the debtor.
2. Special procedures for bankruptcy or restructuring proceedings, in particular for entities from the small and medium-sized enterprises (SME) sector. The existence of such procedures makes the law less severe for debtors.
3. The regulation concerning so-called pre-pack – prepared liquidation, sale of a bankrupt's enterprise with no necessity of carrying out activities required in bankruptcy proceedings, it can be initiated before initiation of bankruptcy



- proceedings (whether there is a possibility of initiation of such procedure and whether there are any limitations to its application). The fewer restrictions and the existence of regulations concerning pre-pack make the law more debtor-friendly.
4. New financing – a new loan in a form of preferential claim and the possibility of converting the claim into shares. The existence of such possibility of new financing is more debtor-friendly, lack of it or insignificant possibilities indicate the severity of the law for the debtor.
 5. Deadline for filing a bankruptcy petition. The longer the time for filing a bankruptcy petition from the moment of the occurrence of circumstances, the more friendly the law is to the debtor.

A team of 3 people (authors of the study), who have knowledge and experience in research of bankruptcy, was appointed to evaluate the individual criteria. Based on the collected data, each of these 3 people evaluated individual bankruptcy and/or restructuring laws according to the given criterion. Each of the authors assigned a grade, based on the indicated range, to each criterion and the minimum change of variable was set at 0.5 (intermediate grade – a regulation is more severe for the debtor than the one from a lower grade and less severe than the one from a higher grade). Unlike many previous studies, the evaluation for all countries included in the study was carried out by each member of the research team. Comparing bankruptcy regulations based on evaluations by another person for each country may cause some problems concerning subjectivity. In the next step, the arithmetic average of grades given by each researchers for each criterion was determined. It allowed, to some extent, to objectivize the analysis, as it was not based solely on the evaluation of individuals. For each criterion, normalisation has been made, so that the final evaluation is within 0 - 1. Normalisation consisted in dividing the arithmetic average of grades by the maximum level. In addition to an aggregated evaluation of severity/friendliness of bankruptcy and restructuring laws for debtors, these actions also allow for the comparison of bankruptcy and restructuring laws concerning individual criteria.

3.2 Results

The results obtained based on the conducted research are presented in Tables 1. and 2. as well as in Figure 1. In table 1 the averaged results for the analysed countries on basis of experts' indications for individual criteria included in the BLSI measure are presented. Table 2. contains normalised results and BLSI measure values for the analysed countries. In Figure 1 BLSI for each country, concerning the median, and centre values of BLSI measure, which range is $<0;1>$, were compared. This centre value, i.e. 0.5 marking the line between countries with more or less debtor-friendly bankruptcy and restructuring laws.

The research shows that countries characterized by low BLSI (below 0.5), i.e. the ones with more debtor-friendly bankruptcy and restructuring law are: Canada (0.24),



France (0.38), Greece (0.41), Ireland (0.26), Italy (0.38), Lithuania (0.40) and the United States (0.18), example of which other countries can follow. Countries with high BLSI (above 0.5), i.e. with less debtor-friendly bankruptcy and restructuring law are: Australia (0.71), Austria (0.73), Croatia (0.68), Czech Republic (0.67), Denmark (0.56), the United Kingdom (0.54), Estonia (0.56), Finland (0.58), Germany (0.64), Hungary (0.70), Latvia (0.55), the Netherlands (0.58), Portugal (0.66), Romania (0.57), Slovakia (0.56), Slovenia (0.81) and Sweden (0.60). Poland (0.50) and Spain (0.50) are on the line between countries with less and more debtor-friendly bankruptcy and restructuring laws.

The analysis of the research results show that BLSI index for most countries is between 0.30 and 0.70. Including: Lithuania (0.40), Greece (0.41), Spain (0.50), Poland (0.50), the United Kingdom (0.54), Latvia (0.55), Denmark (0.56), Estonia (0.56), Slovakia (0.56), Romania (0.57), Finland (0.58), the Netherlands (0.58), Sweden (0.60), Germany (0.64), Portugal (0.66), Czech Republic (0.67), Croatia (0.68) and Hungary (0.70). In many of the above-mentioned countries, the index of severity of bankruptcy and restructuring law is around 0.50. Including: Spain (0.50), Poland (0.50), the United Kingdom (0.54), Latvia (0.55), Denmark (0.56), Estonia (0.56), Slovakia (0.56), Romania (0.57), Finland (0.58), the Netherlands (0.58). Countries with BLSI between 0.30 and 0.70 are members of the European Union.

The countries with the most debtor-friendly bankruptcy and restructuring laws, low BLSI (below 0.30) are: the United States (0.18), Canada (0.24) and Ireland (0.26). Factors affecting low BLSI index:

1. No obligation on the part of the managers to file a bankruptcy petition of the entrepreneur, and thus there are no possible sanctions for failure to file a petition within the set time limit.
2. Priority of restructuring over bankruptcy. In the case of filing a restructuring or bankruptcy petition, the court examines a restructuring petition first.
3. Possibility of automatic releasing from debt after completion of bankruptcy or restructuring proceedings.
4. Possibility to initiate special procedures concerning bankruptcy or restructuring proceedings for small and medium-sized enterprises.
5. Prepack - prepared liquidation.
6. Possibility of new financing and privileges for creditors granting loans during restructuring proceedings.

Countries with the least debtor-friendly bankruptcy and restructuring laws, with high BLSI (above 0.70) are: Australia (0.70), Austria (0.73) and Slovenia (0.81). Factors affecting high BLSI index:

1. Regulations concerning the obligation and deadline for filing a bankruptcy petition and the time set for filing a petition.
2. No priority for restructuring over bankruptcy.



3. A small number of available restructuring procedures.
4. No possibility to initiate special procedures concerning bankruptcy or restructuring proceedings for small and medium-sized enterprises.
5. No pre-pack - prepared liquidation.
6. No possibility of new financing and privileges for creditors granting loans during restructuring proceedings.

Regulations concerning the obligation to file a bankruptcy petition and the time set for filing it are factors affecting BLSI index significantly (the longer the deadline, the more lenient the bankruptcy law is for the debtor). If the bankruptcy law provides for an obligation on the part of managers to file a bankruptcy petition and a deadline for filing it, sanctions for failure to comply are automatically included in the legal regulations. It can include sanctions provided for in both civil and criminal law. The significant impact of these regulations on the BLSI index stems from the fact these two factors were taken into account when evaluating the severity of bankruptcy and restructuring laws.

For example, in countries with a low BLSI index, i.e. in the United States, according to the bankruptcy law, there is no obligation for members of the management board to file for bankruptcy. Members of the management board will not be held responsible if they continue to conduct the company's affairs, even if they knew or, using their best efforts, could have predicted that the company was/would become insolvent. Members of the management board are only obliged to conduct the affairs of the company with due diligence, taking into account the best possible interest of all stakeholders (as a result of failure to meet this obligation, the member of the management board may be subject to civil liability). Similarly, in Canada, there is no obligation under bankruptcy law for members of the management board to file for bankruptcy. Members of the management board are obliged to conduct the company's affairs with due diligence, taking into account the best possible interest of the company (and only the company, as the management board is not obliged to act in the interest of creditors, shareholders or other interested parties, even if a state of insolvency arises).

Therefore, where there is a conflict between the interests of the company and those of creditors, members of the management board are obliged to act in the best interests of the company. In Ireland, bankruptcy law does not provide for an obligation to file for bankruptcy (there is no formal requirement to file for bankruptcy within a certain period); moreover, members of the management board do not even have a *legal standing* to file a bankruptcy petition. However, they do have the legal standing (but not an obligation) to file for the appointment of an administrator ("examiner") to a company that is insolvent or at risk of insolvency. If members of the management board know or should, using their best efforts, anticipate that the company will become insolvent, they are obliged to take actions for the benefit of creditors aimed at minimising potential losses, i.e. to maintain the existing liquidity.



In countries with a high BLSI index (Australia, Austria and Slovenia), bankruptcy law provides for an obligation to file for bankruptcy. In Australia, the law prohibits companies from conducting business in the state of insolvency. Directors who do not prevent the company from indebtedness in a state of insolvency face civil and criminal liability. They may also be required to pay compensation. In Austria, in the event of a lack of liquidity or over-indebtedness, the debtor is obligated to file for the initiation of insolvency proceedings without culpable delay, but in no case later than 60 days after the occurrence of the debtor's lack of liquidity and/or over-indebtedness. If the debtor and/or the management board of the debtor does not file for bankruptcy within the required deadline, they become personally liable to the creditors for any damage resulting from the delay in filing a bankruptcy petition to the court. In Slovenia, in the event of a company's insolvency, the management board submits a report to the Supervisory Board on the possibility of financial restructuring within one month of insolvency. The Supervisory Board issues an opinion within 5 days and communicates it to the Management Board. The Management Board, in turn, has 3 days to file a bankruptcy petition if the opinion on the condition of the company indicates that such petition is justified.

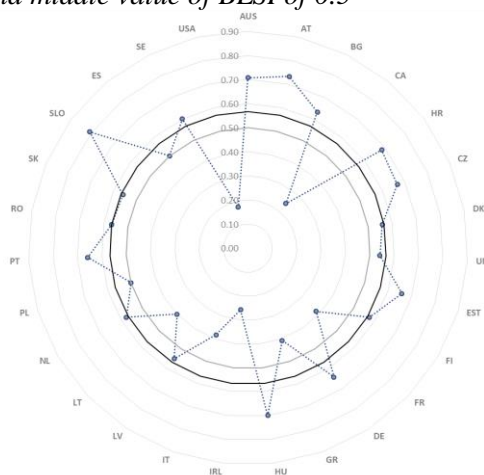
Taking into account the components of the BLSI measure, the most important conclusions are as follows:

1. Sanctions for failure to file for bankruptcy within a specified period or for failure to cooperate with the court are still high in many countries.
2. An increasing number of countries offers the possibility of suspending the bankruptcy proceedings in favour of the implementation of restructuring proceedings, which should be viewed positively.
3. The number of possible restructuring paths is still relatively small in many countries. It should be noted that their number does not always translate into the effectiveness of the proceedings. On the one hand, the more methods of conducting restructuring proceedings, the more appropriate restructuring path can be chosen by the debtor. On the other hand, the knowledge and experience of administrators and bankruptcy judges, as well as their ability to cooperate with stakeholders (mainly debtors and creditors), are often the decisive factors for the success of restructuring.
4. Relatively many countries offer no simplified procedures for smaller businesses. It seems that such proceedings should be adopted in the bankruptcy law as they reduce the costs of conducting them and, due to lower requirements, make them easier for debtors to conduct.
5. A growing number of countries have introduced regulations concerning pre-pack proceedings, which should be assessed positively.
6. In many countries, a debtor may be released from outstanding debts in the framework of bankruptcy proceedings, although it is often subject to various restrictions. It is only automatic in a few countries.



7. In many countries, the debtor can continue managing the company, but mainly after the restructuring proceedings have been initiated and often under the supervision of a supervisor.
8. A positive feature is that more and more countries are introducing regulations to give preference to new financing of entities conducting restructuring proceedings. This is aimed at contributing to the success of these activities and keeping companies on the market.
9. In many countries, the law indicates a specific time limit for initiating bankruptcy proceedings if a specific premise occurs. However, it should be noted that there are also relatively many countries in which this rule has been abandoned.
10. As far as the rules of voting and acceptance of an arrangement by creditors are concerned, they are generally similar and there are relatively small differences.

Figure 1. Comparison of the BLSI measure values for the analysed countries and against the median and middle value of BLSI of 0.5



Source: Authors' own study.

4. Conclusions

The measure we proposed allowed us to compare bankruptcy and restructuring laws of the countries from the point of view of their friendliness/severity towards insolvent debtors.

The greatest friendliness of the law towards debtors was observed in the USA, Ireland and Canada. Among the EU countries, there are still differences in bankruptcy and restructuring laws and it can be seen that measures are being taken to reduce them, for example through the introduction of legal instruments such as directives. Thus, the last Directive (EU) of the European Parliament and the Council of 20 June 2019 on preventive restructuring frameworks, on the discharge of debt



and disqualifications, and on measures to increase the efficiency of procedures concerning restructuring, insolvency and discharge of debt, and amending Directive (EU) 2017/1132, so called Directive on restructuring and insolvency (2019), points out and recommends that the differences between the EU countries' regulations on preventive restructuring should be balanced. In the opinion of the European Union, differences between the Member States with regard to the procedures concerning restructuring, insolvency and discharge of debt translate into additional costs for investors when assessing the risk of debtors getting into financial difficulties in one or more Member States, or the risk associated with investing in viable companies in financial difficulties, as well as costs related to the restructuring of companies whose establishments, creditors or assets are located in the other Member States. The results of the survey indicate relatively small differences in the severity of bankruptcy and restructuring law between the majority of Member States participating in the study. However, several countries still exhibit the characteristics of countries with creditor-friendly law and show little focus on restructuring activities.

Preliminary observation of data on the effectiveness of bankruptcy law, resulting from the annual reports of the World Bank, in comparison with the BLSI measure in the countries studied, shows that the level of BLSI is not related to the effectiveness of bankruptcy law, calculated in terms of the recovery rate for creditors. Research shows that in countries with the lowest BLSI, i.e. the most debtor-friendly countries, the recovery rate for creditors is as high as in countries with the highest BLSI, i.e. the least debtor-friendly countries. Thus, in the countries with the lowest rates of the severity of bankruptcy and restructuring laws, the average recovery rate for creditors in 2010-2020 was 88% in the USA, 95% in Canada, 94% in Ireland, while in the countries with high severity rates, the recovery rate was 87% in Australia, 85% in Austria and 73% in Slovenia (Doing Business Data).

Therefore, the conclusion of the research is positive. The introduction of solutions in the bankruptcy and restructuring law that favour debtors do not have to translate into the deterioration of creditors' rights in these proceedings. The low BLSI index may, in turn, have a positive impact on the development of entrepreneurship, calculated as the survival rate of entrepreneurs and the number of newly registered entrepreneurs, as well as on innovative initiatives taken by entrepreneurs. The above-mentioned dependence requires in-depth research and will be continued by the authors of this publication.

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Table 1: Average assessment of individual component criteria in the BLSI measure for the analysed countries

Variables / countries	Australia AUS	Austria AT	Bulgaria BG	Canada CA	Croatia HR	Czech Republic CZ	Denmark DK	England and Wales UK	Estonia EST	Finland FI	France FR	Germany DE	Greece GR	Hungary HU	Ireland IRL	Italy IT	Latvia LV	Lithuania LT	Netherlands NL	Poland PL	Portugal PT	Romania RO	Slovakia SK	Slovenia SLO	Spain ES	Sweden SE	USA	Average	Median
Sanctions for failure to file for bankruptcy in the required period or for the debtor's lack of cooperation with the court.	2	2	3	0	3	2	1	2	2,2 5	3	2	2,5	2	1,2 5	0,7 5	0,7 5	2,2 5	2,7 5	1,2 5	3	2,2 5	2,2 5	3	2	3	2,5	0	1,9 9	2,00
Suspension of bankruptcy proceeding in the event of an application to open a restructuring proceeding.	0,7 5	0,5	0,2 5	0	0,7 5	0,7 5	0	0,5	0,7 5	0,2 5	0	0,7 5	0,2 5	0,7 5	0	0	0,5	0,5	0	0	0,2 5	0,5	0,2 5	1	0	0,2 5	0	0,3 5	0,25
Number and types of	2	2	2	2	1,7 5	2,7 5	3	2	0,5	0,5	2	2	1,7 5	3	2	2	2	1,2 5	3	0	2	2,2 5	2,5	2,2 5	2	0,2 5	2	1,8 8	2,00



Table 2: Standardised assessments of individual component criteria in the BLSI measure and BLSI values for the analysed countries

Variables / countries	Australia AUS	Austria AT	Bulgaria BG	Canada CA	Croatia HR	Czech Republic CZ	Denmark DK	England and Wales UK	Estonia EST	Finland FI	France FR	Germany DE	Greece GR	Hungary HU	Ireland IRL	Italy IT	Latvia LV	Lithuania LT	Netherlands NL	Poland PL	Portugal PT	Romania RO	Slovakia SK	Slovenia SLO	Spain ES	Sweden SE	USA	Average	Median
Sanctions for failure to file for bankruptcy in the required period or for the debtor's lack of cooperation with the court.	0.67	0.67	1.00	0.00	1.00	0.67	0.33	0.67	0.75	1.00	0.67	0.83	0.67	0.42	0.25	0.25	0.75	0.92	0.42	1.00	0.75	0.75	1.00	0.67	1.00	0.83	0.00	0.66	0.67
Suspension of bankruptcy	0.75	0.50	0.25	0.00	0.75	0.75	0.00	0.50	0.75	0.25	0.00	0.75	0.25	0.75	0.00	0.00	0.50	0.50	0.00	0.00	0.25	0.50	0.25	1.00	0.00	0.25	0.00	0.35	0.25

