

# The Restructuring-Bankruptcy Stigma Nexus – In Light of the 2019 Preventive Restructuring Directive of the EU\*

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\* This publication is the result of research conducted for Central European University, Private University. It was made possible by the CEU Open Access Fund.

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The European Commission: ‘...[a]ddressing the negative consequences of business failure when it occurs and its negative image would help make the best possible use of human creativity in Europe, boost entrepreneurship and promote innovation and job creation’.<sup>2</sup>

## ABSTRACT

As early as the first decade of the 21<sup>st</sup> century, the European Commission had recognised and emphasised the negative repercussions of the pervasive and forceful bankruptcy stigma on Europe’s competitiveness. Nevertheless, this meta-legal phenomenon has since received very little scholarly attention, especially regarding the methods by which its intensity might be reduced. This particularly applies to the stigma’s impact on the business sector.

This is a major lacuna, given that the propagation of the second chance, or fresh start, bankruptcy philosophy throughout Europe has been significantly hindered by the bankruptcy stigma, as also the successful implementation of the 2019 Preventive Restructuring Directive of the European Union.

To substantiate these claims, this chapter *first* outlines the features of stigma as a multi-faceted phenomenon. Secondly, to demonstrate its continuing presence, it sketches the various forms in which the stigma appears through an overview of pertinent scholarly and industrial publications, as well as projects on both sides of the Atlantic. A unique aspect of this paper is the examination of the stigma’s potential presence and impact on previously neglected areas of law, such as abandoned and ‘zombie’ companies. Finally, it presents a range of tested methods for fighting the stigma and advancing the policies enshrined in the 2019 Preventive Restructuring Directive, in Europe and beyond.

As this subject matter is still in its infancy in Europe, and thus the experiences of others are worthy of in-depth exploration, the paper builds on a multi-jurisdictional perspective by examining the experiences and good practices of other developed legal systems such as the United States (US). The US undoubtedly possesses the most tested bankruptcy system in the world, with its success story enshrined in Chapter 11 of the 1978 Bankruptcy Code on reorganisations that served as the main source of inspiration for the drafters of the EU Directive.

## I. WHY FOCUS ON THE BANKRUPTCY STIGMA-RESTRUCTURING INTERPLAY?

### A. The Omnipresence of the Stigma and its Impact on Restructuring

1. The *bankruptcy stigma* appears in the context of both individual (consumer) and business insolvencies, though not necessarily in identical forms. It is a phenomenon that is not confined to a single, or merely a few jurisdictions. Rather, it is omnipresent from rudimentary to developed bankruptcy systems. This is

<sup>2</sup> Commission communication, ‘Overcoming the stigma of business failure – for a second chance policy – Implementing the Lisbon Partnership for Growth and Jobs’, COM(2007) 584 final, 5 October 2007. Hereinafter: 2007 Commission Communication on the Stigma.

a postulate from which we are departing. The intensity of the stigma varies across countries, geographical regions, and business sizes. Further, there is also a difference as to whether bankruptcy stigma and its negative effects are effectively tackled or at least discussed.

2. It is also presumed here that bankruptcy stigma, defined as 'the negative perception of bankrupts',<sup>3</sup> not only hinders the development of a restructuring-friendly system, but it predominantly operates as an obstacle in concrete restructuring cases. It frightens off companies and their officers from resorting to this alternative of devastating liquidations that ends the very existence of a company, which is, variedly, a tax-payer, employer, supplier of valuable goods or services, or developer of top-notch software or new technological solutions. Predominantly, because in environments where the intensity of the stigma is relatively low and regulatory steps have been introduced to curb it, the stigma 'can also function as a stimulus for entrepreneurs to defy the illegitimacy of [their] failed businesses and to actively seek out and engage in innovative behaviour that contribute to the overall diversity of entrepreneurial activities in their country'.<sup>4</sup>

3. These concerns merit attention, because both stigma as a phenomenon and the impact of the stigma on restructuring of companies in, or heading towards, insolvency seems to be overlooked not only in legal scholarship, but also in other disciplines, such as anthropology, psychology and economics, to which bankruptcy stigma as a multidimensional notion<sup>5</sup> should be of utmost relevance. This claim regarding the dearth of literature remains valid though, as the relatively promising number of newer publications and project documents referenced herein will show, an encouraging upward trend may be noticed.<sup>6</sup> Notwithstanding the fact that the severity of punishments for bankrupt individual-traders, and later for individuals who merely spent money, has deescalated from imprisonment (or even death) or public humiliation (e.g. sitting in public and placing baskets over their heads)<sup>7</sup> to subtler forms of consequences such as refusal to do business with, extend credit, or reacting to the business failure of

<sup>3</sup> For an overview of the evolution of bankruptcy stigma, though focused on individual (consumer) bankrupts and the US, see R. EFRAT, 'The Evolution of Bankruptcy Stigma' (2006) 7(2) *Theoretical Inquiries in Law*, pp. 365-393.

<sup>4</sup> S.A. SIMMONS, J. WIKLUND and J. LEVIE, 'Stigma and Business Failure: Implications for Entrepreneurs' Career Choices' (2014) 42 *Small Business Economics*, pp. 485-505.

<sup>5</sup> For the leading monographs on stigma as a multidisciplinary category, see S.C. AINLAY, L.M. COLEMAN and G. BECKER (eds.), *The Dilemma of Difference: A Multidisciplinary View of Stigma*, Boston, Springer, 1986; E. GOFFMAN, *Stigma – Notes on the Management of Spoiled Identity*, London, Penguin, 1990.

<sup>6</sup> From among the more recent publications on stigma, see: E. GHIO and D. THOMSON, 'Corporate insolvency: Why are directors afraid of help? Preliminary study on the stigma associated with corporate insolvency' (2024) 98(2) *Chicago-Kent Law Review*, pp. 391-416.; O. KONONOV, 'Post-War Economic Recovery of Ukraine: What Role Could the EU Preventive Restructuring Directive 2019/1023 Play for the Ukrainian Small and Medium-Sized Enterprises?' (2023) 97(4) *American Bankruptcy Law Journal*, pp. 766-768; R. EFRAT, 'The Evolution of Bankruptcy Stigma' (2006) 7(2) *Theoretical Inquiries in Law*, p. 365.; M.D. SOUSA, 'Bankruptcy Stigma: Socio-Legal Study' (2013) 87(4) *American Bankruptcy Law Journal*, pp. 435-482.; C.G. PAULUS, 'The New German Preventive Restructuring Framework' *Rivista Orizzonti del Diritto Commerciale*, [www.papers.ssrn.com/sol3/papers.cfm?abstract\\_id=3849428](http://www.papers.ssrn.com/sol3/papers.cfm?abstract_id=3849428) (accessed 25 January 2025).

<sup>7</sup> For an overview of the history of punishments for turning bankrupt, see, R. EFRAT, 'The Evolution of Bankruptcy Stigma' (2006) 7(2) *Theoretical Inquiries in Law*.

a spouse by divorce, by the 21<sup>st</sup> century, at least in the economically developed part of the globe, it is a mistake to turn a blind eye to the presence of stigma and its effects on restructurings.

4. Notwithstanding this scholarly oblivion, the presence of intense bankruptcy stigma is a major problem, as it exerts a deleterious influence on the efforts aimed at restructuring financially distressed companies in or heading towards insolvency in concrete *living* cases. Moreover, as the modest growth in empirical case studies and pertinent publications suggest, the general tendency seems to be that the more developed, and thus more efficient and tested, a bankruptcy system is, the lower the intensity of the stigma, and vice versa. Thus, attempts to build a modern, developed and efficiently functioning insolvency system ought to consider stigma and its possible effects on restructurings as a top priority.

5. This is a major issue for all jurisdictions that have elevated the so-called second-chance, or fresh start bankruptcy philosophy, to the level of top policy, and together with that restructuring of businesses in trouble instead of their liquidation. Unfortunately, liquidations still are the predominant outcome in Europe leading to job losses, elimination of taxpayers, and decreasing the competitiveness of Europe on the global scene. The positive development is that since the early years of the 21<sup>st</sup> century, the European Union (EU) has adopted a pro-restructuring stance. The positive experiences of the US with the 1978 Bankruptcy Code's Chapter 11 reorganisation proceedings serving as the primarily source of inspiration for Europe.<sup>8</sup> It is for this purpose that the EU Commission has identified 'addressing the negative consequences of business failure [...] and its negative image'<sup>9</sup> as an important goal.

<sup>8</sup> As aptly stated by a 2024 Global Restructuring Review titled *Americas Restructuring Review 2024 – The EU Adaptation of Important Chapter 11 Provisions*: 'In terms of content, most of the individual domestic regimes [i.e., the laws of the EU Member States] have, like the Directive itself, taken significant inspiration from US Chapter 11, but none have exactly replicated it. Instead, all have adapted the Chapter 11 model to best suit their domestic insolvency history'. See K. BAIRD, K. CRINSON, G. BREMOND, M. BROEDERS, C. AUSEMA, J.-P. WILDE, A. LÓPEZ, S. ANGÓS, M. LISICIO and S. BRAUNSTEIN, 'The EU Adaptation of Important Chapter 11 Provisions' *Americas Restructuring Review 2024, Global Restructuring Review*, 2024, [globalrestructuringreview.com/review/restructuring-review-of-the-americas/2024/article/the-eu-adaption-of-important-chapter-11-provisions](https://globalrestructuringreview.com/review/restructuring-review-of-the-americas/2024/article/the-eu-adaption-of-important-chapter-11-provisions) (accessed 25 January 2025).

<sup>9</sup> Commission communication, 'Overcoming the Stigma of Business Failure – for a Second Chance Policy – Implementing the Lisbon Partnership for Growth and Jobs', COM(2007) 584 final, 5 October 2007.

6. Numerous countries, ranging from Canada<sup>10</sup> to China<sup>11</sup> and Singapore<sup>12</sup> are either following or at least trying to follow suit. New laws are being passed, or the old ones are being amended, to steer development towards socio-economic conditions that are more conducive to restructuring. Nevertheless, it is often forgotten that attempting to change the mentality of businesspeople through a single piece of legislation is unrealistic. Instead, the process has to involve incremental resolution of hurdles, hopefully leading to an environment that supports restructuring. Indeed, one of these obstacles is the routinely disregarded bankruptcy stigma that has varying manifestation forms.

7. This paper, as indicated above, aims to illuminate the ways in which stigma impacts not only the birth of bankruptcy regimes conducive to restructuring, but also, from a multi-jurisdictional perspective, its effects on citizens as consumers, small business owners, or for that matter directors and other officers of larger businesses.

8. The following section provides an overview of developments and traits of the EU and the US as the two key jurisdictions. Although our focus is on Europe, experiences from the US cannot be overlooked. This is because, firstly, the law on reorganisations enshrined within Chapter 11 of the US Bankruptcy Code was the main source of inspiration for the drafters of the 2019 Preventive Restructuring Directive. Secondly, the US remains the richest repository of scholarly publications, empirical studies and already applied tests related to bankruptcy stigma, which are undoubtedly exploitable (with or without adjustments) in Europe.

## B. The European Union and the Bankruptcy Stigma

9. Apart from the rapid development of European data protection laws, the embracing of the second chance insolvency policy-cum-restructuring as its corollary, and the emergence of an economically more desirable alternative of liquidations (winding ups) represent the two primary contemporary priorities of the European Union. The road that began with soft law instruments focused on the desirability and domestication of a second-chance bankruptcy philosophy, quite encouragingly, did not forget to stress on the negative impact of bankruptcy stigma. In 2007, the EU Commission's Communications entitled

<sup>10</sup> In Canada, scholars discussed cross-fertilisation as early as 1999. While key procedural elements were shared then (and continue to be today), '[f]irms in Canada are almost eight times more likely to survive reorganization than are firms in [US] Chapter 11'. See T.C.G. FISHER and J. MARTEL, 'Should We Abolish Chapter 11? – Evidence from Canada' (1999) 28(1) *The Journal of Legal Studies*, p. 233.

<sup>11</sup> 'Chapter eight of the [2006 Bankruptcy Law of China – in force from 1 June 2007] stipulates reorganization [and that this] chapter was formulated on the basis of drawings from chapter 11 of the US Bankruptcy Code', see S. LI and Z. WANG, 'China's Bankruptcy Law after Three Years: the Gaps between Legislation Expectancy and Practice and the Future Road' (2010) 7(1) *Int'l Corporate Rescue*, p. 306; '[I]t is fair to say that the American Chapter 11, to a large extent, helped reshape the Enterprise Bankruptcy Law 2005', see Z. ZHANG, 'Resolving Corporate Insolvencies in China: The Gap between Law and Reality' (2020) 27(2) *University of Miami International and Comparative Law Review*, p. 378. See also S. GAO and Q. WANG, 'The U.S. Reorganization Regime in the Chinese Mirror: Legal Transplantation and Obstructed Efficiency' (2017) 91(1) *American Bankruptcy Law Journal*, p. 139.

<sup>12</sup> K.T. CHUANZHONG, 'A Critical Evaluation of the New Cram-down Tool in Singapore's Restructuring Regime' (2021) 30(2) *International Insolvency Review*, p. 267.

'Overcoming the Stigma of Business Failure – For a Second Chance Policy' specifically targeted the stigma.<sup>13</sup>

10. These efforts culminated in the milestone 2019 Preventive Restructuring Directive,<sup>14</sup> which, in its 101 Recitals, devotes surprisingly little to the stigma's potential impact on the success of the Directive contrary to the propagation and implementation of its central goals: the second chance (fresh start) insolvency philosophy and preventive restructuring. As Recital 1 puts it: 'viable enterprises and entrepreneurs that are in financial difficulties [should] have access to effective national preventive restructuring frameworks which enable them to continue operating; honest insolvent or over-indebted entrepreneurs can benefit from a full discharge of debt after a reasonable period of time, thereby allowing them a second chance [...]'.<sup>15</sup>

11. More attention should have also been devoted to the causal chain and the interplay between two inherent corollaries of entrepreneurship: risk-taking and bankruptcy stigma. This would also have helped to better understand the stigma-restructuring nexus. This neglect is surprising given that the 2007 Commission Communication on the Stigma of the European Commission was much more eloquent in that respect. It is therefore worth quoting the key sentences:

'Entrepreneurship is inherently risky, and it requires self-confidence and autonomy as well as a certain readiness for risk-taking, as business creation, business success and business failure are inherent to the reality of the market economy. However, as part of the general lack of societal appreciation and understanding of entrepreneurship, business distress or even business failure is not yet sufficiently understood as a normal economic development and an opportunity for a new start. The Commission considers that a more supportive environment for businesses at risk may prevent failure. Furthermore, addressing *the negative consequences of business failure* when it occurs and *its negative image* would help make the best possible use of human creativity in Europe, boost entrepreneurship and promote innovation and job creation. [...]' [emphasis added].<sup>16</sup>

12. In these early-generation soft laws, restructuring and bankruptcy stigma appeared invariably hand-in-hand and were referred as 'the negative image', alongside the 'negative consequences of business failure'. But as previously mentioned, by the time the 2019 Preventive Restructuring Directive was enacted, the stigma virtually disappeared. It is a mistaken presumption if this

<sup>13</sup> Commission communication, 'Overcoming the stigma of business failure – for a second chance policy – Implementing the Lisbon Partnership for Growth and Jobs', COM(2007) 584 final, 5 October 2007.

<sup>14</sup> 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, and amending Directive (EU) 2017/1132 (Directive on restructuring and insolvency), [2019] OJ L172/18. Hereinafter: 2019 Preventive Restructuring Directive. The Directive was published on 26 June 2019 in the *Official Journal of the EU*, L172/18, and came into force on 16 July 2019. It should have been implemented by the Member States latest by 17 July 2021.

<sup>15</sup> 2019 Preventive Restructuring Directive, Recital 1.

<sup>16</sup> 2007 Commission Communication on the Stigma.

occurred on the supposition that preventive restructurings will turn out to be unprecedented successes, effacing the stigma. Namely, assessments of the successfulness of preventive restructurings quantified based on the number of *launched* proceedings alone, instead of *successfully completed and implemented* ones, inevitably generates a distorted picture.

13. Despite the decades-long success of Chapter 11 reorganisations in the US, recent research in the country aimed at detecting, comprehending and devising more efficient methods for combating the stigma has established that the latter has not disappeared. In Europe, where the socio-economic environment is still in the process of development, with the 2019 Preventive Restructuring Directive only recently being adopted by the Member States, it is premature to disregard the study of stigma and its effects on restructurings. The concrete examples, including a few neglected but pertinent legal topics, empirical studies and tests to be canvassed on the ensuing pages, will hopefully prove the merit of these claims.

### C. The Stigma, Reorganisations and the Second Chance Policy in the United States

14. The US could be regarded as a paradigmatically low stigma intensity country, primarily due to two distinct types of bankruptcy proceedings. Noteworthy on the one hand is the success story of Chapter 11 reorganisation laws enshrined in the 1978 Bankruptcy Code. On the other hand, the two-legged individual bankruptcy proceedings are of interest. These proceedings offer either the discharge (i.e., writing off) of a considerable number of varying types of debts or additional time for debtors to pay off their debts.<sup>17</sup> Experiences in the US show the prevalence of more successful reorganisation cases and the subsequent dissemination of related information and data leads to a more comprehensive understanding of not only the nuts and bolts of reorganisation proceedings, but also the alternatives, including the out-of-court workouts, which have a history in the US dating back to the 19<sup>th</sup> century.

15. By contrast, out-of-court resolution of insolvency proceedings is still relatively new in much of Europe, with the notable exception of the United Kingdom (UK). In the UK, the floating charge, a security device that has been in existence since the late 19<sup>th</sup> century,<sup>18</sup> had emerged as the alternative to formal insolvency proceedings. This trend persisted until the 1980s, when limitations were gradually imposed.

<sup>17</sup> The first, 'debt-liquidation' proceedings ending with discharge, are subject to rules on Chapter 7 of the Bankruptcy Code. Discharged debts do not have to be paid by the debtor, and creditors may not collect discharged debts. See C.J. TABB, *The Law of Bankruptcy*, 4th ed., St Paul, West Academic Publishing, 2016, p. 942. As opposed to this, Chapter 13 is one of the rehabilitation chapters of the Code that allows for debt adjustments and only exceptionally for discharge. 'Chapter 13 permits a debtor to retain her property and repay her creditors pursuant to a court-approved plan over three to five years'. See C.J. TABB, *ibid.*, at p. 1208.

<sup>18</sup> E. MCKENDRICK and R. GOODE, *Goode and McKendrick on Commercial Law*, 6th ed., London, Penguin, 2020, p. 787. Two cases are cited as the cradle of the floating charge: *Holroyd v. Marshall* (1862) 10 HLC 191, 11 ER 999 and *Re Panama, New Zealand, and Australian Royal Mail Co.* (1870) 5 Ch App 318.

16. Niall Ferguson, in his book *The Ascent of Money*<sup>19</sup> called the US the 'Bankrupt Nation' and emphasised how easy it is for the one and a half million predominantly individual debtors who use the system to get rid of much of their debt in the 'world's most successful capitalist economy [which] seems to be built on a foundation of easy economic failure'.<sup>20</sup> All this allegedly without the stigma. Tabb made the same claim, that the large number of individual bankruptcy cases filed each year proves that people are no longer afraid to exploit what the US bankruptcy law offered, presumably in part because it does not stigmatise them anymore. This may all be true, although no one seems to have developed a more widely accepted test to back this up with some quantitative empirical data. Moreover, empirical evidence from the US shows, '84.3 % of families filing for bankruptcy indicated that they "would be embarrassed" or "very embarrassed if their families, friends, or neighbors learned of their bankruptcy" [...]'.<sup>21</sup>

17. In the context of business bankruptcies, the rules are significantly different, though company officers are also individuals with potentially similar emotions and mindsets. This is particularly applicable to small business owners, where the impact of stigma is still very evident. No wonder that major projects are now being launched to tackle the problems caused by the stigma in this segment of the economy, as will be discussed later in this paper.

18. This paper contends that bankruptcy stigma is ubiquitous, including in the US, although admittedly its intensity is the lowest in the US and other developed common law systems as compared to even the leading European civil law jurisdictions. In the case of US individual bankruptcies, this is largely due to the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005<sup>22</sup> and the concomitant increase in individual bankruptcy filings. Nevertheless, this should be perceived as one of the successful methods of combating the stigma rather than evidence that the stigma has completely disappeared in this niche of the US society. Simply put, the more people know about this possibility, from family, friends or from the media, the less they will fear bankruptcy or end up stigmatising others.

19. It is logical that the most developed body of legal scholarship in this area is in the US, and specifically in the domain of individual bankruptcies. Even in the US, attention has only recently begun to turn towards the stigma's impact in the business context, as evidenced from projects mentioned below. On the international scene, it is fair to claim that there is a genuine dearth of legal scholarship on bankruptcy stigma; both individual and business insolvencies. Since the publication of my first paper on this topic in 2017,<sup>23</sup> which extended

<sup>19</sup> N. FERGUSON, *The Ascent of Money*, New York, Penguin Press, 2008, p. 59.

<sup>20</sup> *Ibid.*, p. 59.

<sup>21</sup> T.A. SULLIVAN, E. WARREN and J.L. WESTBROOK, 'Less Stigma or More Financial Distress: An Empirical Analysis of the Extraordinary Increase in Bankruptcy Filings' (2006) 59 *Stanford Law Review*, p. 213, quoting E. WARREN and A. WARREN TYAGI, *The Two-Income Trap: Why Middle-Class Mothers and Fathers are Going Broke*, New York, Basic Books, 2003, p. 213.

<sup>22</sup> Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (BAPCPA), Pub. L. No. 109-8, 119 Stat. 23 (2005).

<sup>23</sup> T. TAJTI, 'Bankruptcy stigma and the second chance policy: the impact of bankruptcy stigma on business restructurings in China, Europe and the United States' (2018) 6 *China-EU Law Journal*, p. 1.

my research and observations to encompass not only law but also to the works of anthropologists, very few publications on this front have seen the light of day.

20. This is also the case in Europe, where, despite the adoption of the 2019 Preventive Restructuring Directive and associated policies mentioned above, the publication of law review articles remains limited.<sup>24</sup> Given the EU's current exclusive focus on business restructurings, with the shaping of laws on consumer (individual) insolvencies delegated to the Member States, the EU finds itself in a unique historical position. This allows for major advancements in the study of the stigma's impact in the business context, thanks to its focus on business restructurings.

21. Bearing in mind the vacuum that persists in scholarly and industrial publications on the impact of bankruptcy stigma in business contexts, this multi-jurisdictional article modestly aims to fill this gap by linking it with one of EU's foremost projects, the 2019 Preventive Restructuring Directive, which aims to cultivate a restructuring-based business culture throughout Europe, drawing on experiences of the US.

#### D. A Terminology Digression

22. Before proceeding further, it is necessary to make two brief points on terminology. The first originates in diverse connotations of key terms in English legal nomenclature on either side of the Atlantic, and the second relates to the varying designations employed in connection with bankruptcy stigma.

23. It is well known to comparatists that the connotation of terms used to describe identical or similar things in jurisdictions where English is an official language has often become fundamentally different. This phenomenon, particularly relevant to this paper, also applies to the inseparable tandem of *bankruptcy* and *insolvency*.

24. In the US, the term *bankruptcy* denotes a distinct branch of law extending to all recognised types of bankruptcy proceedings, ranging from municipal to individual and business bankruptcies, the latter being the focus in this paper. In contrast, according to UK laws, the term *bankruptcy* is limited to proceedings in which individuals appear as debtors, while *insolvency proceedings* are reserved for companies as insolvent debtors. The importance of this distinction is underscored by the fact that the EU largely follows British nomenclature in this domain of law, especially in its legislation.<sup>25</sup>

25. The etymology of the term *insolvency* in US law is more complex. What is obvious is that bankruptcy proceedings in US law do not incorporate the term

<sup>24</sup> The incomplete list of publications on the bankruptcy stigma directly or related to restructuring and the second chance includes D.C. EHMKE, J.L.L. GANT, G-J. BOON, L. LANGKJAER and E. GHIO, 'International Insolvency Review' (2019) 28 *International Insolvency Review*, p. 1, E. GHIO and D. THOMSON, 'Corporate Insolvency: Why Are Directors Afraid of Help? Preliminary Study on the Stigma Associated with Corporate Insolvency'(2023) 98(2) *Chicago-Kent Law Review*, p. 391.

<sup>25</sup> See, in particular, the title of the key piece of legislation besides the 2019 Preventive Restructuring Directive: the Regulation (EU) 2015/848 of the European Parliament and of the Council of 20 May 2015 on *insolvency proceedings* [emphasis added].

*insolvency*. In case of companies, the applicable terms are either *liquidations* (Chapter 7) or *reorganisations* (Chapter 11). Consequently, the term *insolvency* in US law is merely a reference to the *trigger*, or precondition for filing for bankruptcy. However, it plays such a role exclusively in municipal bankruptcy proceedings, because debtors do not have to become *insolvent* to have the right to file for bankruptcy<sup>26</sup> (i.e. to request the bankruptcy court to open bankruptcy proceedings) in other types of bankruptcy proceedings with individuals or companies as debtors.

26. Now, the strange terminological twist that pops up when stigma comes into play is that, notwithstanding the dominance of the term *insolvency* in the UK and Europe, the phrase *bankruptcy stigma* is also known and used in Europe, along with the occasional *insolvency stigma*.<sup>27</sup> Put differently, *bankruptcy stigma* means the same thing on both sides of the Atlantic, and beyond. For the purposes of this article, *bankruptcy stigma*, or simply *stigma* will therefore be used.

27. It is noteworthy that other names or references to the stigma are also in use. For example, quotations from the EU Commission's 2007 Communication cited above use the phrase 'negative consequences of business failure' and the concomitant 'negative image' to refer to bankruptcy stigma. The US Service Corps of Retired Executives (SCORE) uses the term *negative stigma* in one of its project documents.<sup>28</sup> Tabb, on the other hand, employs a rearranged version of the phrase: the 'stigma of bankruptcy'.<sup>29</sup>

28. Similarly, the references to the 'intensity of the stigma' vary, from 'levels of stigma' and 'stigma markings'<sup>30</sup> to descriptions such as 'pervasive and profound feelings of guilt, shame, and stigma'.<sup>31</sup> Until a commonly accepted neologism surfaces for the quantification of this elusive concept, the ones in general use should suffice, and will therefore be used here too.

## II. THE MANY-FACED BANKRUPTCY STIGMA: FROM PARADIGM TO DERIVATIVE FORMS OF BANKRUPTCY STIGMA

### A. Bankruptcy Stigma as a Meta-Legal Phenomenon

29. Any attempt to define the stigma should begin with the following caveat: stigma and stigmatisation are interdisciplinary categories, primarily the focus of

<sup>26</sup> As Tabb put it: 'Unlike the other chapters [of the Bankruptcy Code], insolvency is required before a municipality-debtor may file under chapter 9. [...]'; see para. 2.2., C.J. TABB, *The Law of Bankruptcy*, 4th ed., St Paul, West Academic Publishing, 2016, p. 124.

<sup>27</sup> See, e.g. E. GHIO and D. THOMSON, 'Corporate insolvency: Why are Directors Afraid of Help? Preliminary Study on the Stigma Associated with Corporate Insolvency' (2023) 98(2) *Chicago-Kent Law Review*, p. 391.

<sup>28</sup> SCORE, 'Small Business Bankruptcy: Failure or Reset?', 14 June 2024, [www.score.org/resource/infographic/small-business-bankruptcy-failure-or-reset](http://www.score.org/resource/infographic/small-business-bankruptcy-failure-or-reset) (accessed 20 December 2024).

<sup>29</sup> C.J. TABB, *The Law of Bankruptcy*, 5th ed., Eagan, West Academic, 2020, p. 1209.

<sup>30</sup> S.A. SIMMONS, J. WIKLUND and J. LEVIE, 'Stigma and Business Failure: Implications for Entrepreneurs' Career Choices' (2014) 42 *Small Business Economics*, p. 485.

<sup>31</sup> World Bank, 'Report on the Treatment of the Insolvency of Natural Persons', 2013, pp. 43-44, [documents1.worldbank.org/curated/en/668381468331807627/pdf/771700WPOWB0In00Box377289B00PUBLIC0.pdf](https://documents1.worldbank.org/curated/en/668381468331807627/pdf/771700WPOWB0In00Box377289B00PUBLIC0.pdf) (accessed 20 December 2024). Hereinafter: 2013 World Bank Report.

sociology, social psychology, and anthropology, but with crucial implications for law and economics. Therefore, in order to define stigma as a social phenomenon, it is necessary to refer to the pertinent studies in these disciplines before proceeding to the context of bankruptcy and insolvency laws. Unlike the literature on bankruptcy stigma, the scholarship on stigmatisation as a sociological phenomenon is voluminous,<sup>32</sup> although definitions differ depending on which attributes of an individual are stigmatised as these are culture dependent.<sup>33</sup> Leaving aside these cultural nuances, a globally applicable definition of stigma as a social phenomenon could be extrapolated from the available variants, as shown below.

30. Etymology is often a good starting point, as in the case of stigma: the term is said to have originated in Athens in ancient Greece, where slave owners marked their slaves with small tattoos called stigma, derived from the verb *stig* meaning to prick and distinguish.<sup>34</sup> Stigmatisation and Christ's stigmata are known among Christians, albeit with different meanings, best depicted in Giotto's painting *Saint Francis Receiving the Stigmata*.<sup>35</sup>

31. Today, stigmatisation could be best defined as 'the societal disapproval associated with an individual or group based upon some characteristic, trait, or behavior that deviates from accepted norms or expectations'.<sup>36</sup> A substantial corpus of sociological studies of stigma has, however, traditionally focused on the stigma associated with physically or mentally disabled, elderly, prostitutes, members of a minority group, juvenile delinquency, adult crime, prison subcultures, alcoholism and drug addiction, or homicide and suicide.<sup>37</sup> The likes of bankruptcy, insolvency, and related phenomena such as indebtedness, however, have received comparatively little attention.

32. Sousa asserts that, as of 2013, no more than a handful of studies have been published on the stigmatisation of individual debtors in the US. This is important as the country has a more than a century-long history of personal credit.<sup>38</sup> Moreover, these studies have had a narrow focus on whether there is bankruptcy stigma in modern societies or if it has declined. Furthermore, it is of relevance to Europe that the conclusions drawn from these studies have been, at times, contradictory or inconclusive, suggesting the need for utmost caution in the design of empirical studies, from selection of a target group to the formulation of the interview questions, to drawing conclusions from the data collected. In

<sup>32</sup> M.D. SOUSA, 'Bankruptcy Stigma: A Socio-Legal Study' (2013) 87 *American Bankruptcy Law Journal*, p. 435.

<sup>33</sup> *Ibid.*, p. 436.

<sup>34</sup> *Ibid.*

<sup>35</sup> The painting of Giotto di Bondone 'Saint Francis Receiving the Stigmata', created between 1295 and 1300, depicts the kneeling Saint Francis receiving the stigmata through rays of light emanating from Christ's wounds during his prayer on Mount Alvano. The painting is currently housed in the Louvre, Paris.

<sup>36</sup> G. FALK, *How we Treat Outsiders*, Amherst, Prometheus, 2001, p. 17., cited in M.D. SOUSA, 'Bankruptcy Stigma: A Socio-Legal Study' (2013) 87 *American Bankruptcy Law Journal*, p. 436, note 1.

<sup>37</sup> A. LIAZOS, 'The Poverty of the Sociology of Deviance: Nuts, Sluts, and Preverts' (1972) 20 *Social Problems*, p. 103., cited in M.D. SOUSA, 'Bankruptcy Stigma: A Socio-Legal Study' (2013) 87 *American Bankruptcy Law Journal*, p. 436, note 3.

<sup>38</sup> M.D. SOUSA, 'Bankruptcy Stigma: A Socio-Legal Study' (2013) 87 *American Bankruptcy Law Journal*, pp. 436–437.

fact, due to the indeterminacy inherent in the definition of bankruptcy stigma, as well as the mixing of its paradigmatic variant with its derivative forms or manifestations, the outcomes can easily controvert the presumptions based mainly on theoretical considerations.<sup>39</sup>

## B. Paradigm and Derivative Forms of Stigma

33. The recent sociological, psychological or anthropological literature mentioned above focuses primarily on what the rest of the society thinks of an individual or a group bearing common characteristics. This could conveniently be called *the paradigm form of stigma*. In the context of bankruptcy law, this denotes what fellow citizens think of their bankrupted peers. In other words, the key components are individuals (both the observed and the one who observes), but only the opinion of the observers count.

34. In the context of bankruptcy and insolvency laws, however, such a simple, unidirectional concept is only a less important cog in a much more complex system, especially if the stigma's impact on restructuring, or reorganisation, is at stake. Of equal importance, besides the paradigm version of the stigma, are also what we might call *derivative forms of stigma*. They are derivative because they are based on and linked to the paradigm form of stigma but yet are different from it.

35. *Self-stigmatisation* (or *internalised stigma*) is one such derivative form: it is a sort of reverse reaction of the bankrupt debtor. The fear of reaction of others and the consequent reluctance to turn to the courts to open preventive or regular restructuring proceedings is a suitable example. An undue delay in filing for bankruptcy due to fear would be a sub-variant of the above, with the negative consequences materialising in delayed or frustrated restructuring.

36. Stigmatisation and self-stigmatisation appearing in the inherently more complex world of business should also be seen as derivative forms. In the case of such *business-context stigmatisation*, fear may also be the reason why,

<sup>39</sup> For example, in the 'preliminary pilot' study conducted by Ghio and Thomson aimed at detecting and studying 'the levels of stigma', nine interviews were conducted – eight face-to-face and one online – with business owners of micro, small and medium enterprises (MSMEs) located in Edinburgh, UK in 2023. The study revealed only 'moderate levels of stigma associated with insolvency' because of why the conclusion reached was that 'stigma does not, in isolation, represent a barrier to pre-insolvency or alternative insolvency measures' uptake. What was found, of relevance as well, that the interviewees 'also have an extremely limited understanding of insolvency law and procedures', see E. GHIO and D. THOMSON, 'Corporate Insolvency: Why Are Directors Afraid of Help? Preliminary Study on the Stigma Associated with Corporate Insolvency' (2023) 98(2) *Chicago-Kent Law Review*, p. 416.

Notwithstanding the very limited pool of observed business managers and thus the limited applicability of the conclusions, the study is valuable, among others, because it raised the question whether treating the stigma and ignorance of insolvency laws as distinct categories is appropriate given that the reluctance of managers to learn about insolvency might be one of the effects, or manifestations, of the stigma along the bare bone logic that if one thinks that insolvency means a dead end, the 'death' of one's business, then it does not really make sense to lose time by reading bankruptcy-related materials, or to participate in workshops. Put differently, perhaps it makes sense differentiating paradigm stigma from its derivative forms, or manifestations.

typically, small business owners would simply abandon their enterprises after having stripped them of all assets of value, leaving behind a mere shell.

37. Some manifestations of derivative forms are of equal relevance in both consumer and business bankruptcies, and yet some are of bearing only in the latter. For example, both consumer and business debtors in distress can expect that certain negative repercussions will follow from others. While consumer debtors should reckon with negative fallout from their banks and other financiers (e.g. refusal to extend a loan), business owners and company officers should expect some of their crucial clients to cancel their purchase contracts or their key expert employees to leave. However, some forms of stigma are unique to the business sector. For example, as a form of self-stigmatisation, small companies in particular may fear that key clients will discard them assuming that they cannot supply the spare parts of high quality on time, honour warranties, or perform as per the concluded contracts.

38. It is worth noting here that the European Commission's soft law instruments mentioned above are compatible with this line of thinking. Indeed, they focus on the derivative forms of stigma in and related to company restructurings. Consumer insolvencies, together with stigmatisation of consumers, is currently a neglected topic in the EU. Nevertheless, there is a likely overlap between consumer and business sectors, so the lessons from the more extensive literature on the workings of the stigma in individual bankruptcies should not be frowned upon by those studying the business sector. For example, the fear of bankruptcy as a consequence of intense stigma is not only felt by consumer debtors in trouble but is also a factor duly recognised in the 2007 Communication of the EU Commission on the advantages of restructuring.

39. Although it was noted almost two decades ago, little has changed for the better in the EU, and hence it is justified to repeat that 'Europeans [remain] reluctant to take up opportunities for self-employment and entrepreneurial activities'<sup>40</sup> especially after a failure.<sup>41</sup> It is hard to prove, but stigma could be one of the factors explaining this unhappy state of affairs. It is also reasonable to assume that stigma is partially responsible for *en mass* failure to use the new preventive restructuring regime or the older regular restructuring systems. Similarly, both quantifiable and an uncountable number of late restructuring (or liquidation) filings could be attributed to the same culprit. Though one may validly claim that there is a nexus between the entrepreneurial reluctance of Europeans and the persistently high number of typically small-scale abandoned businesses that opt for this option rather than exiting the market through court-controlled insolvency proceedings.

### III. WHY IS BANKRUPTCY STIGMA MISUNDERSTOOD OR IGNORED?

40. There is an additional question that needs to be raised: what are the reasons that bankruptcy stigma is often misunderstood and neglected? First and

<sup>40</sup> 2007 Communication, at 6.

<sup>41</sup> *Ibid.*

foremost, this is linked to the very nature of stigma and stigmatisation. As a meta-legal category, it is not of primary interest to lawyers, especially to positivists, who tend to be interested only in law detached from the socio-economic and political context, let alone psychological and anthropological phenomena such as stigma. Suffice it to browse through the topics covered at conferences, workshops and other projects, even by such leading international organisations as INSOL, to realise that stigma has indeed been almost completely left out, notwithstanding the fact that reorganisation and restructuring have become a top priority in Europe, China and several other countries over decades. In a sense, it seems that the overwhelming majority of the legal community today believes that the new restructuring laws in and of themselves are sufficient to cause a volte-face and make restructuring the dominant applied approach overnight, without, *inter alia*, combating the stigma. As will be shown below, the statistics tell a different story as the number of successfully completed preventive restructurings is increasing only moderately and the number of regular restructurings is stagnating even in the most developed economies and legal systems in Europe, let alone countries that are still in the process of creating a functioning bankruptcy system.

**41.** The second related reason is that the study of bankruptcy stigma is often limited to consumer debtors, who could undoubtedly be taken as the paradigm victims and who therefore could, and often are, ignorant and fear bankruptcy proceedings. Yet, the stigma reaches individuals in their capacity as directors, managers, sole traders and, in the case of SMEs, owners (shareholders or partners) who are simultaneously present in the shoes of these officers and perform their duties in their enterprises. Indeed, this paper focuses on the latter categories of derivative forms of bankruptcy stigma.

**42.** The fact is, however, that the vast majority of the otherwise scarce scholarship focuses on individual consumer debtors. This per se should not be a problem, but it is often done with such a generalised language that it extends to derivative forms of stigma without proper delineation of these sectors of the economy. To illustrate, Tabb's claim that the hundreds of thousands of bankruptcy cases filed annually in the US are the proof that bankruptcy stigma has shrunk to a minimum should be understood as a claim that applies only to individual debtors in distress, because the world of corporate and other business bankruptcies is a world of its own, with a different history, rules, patterns of behaviour and thus also quantitative data.

**43.** Given that the astronomical numbers of individual bankruptcy filings represent a fairly recent development in the US, essentially due to the 2005 amendments to the Bankruptcy Code, one might ask whether the stigma could have diminished in such a short period. Especially when one considers that the history of corporate reorganisations goes back to the railroad bankruptcies of the 19<sup>th</sup> century and history has generously endowed the US with more than a century for experimenting, legal engineering, or litigating to get the green light for novel practices, and to learn and propagate the knowledge about the usefulness of both out-of-court workouts and court-administered reorganisations. And, in parallel, to 'tame' the stigma and tackle its negative consequences. The striking realisation, as the recent projects on stigma in the US described

below show, is that despite the long timeframe, stigma is still present also in the business sectors in the US.

#### IV. EVIDENCE ON THE PRESENCE OF THE STIGMA

##### A. Scholarship, International Projects

44. Unfortunately, in many countries, no scholarly or industrial publication could be found on bankruptcy stigma, be it legal or otherwise. In underdeveloped bankruptcy systems, where there is little or no interest in bankruptcy law *per se*, this should not be surprising. In part, this disinterest is due to the prevailing attitudes towards insolvency. There is also a dearth of such literature in EU Member States, which should be surprising if not alarming, especially after the adoption of the 2019 Preventive Restructuring Directive. Certain exceptions nonetheless exist, mainly in some of the major legal systems, although the Babylonian cavalcade of European languages probably takes its toll in this respect as well, presumably making some isolated publications in local languages unavailable.

45. This even includes the UK (no longer an EU member state since the results of the 2016 Brexit referendum came into force on 23 January 2020), deemed to be Europe's most insolvency-friendly country, with expert insolvency courts that are favoured by foreign companies, judging by cases such as that of the German automotive parts producer 'Schefenacker'. The company moved from Germany to the UK in 2006 in order to exploit the latter's flexible restructuring system.<sup>42</sup> On this, McCormack wrote in 2009: 'On the "stigma" point, it is very difficult to find hard empirical evidence but within Europe as a whole, including the UK, there is certainly the opinion that stigma exists and that this works as deterrent to entrepreneurial initiative'.<sup>43</sup>

46. Speaking of Germany, the economic engine and a major legal system in Europe, it is pertinent to cite two leading German insolvency scholars, whose words should be self-explanatory and prove the presence of the stigma. Reinhard Bork, for instance, wrote in 2012, that '[w]hile [i]t may be tempting to disregard this factor as non-serious, but any earnest attempt to construct an efficient restructuring law must take it into account until there is evidence of a wide-ranging and sustained change in popular mentality'.<sup>44</sup>

47. More recently, in 2021, Paulus confirmed that '[e]ven more than 20 years after the introduction of the German version of the US Chapter 11-proceeding in the *Insolvenzordnung* (Insolvency Ordinance, InsO) the sentiment of the

<sup>42</sup> See R. BORK, *Rescuing Companies in England and Germany*, Oxford, Oxford University Press, 2012, p. 3. The relocation was possible by Schefenacker AG (*Aktiengesellschaft*) moving its Centre of Main Interest (COMI) from Germany to the UK thereby becoming a UK plc, and then restructuring through the UK proceedings named as company voluntary arrangement (CVA). The restructuring was successfully concluded on 29 June 2007 thanks to agreement with the major bondholders of the company. See *ibid.*, p. 4.

<sup>43</sup> G. McCORMACK, 'Apples and Oranges? Corporate Rescue and Functional Convergence in the US and UK' (2009) 18 *International Insolvency Review*, p. 114.

<sup>44</sup> R. BORK, *Rescuing Companies in England and Germany*, Oxford, Oxford University Press, 2012, p. 3.

stigma of insolvency is still quite wide-spread and strong'.<sup>45</sup> Note that both of these scholars confirm the presence of the stigma in the context of business and not in the realm of consumer debtor or what was referred to above as derivative forms of stigma. The fact that neither of these quotes related to Germany is limited to *preventive* restructuring, but also includes ordinary restructuring, should not obscure the picture, as stigma permeates both spaces, albeit not to an identical degree.

48. The World Bank's 2013 Report on the Treatment of the Insolvency of Natural Persons, focused as it was not on business but rather consumer debtors, confirmed that 'even in well-developed insolvency regimes, significant numbers of debtors continue to avoid seeking relief, or they seek relief far later than would be optimal, [because] insolvency systems reveal *pervasive and profound feelings of guilt, shame, and stigma* [emphasis added]'.<sup>46</sup>

49. Two comments are necessary here. Firstly, although this report is based on data from before 2013, stigma is such a phenomenon that cannot be eliminated from the society within a decade, even in jurisdictions with developed bankruptcy regimes that have made efforts to reduce the stigma, as recent sources emerging from Germany and the UK and cited in this paper show. As the Report says, 'attitudes about debt and cultural stigma change slowly'.<sup>47</sup> Thus, these caveats remain of utmost relevance and support the claim that stigma is very much present to this day.<sup>48</sup>

50. Secondly, although this report focuses on individual debtors, it is worth noting that company officers are also individuals and, although they are in a peculiar 'corporate shoes', they are far from being immune from the stigma. The examples cited in this paper will hopefully corroborate this.

51. One could also point to the recent 2023 project of the UK Insolvency Service and the findings incorporated into the document 'Call for Evidence: Review of the Personal Insolvency Framework',<sup>49</sup> which not only provides a good overview of the efforts made to move towards a rescue and restructuring-dominated insolvency system from the 1980s onwards, but provides evidence for the presence of stigma to this day. Although centred around individual debtors, the findings also extend to sole traders and other individuals running a business.<sup>50</sup> Two interlinked findings deserve special attention. On the one hand, the slow decline in stigma was found to be attributable not only to requirements such as

<sup>45</sup> C.G. PAULUS, 'The New German Preventive Restructuring Framework' (2021) *Orizzonti del Diritto Commerciale*, 2021, p. 9.

<sup>46</sup> World Bank, 'Report on the Treatment of the Insolvency of Natural Persons', 2013, p. 43, documents1.worldbank.org/curated/en/668381468331807627/pdf/771700WPOWB0In00Box377289B00PUBLIC0.pdf (accessed 16 November 2024). Hereinafter: 2013 World Bank Report.

<sup>47</sup> See n. 42 and 43 *supra*.

<sup>48</sup> In fact, the 2013 World Bank Report devotes an entire sub-section (C) to stigma, with findings and recommendations coinciding with those enshrined in this Article.

<sup>49</sup> UK Insolvency Service, 'Call for Evidence: Review of the Personal Insolvency Framework', 4 August 2023, [www.gov.uk/government/calls-for-evidence/call-for-evidence-review-of-the-personal-insolvency-framework/call-for-evidence-review-of-the-personal-insolvency-framework](http://www.gov.uk/government/calls-for-evidence/call-for-evidence-review-of-the-personal-insolvency-framework/call-for-evidence-review-of-the-personal-insolvency-framework) (accessed 16 November 2024). Hereinafter: 2023 UK Insolvency Service Review.

<sup>50</sup> According to the 2023 UK Insolvency Service Review, out of 5.59 million businesses in the private sector, 99% – or 5.54 million – are small businesses with 0-49 employees. See the section titled 'Options for Sole Traders and Partnerships'.

disclosure of one's *bankruptcy history* in credit applications, but also to 'stigma associated with a particular procedure, concern[ing] [...] privacy and certainty over how their assets and estate may be dealt with'.<sup>51</sup> *On the other hand, as per a 2015 research referenced in the document, almost half of the 2,000 British adults surveyed confirmed the existence of the stigma.*<sup>52</sup>

## B. What Economists Say about the Stigma

52. Stigma is also the domain of economists. The number of publications from their stable is also far from abundant, but they have already made important findings.

53. To illustrate, the Becker Friedman Institute at the University of Chicago's research<sup>53</sup> on the nexus between small and medium-sized firms (SMEs) and bankruptcy confirms the persistence of 'commonly held stigma associated with bankruptcy that could further dissuade small- and medium sized firms from exploring its benefits'<sup>54</sup>. Put differently, a large number of US small business owners lack information about what Chapter 11 reorganisation proceedings could offer them and still presume that 'bankruptcy necessarily entails the death of a firm'.<sup>55</sup> As noted in the findings, this may be a bit unsettling given the numerous efforts taken to 'make bankruptcy more accessible and less costly for small businesses',<sup>56</sup> including the enactment of the Small Business Reorganization Act (SBRA) in 2019,<sup>57</sup> which is tailored for them. This also confirms one of the main postulates of this paper, namely that combating the stigma is a time-consuming process, requiring a lot of effort, and ultimately, its intensity can only be decreased, but stigma itself cannot be eliminated completely.

54. It is erroneous to expect that passing of a law with prescriptive language designed to steer the attention of businesspeople and financiers on restructuring and survival will reduce the intensity of the stigma overnight. This repeated claim applies in Europe (and beyond).

55. The research substantiates another commonality. Namely, that the assumptions that apply to large corporations in terms of their perception and attitude

<sup>51</sup> Ibid., see the section titled 'Motivations for Choice'.

<sup>52</sup> Concretely, 50 % of the interviewees said that the intensity of the stigma is lower than a decade earlier, 48 % was of the opinion that there is still stigma associated with bankruptcy. See *ibid.* section titled 'Motivations for Choice'.

<sup>53</sup> Becker Friedman Institute for Economics, 'Frontier Research, Global Impact', [www.bfi.uchicago.edu](http://www.bfi.uchicago.edu) (accessed 29 November 2024).

<sup>54</sup> S. BERNSTEIN, E. COLONNELLI, M. HOFFMAN and B. IVERSON, 'Life after Death: A Field Experiment with Small Businesses on Information Frictions, Stigma, and Bankruptcy', Working Paper 30933, June 2023, p. 1, [www.nber.org/system/files/working\\_papers/w30933/w30933.pdf](http://www.nber.org/system/files/working_papers/w30933/w30933.pdf) (accessed 29 November 2024). The research brief is available at 'Life After Death', *Becker Friedman Institute for Economics*, March 2023, [bfi.uchicago.edu/wp-content/uploads/2023/03/Life-After-Death.pdf](http://bfi.uchicago.edu/wp-content/uploads/2023/03/Life-After-Death.pdf) (accessed 29 November 2024).

<sup>55</sup> *Becker Friedman Institute for Economics*, 'Life After Death: A Field Experiment With Small Businesses On Information Frictions, Stigma, and Bankruptcy', Research brief, 2023, p. 1.

<sup>56</sup> Ibid.

<sup>57</sup> The Small Business Reorganization Act of 2019 (SBRA), codified as new 11 U.S.C. §§ 1181-1195, is actually a new subchapter V of chapter 11 of the Bankruptcy Code. It entered into force on 19 February 2020, 180 days after its enactment.

to bankruptcy are not entirely valid for small businesses. It is not just that large corporations can finance reorganisations and can employ experts to advise them on restructuring, this is, however, a privilege not normally available to SMEs. Rather, it is that large firms 'often view bankruptcy as a strategic option when facing distress',<sup>58</sup> and therefore resort to Chapter 11 reorganisations, ideally with pre-packaged bankruptcies, which means a speedy conclusion to the formal Chapter 11 process.<sup>59</sup> Such strategic bankruptcies and associated strategic thinking about restructuring are new in much of Europe (and beyond). The reason, again, is partly ascribable to intense stigma.

56. It is also worth mentioning that the project, entitled 'Field Experiment', employed the so-called Randomised Controlled Trial (RCT) method<sup>60</sup> to gather empirical data on, among others, the question of whether small businesses 'exhibit lack of information and stigma about bankruptcy'.<sup>61</sup> According to the results, almost half of the respondents were unaware that it is possible to continue operating through Chapter 11 reorganisation proceedings and that exposure to information about the stigma 'greatly reduces its effects'.<sup>62</sup> Simply put, knowledge of the bankruptcy system and the available bankruptcy proceedings, as well as awareness of the forms and manifestations of the stigma and the methods of combating it, play a crucial role both in respect of changing the perceptions of the stigma and in increasing the willingness to resort to available reorganisation, or when it comes to Europe, restructuring proceedings.

### C. Findings of Nonprofits Active in the Field

57. In those systems where bankruptcy as a phenomenon is important, non-profit organisations, in addition to spending taxpayers' money on educational

<sup>58</sup> Becker Friedman Institute for Economics, 'Life After Death: A Field Experiment With Small Businesses On Information Frictions, Stigma, and Bankruptcy', Research brief, 2023, p. 1.

<sup>59</sup> The formal reorganisation Chapter 11 proceedings of the New York-based global commercial finance company CIT (Commercial Investment Trust) lasted mere 38 days (1 November 2009 – 10 December 2009). This was possible because CIT came to the bankruptcy court with a pre-packaged reorganization plan, discussed and approved by the required majority of creditors. See M. SPECTOR, V. O'CONNELL and K. HAYWOOD, 'CIT files bankruptcy plan, with eye on exit', *Wall Street Journal*, 3 November 2009, p. 25.

<sup>60</sup> The research was conducted in cooperation with SCORE, with participation of 1,386 SMEs, from a wide range of industries, in fall of 2020. Three groups of interviewees were formed, each exposed to information and educational materials, differing both in contents and quantity.

The 'Control Group' was exposed to a one-minute video only with info on a hypothetical small business owner in financial distress and a few possibilities solutions. The 'Information-Only Treatment Group' saw the same as the Control Group but was exposed additionally to explanations on the differences between Chapter 7 (i.e. liquidation) and Chapter 11 (i.e. reorganisation) proceedings, as well as to clarifications on the SBRA. Finally, the 'Information plus Stigma Group' was shown besides the material displayed to the 'Information-Only Treatment Group' also to a one-minute material on how to address the stigma.

The results proved that the said 'information treatments', or exposure to new related material, do 'vastly reduce information unawareness'. For a detailed description, see S. BERNSTEIN, E. COLONNELLI, M. HOFFMAN and B. IVERSON, 'Life after Death: A Field Experiment with Small Businesses on Information Frictions, Stigma, and Bankruptcy', Working Paper 30933, June 2023, p. 3.

<sup>61</sup> Becker Friedman Institute for Economics, 'Life After Death: A Field Experiment With Small Businesses On Information Frictions, Stigma, and Bankruptcy', Research brief, 2023, p. 2.

<sup>62</sup> Ibid.

projects, play a crucial role, because they are more willing than academics to establish direct contacts and to dirty their shoes by going out to their target groups. They can also be important sources of empirical data on, for example, what small business owners think of insolvency. The US Service Corps of Retired Executives (SCORE)<sup>63</sup> is one such 'nonprofit dedicated to helping small businesses start, grow and succeed'. Established in 1964, it claims to have helped more than 17 million entrepreneurs by mentoring them, organising workshops and other educational events, and providing educational resources. SCORE's data is undoubtedly meritorious, *inter alia*, on bankruptcy stigma.

58. To provide more concrete data, a survey conducted by SCORE on 14 June 2024, produced in cooperation with researchers from Brigham Young, Harvard, University of Chicago and University of Toronto,<sup>64</sup> revealed that only 10 % of interviewees reported having 'a good understanding of the bankruptcy system', with 24 % strongly disagreeing with this statement.<sup>65</sup> When asked if there was a negative stigma associated with bankruptcy, more than half the respondents affirmed that there indeed was some form of negative consequences associated with filing for bankruptcy.<sup>66</sup> These responses confirm that bankruptcy stigma is very much prevalent, especially in the small business segment of the US, the world's most tested bankruptcy system.

#### D. Abandoned Companies: Voting on Stigma with Feet?

59. The theme of abandoned companies continues to be among the neglected, whether in company law, bankruptcy law or any other relevant area of law. Even the designation of this particular class of enterprises tends to differ from abandoned, inoperative, defunct, to *zombie* companies, often with different (or erroneous) content and inconsistent use. Their legal treatment also differs, including the naming of the procedure by which they are eliminated from the market, such as *compulsory dissolution* (UK), *compulsory deletion* (Hungary), '*administrative Auflösung ohne Liquidation*' or '*dissolution sans liquidation*', which stands for 'dissolution without liquidation' in Luxembourg. The related literature can therefore only be very limited, although surprisingly there are relevant databases in many countries.

60. What links this neglected topic to bankruptcy stigma is the reasons and motivations behind the decision to abandon a company rather than exit the

<sup>63</sup> SCORE, 'Helping 17 Million Entrepreneurs achieve their dreams', [www.score.org](http://www.score.org) (accessed 24 January 2025).

<sup>64</sup> SCORE, 'Small Business Bankruptcy: Failure or Reset?', [www.score.org/resource/infographic/small-business-bankruptcy-failure-or-reset](http://www.score.org/resource/infographic/small-business-bankruptcy-failure-or-reset) (accessed 24 January 2025).

<sup>65</sup> The three middle classes on the question whether small business owners have a good understanding of the bankruptcy system are: 24 % somewhat agree, 21 % neither agree, nor disagreed, and 20 % somewhat agreed. *Ibid.*

<sup>66</sup> The concrete answers on the existence of bankruptcy stigma of small business owners were: a) 65 % agreed that it is embarrassing for a business owner to file for bankruptcy; b) 60 % agreed that friends and family may look down on a business owner who files for bankruptcy; c) 58 % agreed that employees will be less willing to work for a business that filed for bankruptcy; and d) 54 % agreed that clients will be less willing to buy from a business owner who filed for bankruptcy. SCORE, 'Small Business Bankruptcy: Failure or Reset?'.

market through a regular, albeit summary, bankruptcy proceedings. In the absence of properly collected and analysed empirical data, it is difficult to make a definitive claim. Nonetheless, it can be assumed that in a significant number of cases, bankruptcy stigma is a contributing factor, if not the main factor, in the abandonment of business. The sole proprietor, the few owner-manager-directors of small companies, may find it vital not to disclose and publicise their names connecting them to their former, now insolvent businesses, even though insolvency proceedings do presume the publication of key data not only about the business itself but also about the company officers. Admittedly, among the reasons leading to abandonment could be the urge to avoid washing the metaphorical dirty laundry of the company and its officers in public, or the prohibitive level of the costs (red tape) that the bankruptcy process itself may generate.

61. To the extent that this line of reasoning is correct, it should be of relevance that the number of abandoned companies in different countries is far from negligible. In the UK, for example, which undoubtedly has one of the most developed insolvency systems in Europe, the number of so-called *compulsory dissolutions* between 2 January 2018 and 12 December 2023 was 559,271, according to Companies House data.<sup>67</sup>

62. Similar data can be found for other European companies. For example, according to the Spanish National Statistical Institute, 8,035 new companies were formed in 2024 (up to September 2024) and 1,391 were dissolved (an increase of 11,7 % compared to September 2023). In Spain, every entity that is duly registered in the Commercial Registry and therefore has the status of a taxpayer – even if it is inactive (dormant) and even if it has not started its business activities in the year following its registration – has to file a tax declaration and pay taxes. Failure to do so also leads to dissolution.<sup>68</sup> Spain had about 600,000 ‘dormant companies’ in 2024.

63. In Hungary, a case study for a post-socialist system, the number of compulsory dissolutions (*‘kényszertörlés’*, that in meta-translation, or word-by-word mechanical translations, means ‘compulsory deletion’) remains consistently

<sup>67</sup> According to the UK Companies House dataset, compulsory dissolution is resorted to when ‘[...] the Companies House registrar has reasonable cause to believe that a company is no longer in business or operation. This process is usually commenced when a company fails to file the required financial accounts and/or confirmation statements, which they are required to do annually. Companies House will then send a series of letters to the company and its officers to enquire whether it is operational and, if no contact is received, then a first gazette notice is published in the Gazette, giving notice of the Registrar’s intention to dissolve the company. Additionally, in rarer cases, the compulsory dissolution process is triggered by a company going six months without any registered directors, or when Companies House are not able to contact the company following a complaint’. The dataset with the statistics on voluntary and compulsory dissolutions is available at Office for National Statistics, ‘Company incorporations, voluntary dissolutions and compulsory dissolutions’, [www.ons.gov.uk/economy/economicoutputandproductivity/output/datasets/companyincorporationsandvoluntarydissolutions](http://www.ons.gov.uk/economy/economicoutputandproductivity/output/datasets/companyincorporationsandvoluntarydissolutions) (accessed 24 January 2025).

<sup>68</sup> Agencia Tributaria, ‘Sociedades Inactivas’, [www.sede.agenciatributaria.gob.es/Sede/en\\_gb/ayuda/manuales-videos-folletos/manuales-practicos/manual-sociedades-2020/capitulo-1-cuestiones-generales/quienes-estan-obligados-presentar-declaracion-sociedades/obligados-declarar/sociedades-inactivas.html](http://www.sede.agenciatributaria.gob.es/Sede/en_gb/ayuda/manuales-videos-folletos/manuales-practicos/manual-sociedades-2020/capitulo-1-cuestiones-generales/quienes-estan-obligados-presentar-declaracion-sociedades/obligados-declarar/sociedades-inactivas.html) (accessed 25 January 2025). In Spain, there are about 600,000 dormant companies in 2024.

high, with over ten thousand recorded annually.<sup>69</sup> This figure is comparable to the high number of liquidations and is in contrast to the small number of filed and especially the very small number of successfully concluded reorganisations.<sup>70</sup> The National Office for the Judiciary publishes regular data on these matters.<sup>71</sup> When the size of the economy is considered, the proportion is considerably higher than in the UK. This can undoubtedly be ascribed to the lack of maturity in the insolvency and entrepreneurial system, compounded by very intense bankruptcy stigma. The potential liabilities, the fear of loss of reputation as an entrepreneur-manager or as a trustworthy business partner, and the distrust in the insolvency system due to ignorance and lack of positive experiences are all to be blamed.

64. Similar data, and therefore similar considerations, can be found elsewhere. Estonia, for example, was forced to amend the pertinent legislation, the Business Register Act, in 2023 to speed up the process of deleting non-operational entities.<sup>72</sup> While earlier the process took an average of two years, the amendments reduced it to a few months. As a result, the number of deleted 'non-operational' entities jumped from 13,520 in 2023 to 31,858 in 2024.<sup>73</sup> Most of the deletions were due to the failure to submit annual financial reports, then repeated failure to submit the reports, but fines for wrong address, and non-compliance by the contact person occurred in numerous cases, too. This source speaks neither of the reasons and motives of the controlling persons of deleted non-operational companies, nor of bankruptcy stigma.

65. However, as in the case of the UK and Hungary, one may presume that stigma has played a role in leading to such outcomes. Indeed, as the UK's *The Conversation* argued in 2024, '[t]he stigma around experiencing financial difficulties and the negative way this is talked about may prevent businesses from looking for help at a time when it would provide the greatest change of turning things around'.<sup>74</sup>

<sup>69</sup> While according to the datasets of the Office for 2009, the number of compulsory dissolutions was 9,253. This arose in 2015 to 20,817. In the first post COVID-19 year of 2021, it amounted to 13,180 and almost doubled to 25,911 in 2023.

<sup>70</sup> In year 2023, 64 restructuring cases were filed. Out of these 22 were still in process at the end of the year. In contrast, the number of filed liquidation cases amounted to 27,726, out of which 25,174 were still pending at the end of the year (based on the statistical yearbook of the Office, company and bankruptcy map for year 2023).

<sup>71</sup> The Office publishes, among others, yearbooks with various data, including one related to insolvency law, and another devoted to company law matters; the latter contains data on compulsory dissolutions. These are currently published only in Hungarian and are available at [www.birosag.hu/en](http://www.birosag.hu/en) (accessed 25 January 2025).

<sup>72</sup> See the web-page on 'Deletions and Reinstatements' of the E-Business Register, the official portal of the Estonian Government, [ariregister.rik.ee/eng/statistics/bankruptcies\\_and\\_deletions](http://ariregister.rik.ee/eng/statistics/bankruptcies_and_deletions) (accessed 25 January 2025).

<sup>73</sup> Ibid.

<sup>74</sup> J. TRIBE and E. GHIO, 'The Language of Insolvency: Why Getting it Wrong can Harm Struggling Firms', *The Conversation*, 22 April 2024, [theconversation.com/the-language-of-insolvency-why-getting-it-wrong-can-harm-struggling-firms-228051](https://theconversation.com/the-language-of-insolvency-why-getting-it-wrong-can-harm-struggling-firms-228051) (accessed 25 January 2025).

## E. Zombie Companies versus the Insolvency System

66. There is also statistical data on Europe's 'failing firms that continue operating on the back of cheap credit and debt forbearance [and which] weigh on economic productivity by trapping resources and crowding out the emergence of new, more productive companies'.<sup>75</sup> This strangely named class of businesses in a precarious situation differs from abandoned companies in that they are still active with their officers in place and no insolvency or dissolution proceedings have been launched against them. However, they are incapable of growth. Hence, they are 'zombie', and 'living dead' enterprises, many of which are doomed to go bust and whose survival hinges on additional bank or other financing, government subsidies and similar exceptional support.

67. In China, zombie companies became a major policy concern about a decade ago. Because such banking and various government 'safety belts' have played, and continue to play, a critical role in keeping hundreds of thousands of Chinese businesses afloat,<sup>76</sup> zombie companies have been the focus not only of politicians but also of the various academic disciplines involved, including legal scholars. However, as time progresses, these sources are destined to dry up in China, even for cherished national pearls, let alone newly established private businesses. At this juncture, the question of whether one should file for insolvency or abandon a company arises. No quantitative data seems to be available in China on these issues.

68. Zombie companies also exist in Europe, they are omnipresent. Moreover, various forms of government support, whether central, regional or local, also exist in Europe, although they appear to play a much smaller role than in China, albeit with regional and sectoral variations. In case of European zombie companies, support may also cease or diminish at some point, when many of them face the same dilemma: to file for insolvency proceedings or choose to leave behind a financially hollow company. Fear of insolvency, and of the insolvency system on the part of the officers and officer-owners, especially of small enterprises, whether because of bad rumours damaging one's reputation spreading in the industry, bad experiences in the past or lack of knowledge about it, can take its toll at such junctures. It is presumed that the stigma is partly responsible for many taking the wrong path in such situations. The fact that zombie companies,

<sup>75</sup> T. HELMERSSON, L. MINGARELLI, B. MOSK, A. PIETSCH, B. RAVANETTI, T. SHAKIR and J. WENDELBORN, 'Corporate zombification: post-pandemic risks in the euro area', *European Central Bank Financial Stability Review*, May 2021, [www.ecb.europa.eu/press/financial-stabilitypublications/fsr/special/html/ecb.fsrart202105\\_01~f9b060744e.en.html](http://www.ecb.europa.eu/press/financial-stabilitypublications/fsr/special/html/ecb.fsrart202105_01~f9b060744e.en.html) (accessed 25 January 2025).

<sup>76</sup> According to a shorter article in China Construction News (3 August 2016), referring to the first comprehensive study of Chinese zombie companies prepared by the Chinese National Institute of Development and Strategy of Chinese University titled 'China Zombie Enterprise Research Report – Current Situation, Causes and Countermeasures', from 2016, the industries with the highest level of zombie enterprises in China were:

1. Steel (51.43 %)
2. Real estate (44.53 %)

The industries with the lowest levels were:

1. Banking (0 %)
2. Media (4.12 %)
3. Non-banking finance (4.65 %)

like abandoned ones, have escaped attention of both of policy-makers and scholars, and that statistical data, let alone properly researched and analysed empirical data, are therefore largely lacking in this domain, should not lead to the conclusion that zombie companies and the impact of the stigma on their officers do not deserve attention in Europe.

## V. COMBATING BANKRUPTCY STIGMA

### A. The Odds of an Arduous Task

69. Although the aforementioned 2013 World Bank report warns us that the 'attitudes about debt and cultural stigma change slowly, and relatively little can be done to affect such an expansive and disperse notion directly',<sup>77</sup> the odds are not insurmountable. The adoption of rescue-based systems in insolvency laws by a growing number of countries, accompanied by the introduction of tools that reduce the stigma's intensity, promises to deepen our understanding of effective strategies to address the problem. Cross-fertilisation of ideas already characterises this process, though at a sub-optimal pace. The following sub-section presents selected examples that show that the problems involved are often similar, if not identical, and that mechanisms that could prove effective in combating the stigma could be redeployed in different parts of the world. That steps have been taken, that projects have been set up to tackle the stigma (directly or indirectly), and that publications have seen the light of day, after all, is proof that, like the author of this article, there are numerous other scholars, industry experts, not-for-profit or think-tank activists who believe that bankruptcy stigma does exist.

70. It is vital to bear in mind that the war against the stigma can be direct, by the dissemination of information about the phenomenon and its negative effects, and through education. But it can also be done indirectly, by increasing the number of successful restructuring proceedings, and propagating the lessons learned through various channels. Similar to Tabb's suggestion in the context of individual bankruptcies, that the nearly one million filings per year over the last two decades have gradually reduced the stigma in the US to the level where 'only the naïve or quaintly moralistic would consider the so-called "stigma" of bankruptcy a legitimate policy determinant',<sup>78</sup> the same should be assumed in the business context. Put simply, the more successful the restructurings, the less the stigma. Admittedly, for this nascent theorem to metamorphose into its more established canonical version, the number of successfully completed preventive or regular restructurings in Europe will obviously have to increase, and not in decades but soon.

<sup>77</sup> 2013 World Bank Report, p. 44.

<sup>78</sup> C.J. TABB, *The Law of Bankruptcy*, 5th ed., Eagan, West Academic, 2020, p. 1209.

## B. Direct Methods of Combating Bankruptcy Stigma

### 1. *Choosing the Right Terminology*

71. It is not only the right choice of the nomenclature that matters in this context. As has recently been noted in the UK, ‘the sloppy language’<sup>79</sup> used by the media, including the BBC, has contributed to the strengthening rather than weakening of the stigma’s intensity. The ‘overly negative [referring to insolvency procedures], and sometimes inaccurate [use] of terms’ did, as alleged, result in ‘increasing the stigma around insolvency and potentially deterring businesses from seeking help’.<sup>80</sup> For example, the word ‘collapse’, which clearly has a negative connotation, was used in the context of one of the restructuring-focused ‘administration’ proceedings.<sup>81</sup> This is similar to the Hungarian misnomer of dubbing restructuring proceedings as ‘insolvency’ proceedings.<sup>82</sup>

72. The UK is a good example of why this is of practical relevance. Despite the country’s shift to a pro-rescue culture back in the 1980s through major legislative changes, the number of corporate insolvencies has increased, and the corporate rescue cases have recently fallen.<sup>83</sup> There is nothing to suggest that this trend will change in the short term. This means that even in the UK, the poster child of the insolvency system in Europe, more than 94 % of companies in trouble are liquidated, which means fewer jobs, fewer taxpayers and suppliers of high-quality goods and services, and often the loss of researchers and developers.

### 2. *Case Studies: Spreading Good Practices*

73. Certainly truistic, but the exploitation of case studies of successful restructurings in teaching and disseminating information about them, obviously with a fairly detailed description of the techniques, steps and measures taken along the way leading to positive outcomes, is something that should not be forgotten about as a tool to combat the stigma. Suffice it to mention one such case here, as more and more organisations have found it important to engage in collecting such case studies.

74. This includes the case study library, as well as conferences and workshops organised by INSOL – the International Association of Restructuring, Insolvency & Bankruptcy Professionals.<sup>84</sup> One particularly illuminating case encountered during the INSOL conference in Helsinki on 13 June 2018 exemplifies the

<sup>79</sup> J. TRIBE and E. GHIO, ‘The Language of Insolvency: Why Getting it Wrong can Harm Struggling Firms’, *The Conversation*, 22 April 2024, [theconversation.com/the-language-of-insolvency-why-getting-it-wrong-can-harm-struggling-firms-228051](https://theconversation.com/the-language-of-insolvency-why-getting-it-wrong-can-harm-struggling-firms-228051) (accessed 25 January 2025).

<sup>80</sup> *Ibid.*

<sup>81</sup> *Ibid.*

<sup>82</sup> For more details, see T. TAJTI, ‘Bankruptcy Stigma and the Second Chance Policy: the Impact of Bankruptcy Stigma on Business Restructurings in China, Europe and the United States’ (2018) 6(1-2) *China-EU Law Journal*, pp. 21-22.

<sup>83</sup> *Ibid.* The number of corporate insolvencies in the UK in 2023 were 26,595 (14 % higher than in 2022). In contrast, the number of rescue cases fell from 10 % to 6 % in 2023.

<sup>84</sup> NSOL International, ‘Library’, [www.insol.org/library](http://www.insol.org/library) (accessed 25 January 2025).

efficacy of such case studies in spreading information on this subject. The case detailed the successful restructuring of the Finnish Nanso Group,<sup>85</sup> a venerable family-owned fashion brand in the region. The Nanso Group found itself in financial distress in 2015, largely attributable to the fierce competition of clothing e-commerce sector.<sup>86</sup>

75. The successful restructuring of the group instead of being liquidated, as had transpired to many similarly situated businesses all over the world, including Finland, is due to the fact that someone in Nanso Group's bank knew about restructuring and was influential enough to persuade Nanso Group's directors to take this hardly-tested route, which, if successful, gives a second chance to get up and running again, although in a restructured form and at the cost of numerous painful steps. Standard process ensued, from the closure of the Nanso Group's Estonia subsidiary to the sale of some branded products, and to the closure of a plant in Finland, all accompanied by retrenchment, eventually ensuring survival and a promising new start after more than a year.<sup>87</sup>

76. It is true that no one mentioned bankruptcy stigma in connection with the restructuring of the Nanso Group, either at the conference or in the few publicly available documents. Still, in a country where liquidation was the predominant insolvency procedure, it is reasonable to state that stigma lurked behind the doors even in the case of such mid-size companies. *A fortiori*, the case is an excellent illustration of how stigma can be efficiently fought, from spreading the knowledge, information and data about restructuring and its devastating alternative – liquidation, to learning from and adopting the methods and practices of successful restructuring cases (including those developed in the large business sectors), and finally to the usefulness of restructurings and the accompanying second chance mindset.

### 3. *Exposure to Bankruptcy Mathematics*

77. An inevitable, though often neglected prerequisite for changing the mindset from one dominated by bankruptcy stigma to one that understands and more readily accepts the tenets of the second chance insolvency philosophy is exposure to the expected average recoveries from liquidations (winding-ups) as compared with the benefits of alternative restructuring. We can conveniently name this *bankruptcy mathematics*, or simply *bankruptcy math*, or in Europe *insolvency math*.

<sup>85</sup> Nanso, 'Nanso – Finnish clothing brand', [www.nanso.com/en](http://www.nanso.com/en) (accessed 19 December 2024).

<sup>86</sup> For a similar scenario and the collapse of the UK Comet Group in 2012 due to losing the battle 'with online retailers which have far lower overhead costs and can offer cheaper products', see T. ТАЈТИ, 'Unprotected Consumers in the Digital Age: The Consumer-Creditors of Bankrupt, Abandoned, Defunct and of Zombie Companies' (2019) 24(1) *Tilburg Law Review*, p. 10.

<sup>87</sup> See Nanso, 'Our Story', [www.nanso.com/en/pages/tarinamme](http://www.nanso.com/en/pages/tarinamme) (accessed 19 December 2024). As the webpage of the company itself states succinctly: 'After 2015, the entire company and its operating methods were heavily reformed. Own production had to be abandoned after years of financial struggle. On the other hand, the outsourcing of production made it possible to introduce new product groups to the collection and diversify the materials'. For one of the related reports of the Finnish public service broadcasting company, see also YLE, « Nanso to shut down Tornio factory, drop some brands – 100 jobs on the line », [yle.fi/a/3-8758680](http://yle.fi/a/3-8758680) (accessed 19 December 2024).

78. One such study was conducted by Professor Jacob S. Ziegel in 1987, based on 95 randomly chosen business bankruptcy files from the preceding five years in the Metropolitan Toronto Area.<sup>88</sup> Only three categories of creditors were considered: preferential, secured and unsecured creditors. Although the data on the number and percentage of claims, or the quantum of the claims are informative, they may not be too relevant, especially for small business owners and officers. The data that may come as a shock to them, and which may have life-changing effects in this and any similarly structured dataset, are the recovery rates of the classes observed. Specifically, while preferential creditors (e.g. unpaid taxes) recovered 49 cents on the dollar and secured creditors (in particular, banks) 43 cents on the dollar, unsecured (ordinary) creditors got only 5 cents on a dollar claim.<sup>89</sup>

79. The class of unsecured creditors is usually the largest, with most micro, small, and many of medium-sized enterprises, condemned to this class as they cannot force their debtors to provide highly effective security devices for their claims. The simple lesson is that if the officers of these enterprises refuse to participate in out-of-court negotiations (workouts) or, in the European case, in preventive restructurings, they may end up with drastically low recoveries of 4-5 per cent (if any), given that their debtors are in financial distress. This fact could lead most of them to seriously reconsider their perceptions and attitudes towards insolvency in general and restructuring in particular. If such a change of mind occurs, it would inevitably mean a shift towards a less intense stigma.

80. A final caveat should be added. Namely, the reference to the Canadian chart above does not imply that the recovery rates are the same everywhere, nor that some classes of unsecured creditors could not fare better. Indeed, if secured creditors (typically banks and non-banking financial organisations such as leasing and factoring companies) can lose out in insolvency,<sup>90</sup> unsecured creditors – which are typically SMEs – routinely suffer substantial haircuts. The somewhat varying recovery rates, however, do not change the primary lesson. It pays to be cognisant of the difference between liquidation and restructuring and the potentially very different recoveries, which would improve the willingness to resort to restructuring in due course, and to participate actively in court restructuring proceedings as a creditor with a say in the content of restructuring plans and, usually, the right to vote on them.

<sup>88</sup> J.S. ZIEGEL, 'The New Personal Property Security Regimes – Have We Gone Too Far?' (1989-1990) 28 *Alberta Law Review*, p. 739.

<sup>89</sup> *Ibid.* See the table 1 on p. 740.

<sup>90</sup> As a recent Scottish database shows, the holders (beneficiaries) of 'floating charges' – as the most important and regularly used security devices, used in tandem with fixed charges – may witness relatively frequent major losses. See J. HARDMAN and A. MACPERSON, 'Small and state-funded: An empirical study of liquidations in Scotland' (2023) 32(3) *International Insolvency Review*, pp. 420–446. While the floating charge is a court-made device in England, it spread to Scotland through business channels, eventually forcing the Scottish lawmakers to adapt it statutorily in 1961. See A. MACPERSON, *The Floating Charge*, Edinburgh, Edinburgh Legal Education Trust, 2020. Unsurprisingly, similar quantitative data could be found on the recovery rates of floating charge holders in England and Wales. For floating charge recoveries related data see R.J. MOKAL, *Corporate Insolvency Law*, Oxford, Oxford University Press, 2005, p. 191, note 92.

#### 4. *Exposure to Questions on Bankruptcy Stigma*

**81.** As a practical, empirical, evidence-based examination of the forms in which bankruptcy stigma operates, exposure to questions on bankruptcy and bankruptcy stigma deserves to be mentioned separately from education, as the results may not be the same. The SCORE project mentioned above, for example, also tested how small business owners might respond to educational videos on bankruptcy options. It was found that 74 % of those who watched the educational video were able to answer questions about bankruptcy options and benefits correctly, compared to 40 % of those who had not seen the educational material. Interestingly, in terms of the stigma, 25 % of those who watched the educational video felt that there was no stigma attached to bankruptcy. This figure was 17 % among those who had not received additional information in this manner.<sup>91</sup>

**82.** Critics may rightly frown at this information coming from the other side of the Atlantic. However, in the absence of similar empirical research in Europe to the contrary, one should refrain from uncritically presuming that the opinions of small business owners in Europe are radically different, with bankruptcy laws that have been tested very little and bankruptcy stigma that is much stronger. Moreover, in the absence of tried and tested methods of collecting data on the stigma, it is better to learn from others rather than reject such ideas.

**83.** Formulating appropriate questionnaires aimed at bankruptcy stigma and finding traces of its presence in a particular community – in our case, business communities – is far from easy, largely due to its interdisciplinary nature and the lack of tested questions and methods. Psychology is inherently a disruptive factor as many of us are reluctant to admit ignorance on any subject, including bankruptcy stigma or the insolvency proceedings in general. In addition, for small business owners, insolvency is hardly a priority topic to learn about and requires lots of time and effort; often a hopeless task given the myriad risks that they face daily.

### C. *Indirect Methods of Combating the Stigma*

#### 1. *Borrowing from Growth-Oriented and Other Types of Strategic Restructuring Variants*

**84.** As indicated above, besides insolvency-linked restructuring, other kinds of restructuring variants should be distinguished: from growth-oriented to other forms linked to the one at the centre of our observations here. In Europe, non-insolvency-related versions seem to dominate, although precise figures are lacking, especially in relation to small and mid-scale enterprises. The quantitative data of the European Restructuring Monitor (ERM), launched in 2002 and focusing *not* on insolvency but on 'restructurings which involve the creation or destruction of at least 100 jobs, or affect 10 % of the workforce at sites

<sup>91</sup> See SCORE, 'Small Business Bankruptcy: Failure or Reset?'.

employing more than 250 people’,<sup>92</sup> clearly show this with a database made of 30,899 events in December 2024.<sup>93</sup> The number of both regular restructurings and, in particular, those based on the 2019 Preventive Restructuring Directive are much lower, even though the quantitative data do reveal a slow and steady rise in some EU member states.

85. The caveat that ought to be added is that most of the ‘restructuring events’ in the ERM database were not caused by or do not pertain to insolvency. Consequently, many obviously do *not* give rise to bankruptcy stigma.<sup>94</sup> Over and above bankruptcy-related restructurings, the ERC differentiates between those linked to business expansions,<sup>95</sup> internal restructurings or restructurings related to the closure of certain affiliates, departments within the company or group of companies, and those necessitated by mergers and acquisitions or outsourcing, referred to as ‘offshoring/delocalisation’.<sup>96</sup> Some of the case studies in the ERM dataset do, however, implicate insolvency, and may therefore display some manifestations of bankruptcy stigma, although – given the database’s focus on job losses and job creation – these are not visible in most of the ERM cases.<sup>97</sup>

86. In fact, the ERM and similar datasets are not relevant as direct traces of bankruptcy stigma’s manifestations. Rather, they should be relevant for those debtors and creditors who resort to regular or preventive restructuring, because many of the techniques, knowledge and accompanying practical know-how could be reemployed in the context of insolvency and restructuring. For example, restructuring does not only consist of a few legal decisions of the courts administering such insolvency proceedings, but also of concrete organisational, financial and other types of expert decisions, some of which can be taken

<sup>92</sup> J. HURLEY, D. STORRIE, I. MANDL, S. RISO, E. GEROGIANNIS, C. VACAS and A. BROUGHTON, *ERM Annual Report 2013: Monitoring and Managing Restructuring in the 21st Century*, Eurofound, Publication Office of the European Union, Luxembourg, 2013, p. 7.

<sup>93</sup> Eurofound, ‘European Restructuring Monitor (ERM)’, [www.apps.eurofound.europa.eu/restructuring-events](http://www.apps.eurofound.europa.eu/restructuring-events) (accessed 10 December 2024).

<sup>94</sup> In reference to cases not related to insolvency-restructurings and therefore not involving stigma-related concerns nevertheless named and referred to by ERM as ‘restructuring’, one could mention the following examples: the ‘restructuring’ of the Danish company YUSK was in fact a strategic restructuring aimed at expansion to the Iberian Peninsula, with the opening of 400 new jobs, but without involving insolvency. Although the takeover of the struggling ALITALIA on the brink of insolvency by the Italian government, and the subsequent formation of the successor national ITA Airways, involved extensive restructuring steps, this case should be perceived as atypical due to the involvement of the government. It is rather a bailout case where taxpayers’ money was used to save the company, though obviously involving restructuring as well.

<sup>95</sup> See, e.g. the expansion of the multi-national company Freudenberg Medical in Ireland, adding 250 new jobs to the already existent one thousand in Carrick-on-Shannon, county of Leitrim. Eurofound, ‘Freudenberg Medical, Business expansion in Ireland’, *European Restructuring Monitor*, factsheet no. 201908, 2024, [restructuringeventsprod.azurewebsites.net/restructuring-events/detail/201908](https://restructuringeventsprod.azurewebsites.net/restructuring-events/detail/201908) (accessed 25 January 2025).

<sup>96</sup> See, for example, the Luxembourg SES company outsourcing its satellite telecommunications activities to India after a series of earlier restructurings (announced in November 2024): Eurofound, ‘SES, Offshoring/Delocalisation in Luxembourg’, *European Restructuring Monitor*, factsheet no. 201963, 2024, [www.restructuringeventsprod.azurewebsites.net/restructuring-events/detail/201963](https://restructuringeventsprod.azurewebsites.net/restructuring-events/detail/201963) (accessed 25 January 2025).

<sup>97</sup> A cursory look at the data for the last few months of 2024 shows more cases under the rubric of ‘bankruptcy’, from the Estonian aviation company Nordica, the Slovenian Emo Orodjarn (metal products manufacturing), the French Batimétal (metal furnishings for homes) and others.

directly by the insolvency practitioner (administrator, bankruptcy trustee) or the debtor in possession (DIP) performing the duties of the insolvency practitioner, with some requiring assistance of external experts. Termination of the employment contracts of several employees is an example of the former, while debt-equity swaps belong to the latter more complex category.

87. However, the range of measures is not exhaustive, nor is there a single foolproof formula that can be applied in all cases. Rather, each case should be perceived as a more or less unique set of circumstances requiring a cautious assessment of the possibilities and the aims, often involving the conduct of insolvency proceedings. To illustrate, the complex case of the Thomas Cook Group, once known as ‘the world’s first tour operator,’ involved liquidation and sale of part of the of the group’s assets, as well as a handful of other steps to integrate the assets and operations acquired by external companies.<sup>98</sup>

88. The lessons to be drawn are, on the one hand, that many of the insolvency-generated restructuring cases in the ERC (and other similar) datasets may provide examples of visible or latent stigma in restructurings. On the other hand, the rest of the ERC case studies involving restructuring and the concrete steps taken along the route to the desired ends, be it growth, increased operational efficiency or outsourcing, should be perceived as a toolbox for debtors and creditors to whom the task of insolvency-restructuring is entrusted.

## 2. *Can Small and Mid-Scale Enterprises Exploit the Positive Experiences of Large Business-Restructurings?*

89. Bankruptcy stigma may also be present in the context of restructuring large businesses, but with a negligible intensity that hardly represents such an obstacle to restructuring seen in the case of small enterprises. As a result, at least in those legal systems with a long and reputable history of reorganisation and restructuring, stigma has not been a major obstacle to the development of such advanced restructuring (reorganisation) techniques as pre-negotiated or the more sophisticated form of pre-packaged restructuring plans.<sup>99</sup>

90. As a result, efforts to detect the presence of stigma and its possible negative repercussions may not be very rewarding. Nevertheless, tackling the stigma

<sup>98</sup> Hays Travel acquired, for example, 555 UK shops of the Group, and the Chinese Fosun International the Thomas Cook brand and some of the hotel brands of the Group. For further detail: UK Insolvency Service, ‘Official Receiver to return £280m recovered from the Thomas Cook group of companies’, [www.gov.uk/government/news/official-receiver-to-return-280m-recovered-from-the-thomas-cook-group-of-companies](http://www.gov.uk/government/news/official-receiver-to-return-280m-recovered-from-the-thomas-cook-group-of-companies) (accessed 10 December 2024).

<sup>99</sup> Prepackaged bankruptcies are not defined in the US Bankruptcy Code. Rather, the terms ‘prepackaged’ or ‘prepack’ bankruptcies are ‘terms of art used to describe a plan of reorganization that will be confirmed by a bankruptcy court as part of a bankruptcy case, but where the negotiation and solicitation of votes to accept the plan are conducted in anticipation of, but before, the commencement of the chapter 11 case. If the prepetition solicitation results in sufficient acceptances to confirm the plan, then the company may commence a chapter 11 bankruptcy case and seek prompt confirmation of the plan. Unlike an exchange offer or other out-of-court restructuring, a confirmed plan binds all holders of claims and interests’. See C. MALLON, S.Y. WAISMAN and R.C. SCHROCK (eds.), *The Law and Practice of Restructuring in the UK and the US*, 2nd ed., Oxford, Oxford University Press, 2017, p. 62.

by learning from the positive experiences of successful large-scale restructurings and applying those financial and legal solutions that fit the peculiarities of small-business forms should not be ignored too easily. While debt-equity swaps may not be a realistic option for micro and small enterprises, asset sales, finding new financing, loan buybacks, renegotiating covenant packages (including waivers), or rethinking internal policies may, indeed, come into the picture.<sup>100</sup> The efficient pre-packaged reorganisation of the US CIT Group, which reduced the in-court reorganisation proceedings to a maximum of one and a half months from 1 November 2009 to 10 December of the same year,<sup>101</sup> is one of many examples.

91. As an increasing number of recent case studies show, SMEs may profit from the assistance also of private equity firms, not only in finding the right restructuring methods, but also in dealing with the current manifestations of stigma. In the case of the Polish Żabka, now a major player in the Polish retail market but formerly a mid-sized company, stigma is thought to have caused problems in securing traditional financing needed for growth, as well as in finding and implementing the right restructuring variant. The saviour came in 2000 in the form of the private equity firm PainBridge, which not only invested in Żabka's equity, but also provided much-needed strategic guidance and helped introduce operational improvements.<sup>102</sup>

## VI. CONCLUSION: IMPALPABLE BUT LIVING OR A CLOSED ISSUE?

92. The premise of this paper was that bankruptcy stigma is intense in all four corners of Europe, from the economic engine of the Old Continent – Germany – to the least developed countries, and that as such, in its various manifestations, acts as an obstacle to the successful restructuring of companies in distress or heading in that direction (i.e. preventive restructuring). It disincentivises, if it not outrightly prevents, the timely initiation of restructuring proceedings. If restructuring proceedings are nevertheless kick started, it may cripple efforts to achieve an outcome that is fair to most, if not all, stakeholders, by discouraging active participation in the drafting of the restructuring plan and the voting on it.

<sup>100</sup> C. MALLON, S.Y. WAISMAN and R.C. SCHROCK, 'Arriving at a Compromise with, and Identifying Key Stakeholders: Waivers, Amendments and Standstills, Participations, Debt Buy-Backs, Intercreditor Agreements, and Make-Whole Provisions', in C. MALLON, S.Y. WAISMAN AND R.C. SCHROCK (eds.), *The Law and Practice of Restructuring in the UK and the US*, 2nd ed., Oxford, Oxford University Press, 2017. See generally also: R. BORK, *Rescuing Companies in England and Germany*, Oxford, Oxford University Press, 2012.

<sup>101</sup> CIT (Commercial Investment Trust), founded in 1908 and engaged in asset-based financing, factoring, and small and mid-scale financing, faced financial problems due to the 2008 financial crisis (Credit Crunch). To qualify for funds from the Troubled Asset Relief Program (TARP), it became a bank holding company. It also engaged in negotiations and agreed on a pre-packaged plan with its bond holders. As a result, the in-court bankruptcy proceedings could have lasted only one and a half months in 2009. See M. SPECTOR, V. O'CONNELL and K. Haywood, 'CIT Files Bankruptcy Plan, with Eye on Exit', *The Wall Street Journal*, 3 November 2009, p. 25.

<sup>102</sup> EMPEA, 'The Impact of Private Equity in Emerging Markets: Case Study: Żabka (Poland)', September 2011, [www.globalprivatecapital.org/app/uploads/2017/03/case\\_study\\_zabka\\_web.pdf](http://www.globalprivatecapital.org/app/uploads/2017/03/case_study_zabka_web.pdf) (accessed 19 December 2024). The website of the company today is [www.zabka.pl](http://www.zabka.pl).

93. Even today, the number of contrary opinions, which more often take the form of obiters rather than empirically established studies, is not negligible. They cannot be ignored by any project that wants to present an objective picture of the phenomenon observed, as it was the case here. In that vein, it is undisputed that the intensity of the bankruptcy stigma is low, if not non-existent, and thus its adverse impact is minimal or absent in the context of small and large business reorganisations in the US as the most experienced and leading reorganisation-friendly system. However, a restructuring-friendly socio-economic and legal environment, on which such promising practice rests, is yet to fructify in Europe or in much of the rest of the globe. To presume otherwise is simply wrong.

94. In other words, denying the very existence of bankruptcy stigma, or its adverse effects of varying intensity, is not – as suggested here – the way forward for Europe or any other system that lacks such a restructuring-friendly foundation. Indeed, while it may be argued that the stigma is no longer an issue in the US, given the nearly one million new individual bankruptcy cases currently filed each year, it would be clearly erroneous to presume that the situation in Europe is the same as far as individual bankruptcies are concerned. *A fortiori*, it would be equally a mistake to assume that the same conclusion applies to business restructurings – a significantly different niche of European economies.

95. Finally, one should not turn a blind eye to the examples of projects, interviews and other evidence of various facts of stigma that have been presented with commentary in this paper. While there are very few empirical evidence-based sources on abandoned companies, the very fact that renowned US organisations have found it important to carry out projects with tests aimed at precisely presuming and proving the existence and characteristics of the stigma should speak for itself. This calls into question the validity of claims denying the presence and the *raison d'être* of our central phenomenon.

96. Ultimately, it is a matter of bare bone logic that the nexus between restructuring and bankruptcy stigma should remain relevant until there is solid evidence that the intensity of bankruptcy stigma has fallen to a tolerable, healthy level in all corners of Europe, and until restructuring becomes widely resorted to in Europe. Ideally, this should be done not only on the pages of academic journals, as is the case here, but also in concrete projects – a programmatic agenda item which *sub rosa* and for no reason, has quickly lost its initial credo in the EU, first fading away and then finally disappearing from both the soft and hard laws emerging from Brussels. Time will tell how grave a mistake it was to neglect the stigma, a seemingly unimportant piece in the mosaic. In any case, the quantitative data on the modest increase, if not stagnation, in the number of successful regular and preventive restructurings in Europe, at least for the time being, seem to support the postulates and assertions made in this paper: bankruptcy stigma is alive, it is intense and it impacts restructurings.