

EDUCATION OF JUDGES

Prepared by
Mr. Sijmen de Ranitz,
DeBrauw, Blackstone Westbroek
Amsterdam, Netherlands

1. Introduction

Not the education of judges in general, but only the education of judges involved in insolvency proceedings will be the subject of this brief paper.

A further limitation is that I will focus on the role and education of the insolvency judge dealing with *corporate* insolvency. This is not because I feel that the insolvency of private persons is not important, or that the role of the judge in insolvency proceedings of a private person is not relevant. It is because I believe not only that the overall economic impact of corporate insolvency is often bigger, but also that the handling of a corporate insolvency is as good as always more complicated, and requires additional skills.

As you will have read in the “Annotations” I will have to address three questions (see: annotations, page 7). Before I give any views on those questions I would like to raise and address some questions myself, as an introduction to my views. My first question is:

2. Why do we need the judiciary at all in corporate insolvency proceedings? Can we not do without them?

This may seem an absurd question, but nevertheless a leading insolvency judge in the Netherlands recently raised it. His question was why the judiciary should be involved in the insolvency proceedings once they had started. Could not the court open insolvency proceedings and leave the process to the administrator, the debtor, the creditors and the creditors committee? What value could the court add once the more or less professional parties of interest were at work? Could not the court sit and wait until, if ever, there was a dispute between some parties in interest about ranking or similar problems and then play its traditional role as decision-maker in a dispute?

I think not.

In my mind the two main reasons for involvement of the judiciary in the insolvency proceedings are:

- a. there must be fairness in the process
- b. the process requires important decisions to be taken not only swiftly but also with authority.

Ad a. Fairness in the process is not properly secured if the process is dealt with without judicial control. Insolvency is a game with many players: the debtor, the ordinary creditors, secured creditors, employees, bondholders, shareholders, subordinated creditors, suppliers and customers to name just a few. Their interests will vary considerably. Their relative positions will vary also. Some players run faster than others, some are stronger, some do not mind to play foul play. It is the court that should, at least in my mind, see to it that creditors are properly informed and stay informed about the process, that they are given the opportunity to timely interfere if they feel they are treated wrongly, and, in general, that there is order and balance in the process.

Also, administrators, or trustees or whatever names you may give to the insolvency practitioner handling the case, must sometimes be guided, and their work needs to be controlled and monitored, in order to have conformity in the process.

Ad b. Speed and authority. Time is of the essence in insolvency proceedings. Assets that are not properly used in an economic sense create loss for society. An enterprise without proper working capital and proper financing possibilities will lose ground and it will not create economic growth. Money not repaid to creditors is “dead money” and it does not contribute to society. Therefore, in my view, insolvency proceedings should not be delayed. Now, as I wrote above, many players in the insolvency game have conflicting interests: secured creditors may see things totally different from employees, customers will often have different views than suppliers. Ranking issues may arise, preferences disputed, and worse, the sale of assets may be disputed, the transfer of the business enterprise may be hindered.

This all should not interfere too much with the speed of the insolvency process. And this is where the judge may have to step in. It is simply not always possible to combine speed with absolute fairness; it is not possible to deliberate for years on issues that delay the insolvency proceedings. Then a swift decision of an impartial, respected third party, with authority, is needed. This is where the judges have to play their role, even if the decision to be made is more than just interpretation of the laws, even if business issues are involved.

And then it is my view that the authority of the judiciary, the respect for an objective decision by a judge is extremely helpful. It is my experience that, even if I thought a court decision to be totally wrong, or pathetic and absurd, most parties acknowledge the fact that it is a decision of the judge and that the decision must therefore be respected. This is where and how the judiciary can increase the efficiency of the insolvency proceedings.

The second question I would like to raise is:

3. What role does the insolvency judge play in insolvency proceedings? The question of *Captain* or *Traffic Cop*.

One can (basically) determine two totally different roles of the judiciary. The first and dominant role is the *traditional role* of the judge. In this role the judge is asked by a party to take a decision in a dispute arisen between two or more parties. A dispute they, or their lawyers, have not been able to solve themselves. The dispute is normally more or less concise. The procedure is clear: the parties are heard and the judge rules. His judgement is (may be after appeals) binding for the parties and *only* for the parties involved in the proceedings. It does not directly influence the legal position of third parties.

This traditional role of the judiciary I will refer to as the “*Traffic Cop*” role: one party argues that the car should turn left, the other argues that it should turn right, and the judge decides: left, right or, sometimes: just straight-ahead. The judge is passive; he listens to the arguments raised, and often only to the arguments raised, and then he renders his judgement, based on the interpretation of the law and the evidence shown.

This is not the role of the insolvency judge. The role of the insolvency judge is a different one. Already the opening of insolvency proceedings show the difference. If a creditor requests the court to adjudicate the compulsory liquidation of the debtor, to start insolvency proceedings and declare the debtor bankrupt, this seems at first sight a normal legal procedure. A dispute between two parties, and one party asks the court to make a fair judgement: declare my debtor bankrupt. But this court decision does not only directly affect the rights of the parties involved, it may, it will have a direct legal effect on the rights (and obligations) of all creditors, of shareholders, bondholders, lenders, employees and many others, who are often not even aware of the proceedings.

And once the insolvency proceedings are opened, the role of the insolvency judge is often even more different from the ordinary role of the judiciary. In many jurisdictions the insolvency judge plays fairly active role. It is the judge who monitors the process, who may give instructions to the administrator. Those instructions are not only based on interpretation of the law, but could be business decisions. The question whether or not to continue a business enterprise during insolvency proceedings is sometimes in the hands of the judge. The answer is not to be found in the law only. Here the insolvency judge is not the Traffic Cop, but the Captain of the ship, in stormy weather, mid ocean, huge waves, the Captain who has to instruct which heading to go, which harbour to seek.

In any legal system wherein the insolvency judge may have to play this role, this Captain-role, additional skills are required.

4. Now, back to the questions raised in the Annotations.

4.1. The first part of question 1 is:

“Given the variety in the recruitment system for judges among the countries, what mechanisms can be introduced to ensure that competent judges are assigned to insolvency proceedings?”

The answer lies in the question.

If the recruitment system of a specific country is such that only experienced practitioners are appointed as insolvency judges, one does not have much to fear. If I am not mistaken, this is more or less the English system. Quite often barristers, in their late forties or early fifties, with lengthy experience both in the legal profession as in the business field, being too tired for their job, or having made enough money to do something they prefer, seek a career in the judiciary and are appointed as insolvency judges. Likewise, in the Netherlands there is a tendency, although not too strong, to appoint former insolvency practitioners, lawyers who have great experience in acting as insolvency practitioner, as judge, specifically for insolvency cases. Such a system is probably ideal: recruit experts from the legal system, with fair experience in business and financial law and insolvency cases, allow them some years to acquire judicial experience, and let them then handle insolvency cases.

But what if such a recruitment system is not in place and can not be used for whatever reason?

Here I can combine my views with those on the 2nd question.

4.2. An insolvency judge is, in my view, first of all a judge. His authority is linked to the respect for the judiciary. So first of all, the insolvency judge must be a trained judge with experience in normal commercial cases. It is, in my mind, inconceivable that an insolvency judge should not have proper knowledge of the law on contracts, the laws on security rights, of business-disputes or should not have experience in handling cases in that area. The interpretation of the laws by insolvency judges should not be different from the interpretation by the other courts or judges in a certain jurisdiction.

Then of course the insolvency judge must have proper knowledge of the insolvency law. But this, in my opinion, is not a major issue. A law as well as case law can be studied and discussed. Any general judge can get acquainted with the insolvency law.

But further training is required.

It is important that the insolvency judge understands the economic and commercial considerations that play a role in the context of a stable economic development.

An insolvency judge must understand why an effective insolvency system provides fresh air for the economy, whilst an ineffective, inefficient system suffocates the economy.

It is important for the insolvency judge to understand the economic role of corporations, of corporate structures, to understand what role they play, to understand the objectives of managers, to understand that profit, risk and opportunity are closely related. It is equally important to understand the checks and balances that should be in place in a corporation or a corporate structure, and to understand the risks and dangers if such checks and balances are not in place.

It is important to understand the banking and finance sector. How do banks operate, and why? How is funding of corporations seen by bankers, and how by management of corporations? How do banks manage risk, what information should be provided to them in order to keep them in the game, in order to avoid that the banks feel cheated?

It is equally important to understand the basics of the regulatory and tax issues; the reorganisation tools like debt for equity swaps, post-commencement financing, debt-trading and similar instruments.

Also, I am afraid, the insolvency judge must have reasonable knowledge of the accounting principles and practises in order to at least understand the language of accountants and the principles used. He must have some understanding of the influence of the checks and balances in a corporation on the reliability of business figures.

And quite important is to learn what really matters for the major players in insolvency. Just to give an example, in my experience lenders really do understand that, under certain circumstances, they do have to take a “haircut”, they do have to make a deal on outstanding loans. But before agreeing to any proposal, they need, they must have, reliable financial information. They must be convinced that they get fair treatment. Also the banker must defend his decision to his boss. Communication is then, as often, essential. If the insolvency judge does understand such much is won.

Transparency and communication are key issues.

4.3. Some conclusions on the education issue are therefore:

- Judicial authority is effective and should be safeguarded.
- Judges should have experience in handling commercial cases prior to be appointed as insolvency judge.
- Judges should, if possible, have experience and knowledge of commercial, corporate and financial law prior to being appointed as insolvency judge
- Education on local insolvency law issues may be helpful, but is often not strictly necessary; the judge is more then often able to resolve the strictly legal issues properly.

- Education on economic issues, like how corporations, lenders, managers operate in a commercial, or in the local commercial, environment is often much more useful. The economic rationales of entrepreneurs and lenders must be understood.
- Education on tax and regulatory issues will help.
- Accounting principles and financial analysis should be studied, so that at least the language of financial experts is understood and necessary questions are asked.

5. Question 1, second part: The use of business professionals for full time or “ad hoc” judges.

To start provocative, I would like to rephrase some words of a German judge, Dr Voss. When asked about the issue of appointing senior businessmen, senior lawyers and similar outsiders as judges, he stated that that would be excellent, but that one should take care not to appoint people who did not make a proper career in their own field. And as people who made that career may not easily be interested in a job that pays less, it is difficult to find the proper outsider.

Also, according to Dr Voss, successful outsiders will be accustomed to excellent secretarial and other support, something not often offered to insolvency judges.

I think Dr Voss may well be right. Although this system of appointing outsiders with experience works in some countries (like England) where outsiders may have made sufficient money when they are in their early fifties, one should be aware of the risk of appointing “losers” on the bench. The authority of and respect for the judiciary must be safeguarded.

But, if bankers with a legal background and a proper career, or lawyers with insolvency experience and a successful history, or legally trained businessmen seeking a challenge after retirement can be found and are willing to accept appointment, this may increase the quality of the insolvency court. But, again, I would prefer some general judicial training for those outsiders before they are appointed as insolvency judge. And one must be convinced on the issue of impartiality.

6. The last question: External experts as advisors.

Again, I will be provocative and hopefully stimulate the discussion. I do not believe that an insolvency judge should seek advice from external experts when handling a specific case. Leaving alone the question whom is to pick up the bill for the costs involved, I do not think it is appropriate. It is the judge who appoints the administrator, and I trust he will appoint an administrator that he has confidence in. If specific advice is needed, I think it is the administrator who should seek that advice, either on his own request, and with approval of the judge, or on request of the judge. It is the administrator who is responsible for the

objectivity of his choice of the external expert and for the objectivity of the expert himself. It is the administrator who should identify, and can identify, conflicts of interest and it is the administrator who should investigate this.

It is the administrator who should inform the creditors committee about his intention to appoint an external expert, so that his choice can be discussed. And if a conflict arises, then the judge may have to step in. That judge should not be hindered by his involvement by the choice of the expert.

If the advice of the external expert is contested, it is the judge who decides if another expert should be asked to review the opinion rendered. If the wrong expert is chosen, or the wrong advice given, this should never be the liability of the judge, but a liability of the administrator.

In what areas may external advice be sought? In my experience the options are few. If the administrator is professional lawyer, the advice of financial experts may be needed, and vice versa. Also, sometimes the advice of people with specific know how of the market, of that type of business, may be asked to give their views on the business-plan, on the position of the product and on the position of the company in the market, or of the fair value of the enterprise.

But basically, I feel that the experienced administrator will know where he needs advice, and when.

7. Final remarks

In my own professional organisation in Holland I do have a nickname: “Mr Education”. I strongly believe that ongoing education is a must for all insolvency professionals, including the insolvency judges. But one must be realistic: training costs time and money, and both are scarce.

When I was a young lawyer, involved in insolvency cases, I had the great opportunity to work for some years with an older, very experienced insolvency practitioner. I have learned much from him.

May be that is why I am of the opinion that the best training for judges is the training by experienced senior judges, combined with special courses given by practitioners, financial experts and economic experts on the practical, financial and economic issues related to the insolvency process.