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ENFORCING PROPERTY RIGHTS THROUGH THE ELEMENTS OF FREE MARKET; A CASE FOR IRAN'S BANKRUPTCY LAW

Abstract

In an unhindered market, firms use their resources to meet the expectations of consumers in productive ways; therefore, competition among firms is inevitable. Those firms that use new technologies and produce efficiently can make a profit. This mechanism is only workable when the right to property would be respected and applied. Although this is an undeniable right of individuals, governments seek to bypass the simple rules of the market even in the case of bankruptcy and reallocation. As a prima facie fact, bankruptcy is one of the outcomes of the market process in a free market. In the absence of the government's apparatus, firms and creditors are free to continue their businesses or to reach an agreement to defer the timing of payment and conducting the insolvency to pay the debts. In spite of this, governments whose political benefits lead them to use interventionist methods such as securing jobs and subsidizing local businesses, enact modern bankruptcy law to protect the insolvent firms, and give them the opportunity of reconstruction. Iran whose modern bankruptcy law has been prepared is the case study of this article. This article discusses that bankruptcy is part of the normal process of the free market, and rule of law ought to guarantee freedom of parties to negotiate and compensation of the creditors in conclusion. A case study is offered to enlighten that the implementation of modern bankruptcy law would not solve the problems because the main problem is the lack of strengthened property rights.

Annotasiya

Azad bazarda firmalar istehlakçıların gözləntilərini məhsuldar şəkildə təmin etmək üçün öz imkanlarından istifadə edirlər; buna görə də firmalar arasında rəqabət qaçınılmazdır. Yeni texnologiyalardan istifadə ilə keyfiyyətli istehsal edən firmalar qazanc əldə edə bilər. Bu mexanizm yalnız mülkiyyət hüququna hörmət edildikdə və onun tətbiq zamanı işləkdir. Bu, fiziki şəxslərin təkzibedilməz hüququ olsa da, hökumətlər hətta iflas və yenidən təşkil zamanı belə sadə bazar qaydalarından yan keçməyə çalışırlar. Prima facie faktı kimi iflas azad bazarda bazar proseslərinin nəticələrindən biridir. Hökumət aparatı olmadığı təqdirdə firma və kreditorlar işlərini davam etdirmək və ya ödəmə müddətini təxirə salmaq, eləcə də borcları ödənişləri üçün ödəmə qabiliyyətli olmamaq barədə razılığa gəlməkdə sərbəstdirlər. Buna baxmayaraq, siyasi mənfəətlərinə görə hökumətlər iş yerləri ilə təmin etmək, subsidiya vermək kimi müdaxilə metodlarından istifadə yolu ilə iflas edən firmaları qorumaq üçün müasir iflas qanunu qəbul edir və onlara yenidənqurma imkanı verir. Müasir iflas qanunu hazırlayan İran bu məqalənin nümunəsidir. Bu məqalədə iflasın sərbəst bazarın normal prosesinin bir hissəsi olduğu və qanunun aliliyi tərəflərin danışıqlar azadlığı və sonda kreditorlara təzminat verilməsini təmin etməli olduğu müzakirə olunur. Müasir iflas qanununun tətbiq olunan problemləri həll edə bilməyəcəyini aydınlaşdırmaq üçün bir əsas təklif verilir, çünki əsas problem möhkəmləndirilmiş mülkiyyət hüquqlarının olmamasıdır.

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CONTENTS

Introduction

The property right is a key element to flourish the economy and prosper people's lives.[1] Humans need the proper implementation of this right because of the reasons like scarcity of goods and unavailability of free goods.[2] It is apparent that any action to abolish property rights has failed.[3] Hence, all the activities either aggression or cooperation in the market are encapsulated in the concept of property rights. In accordance with this concept, some activities such as expropriation,[4] price controls, competition rules, and bankruptcy law form the notion of aggression against property rights which are often enforced by government interference.[5] In this sense, governments usually try to implement a set of rules and institutions to engineer the market and even the time of a firm's vanishing based on their favors.

[1] For instance: "America's founders understood clearly that private property is the foundation not only of prosperity but of freedom itself". *See* Cato Handbook for Policymakers, 173 (8th ed. 2017).
[2] Hans Hermann Hoppe, A Theory of Socialism and Capitalism, 18 (2010).
[3] Karl Marx and his fellows strongly promote nationalization or socialization of the resources and means of production. They emphasize that this is the best alternative of capitalism which brings prosperity. *See* Leszek Kolakowski, Main Currents of Marxism, 416-420 (1978).
[4] This case can be seen in urban renewal and compulsory reassignment of property to developers which is against homeowners' property rights and the rationale of identity. *See* Gary Chartier, Economic Justice and Natural Law, 148 (2009). Also Chiragov and Others v. Armenia can clarify this angle. In this case, the European Court of Human Rights held that Azerbaijani refugees' right to property was invaded by Armenian government's discretion to not permit them to come back to their area. This action was in a stark contrast with the peoples' property rights and their attachments. For more information: *See* Valentina Azarova, *Chiragov and Others v. Armenia (Eur. Ct. H.R.)*, 54 International Legal Materials 961, 961 (2015).
[5] Murray N. Rothbard divides various types of aggression into a binary intervention and a triangular intervention. In a binary intervention, aggressor directly establishes a hegemonic relation with individuals (for instance taxation), while in a triangular intervention, aggressor compels individuals to make an exchange (for instance minimum wage). *See* Murray N. Rothbard, Power and Market: Government and the Economy, 13 (4th ed. 2006).

While bankruptcy[6] is an indispensable part of a free market, scholars are inclined to manage it through the external forces especially when a recession or crisis might appear.[7] There is no guarantee in place to secure merchants from the possibility of bankruptcy. "Decentralization, markets, profit, and loss tests, allowing inefficient firms to go bankrupt".[8] That is why many communities have decided to frame bankruptcy in accordance with the communal norms and customs; therefore, bankruptcy law has a long history in the business.[9]

However, governments in line with regulating the competition have gradually extended their power to equilibrate bankruptcy at their own discretion and restrict property rights. In this case, they usually implement neoclassical views[10] to preserve market equilibrium and avoid any so-called market failure despite the fact that it could eventually expand the government's size.[11] In this sense, bankruptcy is an abnormal status that needs to be regulated. For instance, President Hoover's New Deal intended to amend the Federal Bankruptcy Law to purportedly prevent market failure while this law weakened the property rights of creditors.[12]

The aim of modern bankruptcy law[13] is correcting the old method of bankruptcy and proposing the notion of reorganization in order to decrease

[6] Bankruptcy is defined as "system of laws by which an insolvent debtor surrenders his property to a court which distributes the proceeds proportionately among his creditors and usually declares the debts discharged". Reginald Parker, Creditor Rights and Bankruptcy, 19 (1951).

[7] It can be seen that there has been an ongoing interest to come into force some regulations regarding corporate rescue and rehabilitation. Jason Corbett, Twelve Years to Sharpen one Sword, but Can It Cut? Does China's New Bankruptcy Law Provide Adequate Protection for Foreign Creditors?, 74 (2010). Some scholars believe that "a fresh start can also foster productivity growth via better incentives for entrepreneurship and experimentation by increasing firm entry". Douglas J. Cumming, Measuring the Effect of Bankruptcy Laws on Entrepreneurship across Countries, 16 Journal of Entrepreneurial Finance (2012). Also, their past experience could shed light on their new business. B. Burchell, A. Hughes, *The Stigma of Failure: An International Comparison of Failure Tolerance and Second Chancing*, 334 University of Cambridge Centre for Business Research Working Papers (2006). It is interesting that most reorganization codes inspired by the U.S. Bankruptcy Code Chapter 11.

[8] Murray N. Rothbard, Making Economic Sense, 414 (2006).

[9] For a brief of the historical background of bankruptcy law: Lawrence White, *Bankruptcy as An Economic Intervention*, 1 Journal of Libertarian Studies 281, 281-282 (1977). Also its history in the 18th century of USA is accessible in Bruce Mann, Republic of Debtors: Bankruptcy in the Age of American Independence (2009).

[10] Neoclassical views include but not limited to public choice theory, theory of welfare, Coase theorem, and so on. The core of every neoclassical view is the rationality of players and the necessity of market equilibrium.

[11] "…more governments within a metropolitan area are preferred to fewer governments and interventions". Thomas J. DiLorenzo, *Competition and Political Entrepreneurship: Austrian Insights into Public-Choice Theory*, 1 The Review of Austrian Economics 59, 60 (1988). Talking about public-choice theory is complementary to the research's debates about natural and property rights. On this view, any authorities' intervention in the market at least should be logically justifiable by this theory, unless otherwise it could undermine property rights of the individuals.

[12] Murray N. Rothbard, America's Great Depression, 318 (2000).

[13] In this article, modern bankruptcy law refers to a set of rules that are seeking to restrict property rights of creditors, discharge of the debtor, and compel parties of bankruptcy to reorganizing the distressed firm.

social cost. In this sense, government intervention is a requirement to protect the debtor and prevent market failure.[14] Governments use various means such as subsidies,[15] tariffs,[16] empowering monopolistic behaviors, and so on to preserve the status quo and protect corporations. In addition, these kinds of activities have been supported by rent-seekers and distressed firms. It can be seen that "from the great crisis of 1929 onwards, a regulatory apparatus that supports and protects insolvent enterprises have been developed at various levels".[17]

The current commercial code of Iran was enacted in 1969. With regard to the importance of a harmonized and internationalized commercial code, in 2006, the government provided a bill of commercial code and proposed it to the parliament.[18] Based on the bill, bankruptcy rules have been dramatically changed and reorganization is added to the process of liquidation of a bankrupt firm. In accordance with the current Commercial Code, the government does not have a main role to dictate how to liquidate or reorganize the bankrupt firm. However, this role prevails in the bill.[19]

This article begins by elaborating on the main elements of a free market; the elements can help people to preserve their own rights to their property and enable them to set their own goals from the beginning of a commercial relationship until the end of it in accordance with the indigenous forces of a market. In part II, the envisaged accounts of the free market are stipulated because every account would vary the available tools and the level of aggression against property rights being applied by the governments. Further, the elements of a free market are elaborated in order to draw the conceptual framework of the article. Part III makes it clear that by reliance on the free market requirements, it would be nonsense to seek external forces to maintain market equilibrium. Further, the creditors' option to negotiate with the insolvent firm would be reinforced. I conclude that enacting the bill of

[14] "A situation in which the allocation of goods and services by a free market is not efficient, often leading to a net social welfare loss". Daniel Tenreiro, Bailouts Don't Distort the Market — They Address Its Failures (2020), https://www.nationalreview.com/2020/03/bailouts-dont-distort-the-market-they-address-its-failures/ (last visited Nov. 3, 2020).

[15] "Subsidies consequently prolong the life of inefficient firms at the expense of efficient ones, distort the productive system, and hamper the mobility of factors from less to more value-productive locations". Rothbard, *supra* note 5, 209.

[16] For instance, the government of Iran imposes high tariffs on imported cars and prohibits importation of some car models which has created a cartel in the car industry under the pressure of two main car manufacturers. For more information on car tariffs: *See* Financial Tribune, Iran: Imported Cars Unaffordable (2017), https://financialtribune.com/articles/auto/78308/iran-imported-cars-unaffordable (last visited Nov. 3, 2020).

[17] Valerio Tavormina, *Insolvency Regulations and Economic Recession: An Austro-Libertarian Point of View*, 5 Beijing Law Review 150, 150 (2014).

[18] Iran's commercial code reform invites turmoil (2019), https://www.al-monitor.com/pulse/originals/2019/11/reform-commercial-code-iran-deteriorate-business-environment.html (last visited Nov. 11, 2020).

[19] For more information: *See* Ardeshir Atai, *Investor Protection in Iran: A Bankruptcy Approach*, Bankruptcy Law Client Strategies in the Middle East and Africa, (2011).

bankruptcy code will deteriorate the current situation of bankruptcy in Iran and open the door for additional government interference in the natural process of the market. Further, reorganization is a lengthy and costly process that creates bureaucratic organization and complicates the bankruptcy process.

I. Conceptual framework of the free market on the occasion of bankruptcy

It could be considered that the free market is equivalent to capitalism and what we see in the developed countries is the ultimate version of the free market. However, there are at least three main accounts of capitalism[20] that one of them appears to be a free market.[21] It is necessary to recognize the main prerequisites of the free market i.e. non-aggression principle and individuals' market forces.[22]

A. The relationship between the free market and the possible accounts of capitalism

Based on the abovementioned proposition, some scholars use the free market instead of capitalism.[23] The free market features property rights and voluntary exchanges of goods and services.[24] In a free market, we cannot expect large corporations because large corporations cannot promptly react to market changes or consumers' choices and it is not surprising to not envisage their survival in a free market.[25] Also, free competition and the least market barriers leave no option other than decentralization for large corporations. In this system, social hierarchy is implausible and naturally equalizes wealth.[26]

It is clear that pure capitalism (a free market system) is the cornerstone of free voluntary transactions and everything can be considered as a process. For

[20] The two other accounts of capitalism are
a) An economic system that maintains a relationship between big businesses and government. Hence, political elites and corporations have a meaningful exchange to benefit themselves and the role of quasi-governmental institutions in the market is highlighted.
b) An economic system that relies on the past and present intervention of government. In this sense, the government has a determinant role to define and enforce laws to regulate the market. *See* Gary Chartier, Advocates of Freed Markets Should Embrace Anti-Capitalism (2010), https://c4ss.org/content/1738 (last visited Jul. 12, 2020).
[21] Hoppe, *supra* note 2, 29.
[22] Gary Chartier, Flourishing Lives: Exploring Natural Law Liberalism, 214 (2019).
[23] *See* Gary Chartier, Charles W. Johnson, Markets Not Capitalism, 59-82 (2011); Gary Chartier, Advocates of Freed Markets Should Embrace Anti-Capitalism (2010), https://c4ss.org/content/1738 (last visited Jul. 12, 2020); Eric Hugo Weinhandl, Capitalism and Free Markets. Two Sides of the Same Coin? (2019).
[24] Gary Chartier, Advocates of Freed Markets Should Embrace Anti-Capitalism (2010), https://c4ss.org/content/1738 (last visited Jul. 12, 2020).
[25] Large corporations depend on hierarchical structures and governmental aids such as subsidies, grants, and etc. (Chartier, *supra* note 4, 99). Large corporations are comparable to the central planning economy. *See* Kevin Carson, Organization Theory a Libertarian Perspective, 198 (2008).
[26] Chartier, Johnson, *supra* note 23, 20.

instance, the life of a firm is a process that can lead to merger or even bankruptcy due to a lack of productivity. Based on this standpoint, regulations enforced by the government can be regarded as governmental action to hamper the market.

In a free market, rationales such as non-aggression, collective action, and the least government interference can be useful to enhance the efficiency toward bankruptcy while the two other senses of capitalism are protected by the government without considering the social cost of its discretions. For instance, modern bankruptcy law has been imposed by the government in line with the benefits of big businesses to maintain their power in the market despite their inefficiencies and deteriorate competition, while the issue should be settled under the free market's requirements: "where there is no room for politics at all and all relations are exclusively contractual".[27]

B. The elements of free market

A free market has its own elements that a given society ought to stick to them. Based on this order, any government interference can attenuate individuals' property rights even though many scholars believe in such interference especially at the time of the emergency situations.

1. Prohibition of aggression against property rights

In a free market, businesses ought to enhance productivity in order to preserve their shares in the market. Without external supports such as government interference, businesses should strengthen their financial stability and change patterns based on the probable future changes. It helps them to avoid financial distress. For instance, in 2017, Unilever's shareholders were exposed to a big takeover by Kraft Heinz that was rejected by Unilever. However, it was a turning point for Unilever to concentrate on revising the company's operations in order to increase profitability and work on the efficiency of the business.[28] In this sense, the modern bankruptcy law aggresses against the property rights of the creditors by means of the compulsory discharging of debts.[29] As bankruptcy laws are not costless to implement and enforce, it is important how they are structured.[30] However, the question is whether this aggression decreases the transaction cost.

In this sense, some scholars distinguish between natural and artificial property rights[31] and emphasize that bankruptcy is an artificial limitation on

[27] Hoppe, *supra* note 2, 70.
[28] Chad Bray, Unilever to Sell Its Spreads Business and Restructure (2017), https://www.nytimes.com/2017/04/06/business/dealbook/unilever-spreads.html (last visited: Nov. 8, 2020).
[29] Murray N. Rothbard, The Ethics of Liberty, 143-144 (1998).
[30] Susan Block-Lieb, *The Logic and Limits of Contract Bankruptcy*, 2 University of Illinois Law Review 503, 525 (2001).
[31] Elizabeth Anderson, *Ethical Assumptions in Economic Theory: Some Lessons from the History of Credit and Bankruptcy*, 7 Ethical Theory and Moral Practice 347, 358 (2004); Thomas

the natural property rights of creditors. Then, it is a matter of capitalism to disregard oppressive contractual relations and allow the insolvent firm to maintain its dignity. Anderson stipulates that capitalism requires artificial property rights:[32]

"When people enlist state power to escape oppressive contractual relations and reformulate the rules of private property in ways that better comport with their dignity, equality, and freedom,[33] such movements should be seen as realizing the promise of capitalism, not as violating its essence. To see this, we must step out of the formalism of economic theory and represent economic systems in terms of their import for substantive social relations of freedom and equality". [34]

Although this account of bankruptcy law tries to protect the artificial right of a debtor, the creditor's natural property right might be violated,[35] while even implementing modern bankruptcy law does not guarantee that the reorganization plan would successfully decrease the costs [36] while, a bankrupt industry would be sold, readily, for its plant and equipment to be used by productive private firms.[37] In a free market, contract based bankruptcy would be expected to reduce the cost and can be an efficient alternative to bankruptcy legislation.[38]

Hence, "the government should allow debtor and creditors to contract for the bankruptcy system that they see optimal".[39] Further, the only optimal solution is to acknowledge creditors' rights to either forgive debts or follow them, despite the fact that "reaching voluntary agreement is often impeded by the ability of creditors to take individual enforcement action".[40] It means

Hodgskin, The Natural and Artificial Right of Property Contrasted, 147 (2008). Hodgskin emphasizes that artificial property rights are those acquired by government power.

[32] *Ibid.* 347.

[33] It does not mean that based on the libertarian point of view, dignity and freedom of a debtor are destructed. In this case, Spooner says that: "if, therefore, a debtor, at the time his debt becomes due, pays to the extent of his ability, and has been guilty of no fraud, fault, or neglect, during the time his debt had to run, he is thenceforth discharged from all legal obligation. If this principle were acknowledged, we should have no occasion, and no use, for insolvent or bankrupt laws". Lysander Spooner, A Letter to Scientists and Inventors, on the Science of Justice, and their Right of Perpetual Property in their Discoveries and Inventions, 63 (1884); *See also* Carson, *supra* note 25, 399.

[34] *Supra* note 31, 359.

[35] Regis Noel, A History of the Bankruptcy Clause of the Constitution of the United States of America, 187-191 (1920).

[36] "The rate of successful Chapter 11 reorganizations is depressingly low, sometimes estimated at 10% or less. The complex rules and requirements in Chapter 11 increase the costs to file the case and prosecute a plan to confirm far beyond other forms of bankruptcy". Cathy Moran, Chapter 11 Bankruptcy Explained, https://www.bankruptcyinbrief.com/chapter-11-bankruptcy-explained/ (last visited Jun. 13, 2020).

[37] Rothbard, *supra* note 8, 40.

[38] Block-Lieb, *supra* note 30, 505.

[39] Alan Schwartz, A Contract Theory Approach to Business Bankruptcy, 107 The Yale Law Journal 1807, 1850 (1998).

[40] UNCITRAL, Legislative Guide on Insolvency Law, 29 (2005). In spite of this, it can be seen that "insolvency systems with greater creditor rights and efficient judicial systems encourage less risky behavior and more out-of-court settlements". Stijn Claessens, Leorra Klapper, *Insolvency Laws*

that "each creditor may forgive only his own debt may only surrender his own property claims to the debtor".[41] It seems that:

"The only force, function, or effect of a legal contract is to convey and bind the rights of property. A contract that conveys and binds no right of the property has no legal force, effect, or obligation whatever. Consequently, the natural obligation of a contract of debt binds the debtor's property, and nothing more. That is, it gives the creditor a mortgage upon the debtor's property, and nothing more". [42]

2. Importance of collective action

An efficient outcome of a bankruptcy procedure is the maximization of the total value for the debtors, creditors, and workers.[43] With a collective action, the agreement of debtor-creditor to determine the mechanism of payments, timing, etc. is facilitated. There is no external power to decide instead of them and both parties are aware of their property rights. For example, in accordance with the current Commercial Code of Iran, the possibility of a debtor-creditor's agreement depends purely on the bargaining power and the incentives proposed by the debtor.[44] As far as the negotiation between a distressed firm and creditors is possible to reach an optimal choice, government interference is not rational. In line with this proposition, in the United States, "if the insolvent firm is willing to accept liquidation and all creditors agree, legal proceedings are not necessary."[45] In addition, the pre-insolvency agreement is significant that "if the debtor makes certain investments and fails to have the property at the due date, they explicitly put a clause in the agreement that the future debts will be automatically forgiven; in short, the creditor grants the debtor the rights of a partial co-owner of the property".[46] Post-insolvency agreement is significant as well. When debtor and creditors agree on a restructuring system to reorganize the distressed firm and commit the creditors to support a proposed plan,[47] there is no room for the external intervention of the government. Hence, rule of law should promote such innovations. In contrast, the new bill of Commercial Code stipulates that the plan of reorganization shall be approved by the board of inquiry, which is amazingly constituted by governmental experts and supervised by Reconstruction Organization.[48]

Around the World- A Statistical Analysis and Rules for Their Design, 1 CESifo DICE Report 9, 15 (2006).

[41] Rothbard, *supra* note 29, 145.

[42] Ludwig Von Mises, Human Action, 339 (1949).

[43] Oliver Hart, Different Approaches to Bankruptcy, HIER, NBER Working Paper Series, 3 (2000).

[44] Article 504 of current Commercial Code: "Failing a composition, the Liquidator shall immediately proceed with the closing of the accounts and the liquidation of the bankruptcy".

[45] Donald M. DePamphilis, Mergers, Acquisitions, and Other Restructuring Activities, 609 (2014).

[46] Murray N. Rothbard, Man, Economy, and State, 180-181 (2009).

[47] David A. Skeel Jr., George Triantis, *Bankruptcy's Uneasy Shift to a Contract Paradigm*, 166 University of Pennsylvania L. Rev. 1777, 1809 (1991).

[48] Article 909 of the new bill of Commercial Code.

Regardless of this, collective action refers to an undeniable force of the market, which is individuals. It can be seen that the Statement on the Purpose of a Corporation, CEOs of 181 big corporations around the world acknowledge that corporations are accountable toward communities and employees as well as shareholders.[49] It should be noted that in a free market, individuals are market forces. It means that "free markets put economic power into the hands of the people, and they call on us to build a self-regulating order by means of free choice and grassroots organization".[50] Richman concedes that:

"When the marketplace is free and competitive (rather than constricted by the state to protect privileged interests), it is we collectively who decide who controls the means of production. We do not do this in the legal sense, for example, by literally expropriating the assets of some people and transferring them to others. Yet that is the effect of free competition and individual liberty".[51]

The strong point of this angle is solving the problem of principal-agent that is in place and can complicate the situation of a firm during bankruptcy. This is important that managers of a firm seek for the benefits of a firm in particular on the occasion of financial distress. In spite of this, "managers of a firm have a personal interest in prolonging their reign and retaining the firm's control for as long as possible and that they would use the modern bankruptcy law for this purpose if they have to".[52] By contrast, workers are keen on business continuity in a profitable manner.[53] As an illustration, Behshahr Textile Enterprise was bankrupted due to old equipment, mismanagement, and accumulated debts to various creditors, particularly governmental organizations.[54] Further, enacting the "Protection of Reorganization and Reconstruction of Textile Industries Code"[55] in 2000 could not only solve the problem of the textile industry but also accelerate bankruptcy. Apart from this, let's hypothesize that the new commercial code is in force: How could it be possible to reorganize the mentioned enterprise? It is a prima facie fact that the enterprise suffers from both internal and external issues. As a matter of

[49] Business Roundtable Redefines the Purpose of a Corporation to Promote An Economy That Serves All Americans (2019), https://www.businessroundtable.org/business-roundtable-redefines-the-purpose-of-a-corporation-to-promote-an-economy-that-serves-all-americans (last visited Nov. 8, 2020).
[50] Chartier, Johnson, *supra* note 23, 394.
[51] Sheldon Richman, Free Market Socialism (2014), https://reason.com/2014/11/16/free-market-socialism/ (last visited Jul. 08, 2020).
[52] Iraj Hashi, *The Economics of Bankruptcy, Reorganization, and Liquidation: Lessons for East European Transitional Economies*, 41 CASE Network Studies and Analyses, 16 (1995).
[53] *Ibid*.
[54] The Bankruptcy Order of Behshahr Chit Factory (2006), https://www.magiran.com/article/1292129 (last visited Nov. 8, 2020). Behshahr Chit Factory Owes 400 billion Rials (2013), https://www.ilna.news/fa/tiny/news-102647 (last visited Jun. 15, 2020).
[55] Law on Support for Reconstruction and Renovation of Textile Industries, https://rc.majlis.ir/fa/law/show/93626 (last visited Jul. 08, 2020).

fact, the enterprise will not be profitable if it is not managed efficiently. It has been proved that the privatization and governmental bureaucracy cannot make it profitable. While it would be possible to implement the alternative that is the engagement[56] of workers in the process of negotiation with the creditors.[57]

3. The least government intervention

Government intervention in the market in most cases is against the normal process of transactions. In particular, the government has no moral right to intervene in the market, reallocate risks between debtor and creditors, and free the debtor from his debts. In this regard, bankruptcy law can be interpreted as "a system of interventional legislation which with the ability of individuals freely establish the terms of their transactions".[58] The proponents of government interference believe that rescuing distressed firms is highly necessary if their failure causes market wide harm.[59] That is why modern bankruptcy laws have been activated and many countries praise the role of government to preserve market equilibrium. Mises stipulates that:

"In the eyes of all reformers such as Plato, the "body politic" could not operate without interference from the top. Intervention by the "king," by the government, and by the police was necessary to obtain action and results".[60]

Hence, the philosophy behind modern bankruptcy law is the entitlement of a firm to eliminate its debts. Apparently, without third-party interference (the government) the extra-contractual dissolution of debts is not possible. Then, in a free market, there is no room for the governments to deviate from the rule of law.[61] Further, it cannot be construed from the notion of bankruptcy that the government has to save distressed firms for the sake of the market. Bankruptcy means that healthier firms have an opportunity to conduct a merger[62] and distressed firms can sell their assets or revise plans to increase their profitability.[63] In other words, a merger can help the debtor and creditors to think about restructuring a distressed firm. In addition, "merger may increase the combined value of the target because the combined firm has insights into correcting managerial deficiencies and can use financial

[56] Chartier, *supra* note 4, 106-107.
[57] The current Commercial Code of Iran as well as the bill of Commercial Code has no provision to encourage the participation of workers in such a negotiation.
[58] White, *supra* note 9, 281.
[59] Robert K. Rasmussen, David A. Skeel Jr., *Governmental Intervention in an Economic Crisis*, U. of Pennsylvania Journal of Business Law 7, 16 (2016).
[60] Ludwig Von Mises, The Free Market and Its Enemies: Pseudo-Science, Socialism, and Inflation, 3 (2004).
[61] *Supra* note 8, 283.
[62] "Carefully selected distressed M&A opportunities could become a valuable corporate strategy alternative, especially during troubled economic times". Joseph Calandro, *Distressed M&A and Corporate Strategy: Lessons from Marvel Entertainment Group's Bankruptcy*, 37 Strategy & Leadership 23, 23 (2009).
[63] Jeffrey A. Miron, *Bailout or Bankruptcy? A Libertarian Perspective on the Financial Crisis*, 29 Cato Journal, 9 (2009).

synergy."[64] Delta and Northwest Airlines merger which indicates a successful plan to avoid bankruptcy.[65] "The merger will create a stable airline in a quite volatile market, can be considered in this regard the most expansive and impressive network worldwide."[66] Governments are addicted to use protectionist methods such as restricting importation and imposing high tariffs to keep distressed firms alive. In case of failure, they put their endeavors to use the reorganization plan to revitalize inefficient firms. "The irony is that the government is stepping in to solve the problems it created".[67] For instance, "in the case of the GM restructuring of 2009, GM focuses attention on gaming the rule-makers to gain an advantage. In return, the rule-makers get political patronage and discretionary power".[68] In this scenario, the probable binding contracts between the debtor and the creditor are ruled out, while they could include the responsibility of debtor in the case of bankruptcy.[69] More broadly, during the 2008 financial crisis in the United States, the government decided to rescue the financial sector through government ownership. The government provided funds for the distressed financial agents by enacting the Emergency Economic Stabilization Act.[70] Although such an intervention has made them profitable,[71] it increases future moral hazards and risky activities because of the possible intervention of government on the occasion of crisis.[72]

Notwithstanding this, consumers' right to choose would be deteriorated and the efficient allocation of resources has been ruled out. In a free market, such firms have only two options: a) to do nothing and go out of business, completing its entropic collapse; or, b) to move into a completely new-and more profitable-product line.[73] For instance, Crystal Oil Company which was bankrupted in 1986, reach an agreement out of court with the major creditors

[64] Clas Bergström, Theodore Eisenberg, Stefan Sundgren, and Martin T. Wells, *The Fate of Firms: Explaining Mergers and Bankruptcies*, 2 Journal of Empirical Legal Studies 49, 50 (2005).
[65] *See* Aviation Strategy, Delta/Northwest Merger: Now Looking More Promising, 131 Aviation Strategy 19 (2008).
[66] Jill Mogensen, A Strategic Analysis of the Delta Northwest Merger (2008). Available at: https://dra.american.edu/islandora/object/0708capstones%3A64/datastream/PDF/view (last visited Nov. 8, 2020).
[67] Henry Thompson, In Praise of Bankruptcy (2008), https://mises.org/library/praise-bankruptcy (last visited Oct. 26, 2020).
[68] Cameron M. Weber, *What Is Good for General Motors Is Bad for America: The 2009 Bailout through the Lens of Heskett's Design Oriented Theory of Value*, 2 She Ji: The Journal of Design, Economics, and Innovation 183, 188 (2016).
[69] Lysander Spooner, Poverty: Its Illegal Causes and Legal Cure: Part First, 74 (1846).
[70] *See* https://www.congress.gov/110/plaws/publ343/PLAW-110publ343.htm (last visited Nov. 8, 2020).
[71] *See* Troy Brownfield, The 5 Biggest Bailouts Ever (2020), https://www.saturdayeveningpost.com/2020/01/the-5-biggest-bailouts-ever/ (last visited Nov. 8, 2020).
[72] Miron, *supra* note 63, 9.
[73] Butler Shaffer, In Restraint of Trade: The Business Campaign Against Competition, 1918-1938, 40 (1997).

and restructures debts.[74] Also, in 2019, Sungard Availability Services negotiated to reduce its debt, while the control of the company will be transferred to a new group of creditors.[75] These cases indicate that in a free market, it is possible to prevent liquidation, while the debts would be settled in an efficient way.

However, in the presence of government and modern bankruptcy law, they can persuade the government to protect them and defer settlement of debts.

By considering the preferred account of capitalism, the role of voluntary exchanges prevail and property rights transform into the heart of any market decisions. Hence, any government action to restrict property rights by means of regulating bankruptcies can be taken into account as aggression and the notion of reorganization is used by the government to strengthen its role in the market and protect inefficient firms. It aims to restrict people's autonomy especially workers to reach an agreement without the involvement of authority.

II. The implications of the free market elements on bankruptcy law

Reaching out the implications of the free market on bankruptcy law needs to have insight into the beneficiary of modern bankruptcy law. The question is why do legal systems intend to introduce a new approach toward bankruptcy called fresh start by focusing on the restricted freedom of negotiation? Further, the proposed solutions under the free market to balance between property rights and debtor-creditors' way forward are embraced.

A. Wertfrei analysis of modern bankruptcy law

The assessment of any modern bankruptcy law should consider the costs and benefits of bankruptcy. Some scholars emphasize that implementing a reorganization plan leads to maintaining jobs, preventing the cost of the judiciary, and increasing the productivity of an insolvent firm.[76] In other words, the modern economy has invalidated the proposition that the liquidation can maximize debtor's assets; therefore, long-term economic benefits would be preserved by the reorganization process.[77] In accordance with the Principles for Effective Insolvency and Creditor/Debtor Regimes, "providing for the efficient liquidation of both nonviable businesses and businesses whose liquidation is likely to produce a greater return to creditors

[74] Patrick A. Gaughan, Mergers, Acquisitions, and Corporate Restructurings, 462 (2007).
[75] ABF Journal, Prepackaged Filing Are Flying Through Bankruptcy: Is That Really a Good Thing? (2019), https://www.abfjournal.com/articles/prepackaged-filings-are-flying-through-bankruptcy-is-that-really-a-good-thing/ (last visited Nov. 8, 2020).
[76] William Walter Brown, *Correspondence*, 4 Journal of Economic Perspectives 207, 210-211 (1990).
[77] UNCITRAL, *supra* note 40, 28.

and reorganization of viable businesses"[78] should be one of the requirements of modern insolvency laws. In fact, the government of Iran by considering the dynamism of the economy has proposed a new bill of commercial code to harmonize the procedure of bankruptcy with the globalized norms and protect insolvent firms through the privilege of compulsory reorganization.[79] It can be seen that many developed countries have enacted modern bankruptcy law to defer the bankruptcy of firms.[80] Hence, distressed firms have this opportunity to remain in the economic cycle and reorganize themselves by preserving the right of creditors to receive their debts through the future earnings of the firms.According to Iran's bill of Commercial Code, reorganization is compulsory for an insolvent firm.[81] The insolvent firm must designate its plan of reorganization under the supervision of a creditors committee and submit it to the board of inquiry.[82] Besides, the commercial court is allowed to announce bankruptcy of a firm only after confirming the impossibility of reorganization.[83]

"The benefits of reorganization are increasingly accepted and many insolvency laws include provisions on formal reorganization proceedings".[84] In fact, it can be said that the reallocation of assets in a productive way should be the ultimate goal of any modern bankruptcy law.[85] Hence, "efficient modern bankruptcy laws should, in principle, result in the exit of those firms whose resources could be deployed more effectively elsewhere. But, at the

[78] The World Bank Principles for Effective Insolvency and Creditor/Debtor Regimes (2015), https://www.worldbank.org/en/topic/financialsector/brief/the-world-bank-principles-for-effective-insolvency-and-creditor-rights (last visited Nov. 3, 2020).
[79] Based on Doing Business studies, the current world rank of Iran in resolving insolvency is 133. https://www.doingbusiness.org/en/data/exploretopics/resolving-insolvency/reforms (last visited Nov. 3, 2020).
[80] For instance "The United Kingdom has its Companies' Voluntary Arrangement (CVA); France has the Proce´dure de Sauvegarde; Germany has included a copy in sections 217 of its Insolvency Ordinance (Planverfahren), and Italy also has a copy as do Spain and Greece. The Netherlands is said to be including a variation of it in its new long-awaited legislative act". Christoph G. Paulus, *Competition Law versus Insolvency Law: When Legal Doctrines Clash*, 18 Unif. L. Rev. 65, 73 (2013).
[81] In the United States, "If the plan is not approved by all classes of creditors, an alternative procedure, called "cram-down", maybe embarked on. Under "cram-down", a modified version of the reorganization plan is approved by the Court and provisions are made for the 'fair and equitable' treatment of the dissenting classes of creditors under the Court's supervision. This implies that, to accelerate economic recovery, it is decisive that creditors recover as soon as possible their financial means, which are instead stuck with the insolvent entrepreneur, and that the latter's fixed assets are productively reinvested, insofar as possible". Tavormina, *supra* note 17, 150.
[82] Article 842: "The merchant who has been subject to reorganization by the decision of the board of inquiry, must, within three months from the date of the Board's announcement, prepare the reorganization plan with the supervision of creditors' committee and submit to the Board for Inquiry and approval. This period is renewable once".
[83] Article 939: "Bankruptcy order in only issued by commercial court following the issuance of document for impossibility of reorganization by the inquiry committee and is implemented temporarily".
[84] UNCITRAL, *supra* note 40, 29.
[85] Paulus, *supra* note 80, 66.

same time, they should also prevent premature liquidation".[86] For instance, some scholars believe that chapter 11 reorganization of U.S. Bankruptcy Code "is an alternative to liquidation and it cannot only put more dollars in the pockets of the creditors but also can save more jobs and preserve local tax bases".[87]

Notwithstanding the so-called benefits of modern bankruptcy law, the contradiction between competition and bankruptcy is seen. Competition in a free market has of utmost importance. It helps to find productive ways of manufacturing and enhance the welfare of consumers. In between, the bankruptcy of firms is an inevitable externality of the market process and indicates that some firms could not productively use the means of production. Here, complying with the simple rules of a free market such as efficient allocations of resources is the prerequisite of success. Mises says:

"There the economic problem is to employ these factors in such a way that no unit of them should be used for the satisfaction of a less urgent need if this employment prevents the satisfaction of a more urgent need".[88]

B. Protecting both creditors' and insolvents' rights in free market: a dilemma

One objection to a free market mechanism is that there is no institution such as the government to enact and enforce the laws. Without this, the transparency and enforceability of any rule of law include bankruptcy laws would be diminished and in such a chaotic environment, multiple bankruptcies would vitiate the resources and increase transaction costs. Hence, the government can efficiently intervene in the market to both protect the insolvent, but efficient firm and enforce the laws to direct the debts in a sense that no damage incurs to the market. Although enforcement of laws is vital to secure any given community, it is still possible to solve negative points of bankruptcy without government intervention. From this point, different solutions are introduced to prevent external interference:

1. Toward a polycentric legal order

The government is frequently keen on enacting monopolistic rules and force all the members of a given community to obey them. By contrast, polycentric law is a set of rules "arising from a variety of customs and private processes rather than law coercively imposed by a single state authority".[89] In a polycentric regime, individuals are free to not execute some rules in their deals.[90] In this case, Rothbard says:

[86] Hashi, *supra* note 51, 22.
[87] Elizabeth Warren, Jay Lawrence Westbrook, *The Success of Chapter 11: A Challenge to the Critics*, 107 Mich. L. Rev. 603, 612 (2009).
[88] Mises, *supra* note 42, 336.
[89] Tom Bell, *Polycentric Law in a New Century*, Policy Magazine, 34 (1999).
[90] Gary Chartier, *Enforcing The Law and Being A State*, 31 Law and Philosophy 99, 117 (2012).

"The law merchant, admiralty law, and much of the common law began to be developed by privately competitive judges, who were sought out by litigants for their expertise in understanding the legal areas involved".[91]

In this sense, modern bankruptcy law is definitely beyond this definition and against the spontaneous order of the market. According to polycentric law, people are free to choose what sort of legal rules can be applied. Moreover, in this community, it is seldom that everybody would consent to defer insolvent's payments in any case of insolvency by means of uniform bankruptcy law because such a mechanism is only possible through the government's apparatus.[92]

The number of creditors can indeed complicate the case and decrease the probability of an agreement to defer the debts, but it is not a rational justification to unify bankruptcy law. For instance, it is always possible to find "an investor who would like to take a position in the company to use that position, to obtain control of the business. It is not unusual to see a pre-bankruptcy lender end up owning the company when it emerges from bankruptcy. The lender buys its stake looking to be involved in the company for the long haul".[93] Also, lenders with a preexisting relationship with the distressed firm may be more willing to lead the negotiations on loan terms due to their greater familiarity with the firm's management and financial balance.[94]

2. Non-coercive way of compensation

Voluntary and peaceful exchanges constitute the cornerstone of a free market. In such an order, we can embrace individuals' peaceful and voluntary cooperation.[95] In spite of this, it is presupposed that enforcement of law requires coercion; therefore, in a free market, it is impossible to implement legal rules because there is no governmental institution to guarantee enforcement of the law. The government provides legal protection and settlement such as police and judicial process to warrant contract enforcement. Otherwise, there is no binding contract.[96] If so, processes in a free market require the government monopoly to solve the problem of enforcement and authority; therefore, its existence depends on government's apparatus. Obviously, such a phenomenon is in stark contrasts with the nature of a free market because the government attenuates peaceful and voluntary cooperation by its monopolistic order.[97] It can be said firmly that

[91] Murray N. Rothbard, *On Freedom and the Law*, New Individualist Review, 37-40 (Winter, 1962).
[92] *Supra* note 4, 102.
[93] Rasmussen, Skeel Jr., *supra* note 59, 35.
[94] Claire M. Rosenfeld, *The Effect of Banking Relationships on the Future of Financially Distressed Firms*, 25 Journal of Corporate Finance, 403 (2014).
[95] Gary Chartier, Anarchy and Legal Order (Law and Politics For A Stateless Society), 165 (2013).
[96] Murray N. Rothbard, Society without a State (2006), https://mises.org/library/society-without-state (last visited Jun. 14, 2020).
[97] Chartier, *supra* note 95, 215.

there is no difference between such services (enforcement of the law and maintaining the order) and other services provided by the private sector. Hence, the private sector in a free market can provide such services and promote institutions to not only enforce the laws but also use coercion in rare situations. Here, legal institutions that rooted in a free market order and beyond the centralized nature of state institutions are vital to provide a consent-based legal order in accordance with the communal norms of a given society.[98]

These legal institutions may have no monopoly over the market and they are not seeking to justify their legitimacy because consumer choices are the ultimate signals of their efficiency and as far as the main purpose of laws in a free market and its legal institutions is to serve the common good of all,[99] enforcement of laws through the market forces is possible. As Rothbard says:

"On the free market, defense against violence would be a service like any other, obtainable from freely competitive private organizations".[100]

Besides, the usage of force to implement the rule of law is still possible in a free market while condemning the monopoly of the government. Modern bankruptcy law is a legal device by which the state legally and economically intervenes to absolve insolvent debtors from their full financial obligations once the debtors have paid their debts to the limited extent that their assets allow.[101] Here, the notion of voluntary exchanges is undermined and governmental account of the situation trumps the contractual obligations and agreements.

The free market is not opposition to rules; it is opposition to the misinterpretation and lack of consistent approach to rule of law. It means that modern bankruptcy law cannot provide a fairer system for both creditors and debtors mainly because of the monopolistic nature of government and its solutions. For instance, the government's approach to privatization of firms in Iran[102] has resulted in many failed cases in the market and government additional interference has dramatically increased, while the modern bankruptcy law would enable the government to preserve its power over the market and stay away from the elements of the free market.[103]

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[98] Jonathan Crowe, Natural Law and the Nature of Law, 127 (2019).
[99] Veryl Victoria Miles, *Assessing Modern Bankruptcy Law: An Example of Justice*, 36 Santa Clara Review, 1054 (1996).
[100] Rothbard, *supra* note 5, 10.
[101] William H. Meckling, Is Bankruptcy Law Bankrupt? (1979), https://www.libertarianism.org/publications/essays/is-bankruptcy-law-bankrupt (last visited Oct. 28, 2020).
[102] Due to reduction of crude oil exportation stem from sanction re-imposition, Iran government seeks to secure its revenue through increased taxation and selling governmental assets. In addition to this, the government will continue the privatization policy. Al-monitor, Analyzing Iran's New State Budget (2019), https://www.al-monitor.com/pulse/originals/2019/12/iran-new-budget-rouhani-sanctions-economy.html (last visited Oct. 28, 2020).
[103] Privatization of Qazvin Counter Manufacturing through a weak system and without clear rules resulted in unpaid workers and bankruptcy ex-post, while it was the sole manufacturer of counters in

Conclusion

The article advances the impossibility of bankruptcy's separation from the market process. Hence, the government's intervention in the market and introducing the bureaucratic mechanism to prolong the process of insolvency cannot be a matter of efficiency. By enacting the bill, it seems that the role of creditors in the process of liquidation will be replaced by the bureaucratic procedure under the supervision of governmental experts. This mechanism does not only make the bankruptcy costly and timely but also decreases efficiency. It is a prima facie fact that external intervention in the market process will not accomplish its mission. In addition, enforcing the rule of law in a free market is possible through a polycentric legal order instead of a monopolistic governmental system of law.

Bankruptcy law should have transparent and plausible rules to increase the incentives of investors to invest in the firm. If bankruptcy law restricts the right of creditors, the level of investments will decrease dramatically. By contrast, in the current Commercial Code of Iran, an insolvent firm can reach an agreement with the creditors to stop the procedure of bankruptcy and continue its business in order to pay its debts in the future.[104] Although many scholars[105] believe that modern bankruptcy law has been enacted to solve the collective decision-making problem of creditors and it provides an opportunity to decrease the direct and indirect costs of liquidation, the article indicates that these hypotheses are not realistic.

The article acknowledges that while the current Commercial Code of Iran can be a cornerstone to attain an agreement between debtor and creditors, weakness of rule of law and government interference hinder people's resolution. In terms of modern bankruptcy law, we understand that creditors are prohibited to pursue their own interests after the commencement of the proceeding on an individual basis;[106] therefore, its convergence with the free

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the middle-east ex-ante. Qazvin Counter Manufacturing Was not Spared from Privatization/Workers Gathered due to Overdue Payments (2009), https://snn.ir/fa/news/789223 (last visited Oct. 28, 2020). Indeed, the government supports implicitly a discretive reorganization plan to recompense its previous failures. Such as arbitrary privatization and on-time investments on technology or innovation.

[104] Article 480 of the current Commercial Code: "A composition or scheme of an arrangement must be agreed to by at least one-half of the creditors plus one, representing a minimum of three-quarters in value of the total amount of debts, verified and admitted, or admitted provisionally, in conformity with Treatise V of Chapter Six, otherwise it shall be annulled".

[105] *See* Nadine Levratto. *Bankruptcy: from Moral Order to Economic Efficiency*, Financial Institutions, Markets and Ethics: Mixed Approaches in the European Context Conference (2007); Warren, *supra* note 87; A. Schawartz, R. Scott, Commercial Transactions: Principles and Policies, 806-807 (1982) (advancing the prisoner's dilemma and finding some resemblance between the prisoner and debtor-creditor deadlock in decision-making). Douglas Baird, Thomas Jackson, Cases, Problems and Materials on Bankruptcy (1990). Thomas Jackson, *Bankruptcy, Non-Bankruptcy Entitlements, and the Creditors' Bargain*, Yale Law Journal 857, 907 (1982) (concentrating on collectivization as a means of cost reduction and agreement finalization).

[106] Rothbard, *supra* note 46, 73.

market is doubtful because in a free market there should be no government interference. The fundamental principle of the free market is the ignorance of any government intervention in human affairs. In such an atmosphere, our role as individuals and our rights to property are highlighted.