Corporate Rehabilitation Proceedings in the United States and Germany

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I. Introduction

A. Introduction to the corporate rehabilitation proceedings

Chapter 11 of the United States (US) Bankruptcy Code of 1978[1] is entitled "Reorganisation". It governs the rehabilitation of a debtor and the restructuring of its debt obligations.[2] The first section of the German Insolvency Code states the objectives of the German insolvency law. Its purpose is to jointly satisfy the creditors. Hence a single glance at the titles of both procedures is sufficient to establish that the basic aims of both codes are laid out differently. Whereas the American system centres on freeing the debtor of his debts,[3] the German code focuses on the satisfaction of the creditor.[4] In the US, a debtor sees the bankruptcy procedure as an opportunity. In Germany, to the contrary, bankruptcy traditionally meant the economic death of the debtor. A German entrepreneur would have been prepared to effect a composition, but rarely to file for bankruptcy.[5] However, with its new Insolvency Code, which came into force on 1 January 1999, Germany set great store by the newly introduced means of reorganisation, a codified reorganisation plan ("*Insolvenzplan*"), which was set up using the Chapter 11 BC plan of reorganisation as a model.

After nearly four years' experience with the new German insolvency legislation, not many insolvency plans have been filed. According to statistics, approximately 25 000 corporate entities have filed for insolvency since 1999 and only 64 of these cases have filed for an insolvency plan.[6] Whether this should be interpreted as a sign that the plan procedure cannot fulfil expectations or that the German debtors, creditors and trustees need more time to get accustomed to this new means is still to be seen.

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1. Hereafter abbreviated BC.

2. Collier, *International Business Insolvency*, 3.01.

3. Terms such as the debtor, the creditor/s, the trustee etc. importing the masculine gender only include the feminine gender and in case of entities even the neutral gender.

4. See for this in a more detailed way: II.B. infra.

5. Kirchhof, *ZInsO*, 2001, 1, 8 first column.

6. Named by RA Wutzke in a report on the insolvency plan procedure on the occasion of the ZInsO—conference in May 2002 in Berlin. See as well: Bretz, *ZinsO*, 2002, 619 et seq.

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B. Structure

Section II of this paper will focus on the history and the different objectives of both plan procedures in the US and Germany. After comparing the plan procedures in section III, section IV will contrast the respective procedures. Since one of the major issues arising under a Chapter 11 plan is the danger of manipulation of the classification of creditors claims by the proponent of the plan, and this may well occur under the German system too, section V will address this problem. Finally section VI will give a brief summary and concluding remarks.

II. History

A. US

There is a long history of remedies against business debtors, including reorganisation proceedings in the US. The reason for this is to be found in the historical roots of the nation's legal and social system. As a colony of the British Empire, the US relied on capital from England. Simplifying the picture, the lenders were positioned in England and the debtors in the colonies.

Even today the government of the US acts cautiously with respect to any intrusions into the entrepreneurial liberty. On the other hand, the social system of the US provides less comfort and protection than the average European country. Hence it is close to conclusive that a US entrepreneur, after failing within the economic system, needs a second chance as a social component or social compensation. This idea of a fresh start is a fundamental concept to US bankruptcy law and refers to individuals and companies equally.[7] This goal of bankruptcy procedure has already been confirmed by the Supreme Court in *Wetmore v. Markoe* in 1904.[8]

1. The equity receivership

The core of today's Chapter 11 proceeding can be traced back to the equity receiverships in the late 19th century. This legal creation was invented with the building of the railroads across the US. As with every commercial revolution a great financial risk was involved. The capital was merely secured upon the rail tracks and the train itself. The material value was out of all proportion to the capital expenditure necessary to build the railway. Therefore it was worth thinking about keeping the railroad intact, since the best use of its assets may well have been as a going concern, especially as there was no other real use of the assets of a railway. However, to be used or even built readily, either new capital or other kinds of new reorganised financial conditions were necessary.[9] As no bankruptcy law existed,[10] solutions for

7. Braun/Uhlenbruck, *Unternehmensinsolvenz*, pp. 427, 428; see for individual debtors and the possibility of a fresh start: Baird, *Elements of Bankruptcy*, pp. 28–36 (Chapter 2).
8. Wetmore v. Markoe, 196 US 68; 25 S. Ct. 172, 176, 49 L.Ed. 390 (1904).
9. Braun/Uhlenbruck, *Unternehmensinsolvenz*, pp. 428, 429; Baird, *Elements of Bankruptcy*, pp. 63, 64; Kübler/Prütting/Otte, *InsO*, § 217 marg. no. 8–11.
10. Baird, *Elements of Bankruptcy*, p. 65.

these problems had to be found by the lawyers of the creditors, and thereafter these solutions had to be overseen by judges.

Within the receivership proceeding a judge appointed a receiver to take control of the debtor's assets as an equitable remedy. The receiver sold the assets as a whole to a specially created rescue company (foreclosure sale). Selling a company as a going concern preserves its value and avoids the devaluation of a business that is liquidated and sold piecemeal. The creditors participated in the new company in proportion to their value and quality of receivables within the old company. As compensation, new shares were issued to the creditors. The core idea was to leave the assets in the company so that the value of all assets, including assets like know-how were kept within the company, but the debt and equity capital were changed.

The participation of the previous debtors within the rescue company was governed by a creditor or reorganisation committee.[11] Within the system of such a committee the problem occurred that the secured creditors through arrangements with the old management of the indebted company could determine a low takeover price for the assets. By doing this, the payment of subordinated or unsecured creditors was jeopardised. As a solution a judge would insist upon an upset price. This was the minimum price that the reorganisation committee had to bid at the foreclosure sale to acquire the assets of the company. However, judges tended to keep this price low. They feared that otherwise the reorganisation could be endangered, as it might require more financial funds than the reorganisation committee would be able to raise.[12]

The National Bankruptcy Act of 1898 replaced the receivership procedure, developed as equitable law, with a reorganisation procedure.[13] Chapters X and XI of the National Bankruptcy Act of 1898 distinguished between complex reorganisations for bigger corporate enterprises and simpler debt arrangement proceedings for small businesses, primarily merchant debtors. The latter required a plan proposed by the debtor. This plan, known as the composition, would be approved by the court if it obtained the consent of the majority of creditors (pro capita and more than half of the represented creditors) and was in the best interests of the creditors.[14] By way of interpretation, courts held that the best interests of the creditors meant that the creditors should not be paid "considerably less than they might reasonably expect to realize in the administration of the assets in due course".[15]

11. Braun/Uhlenbruck, *Unternehmensinsolvenz*, p. 429; Baird, *Elements of Bankruptcy*, pp. 66–69; Kübler/Prütting/Otte, *InsO,* § 217 marg. no. 8–11.

12. Braun/Uhlenbruck, *Unternehmensinsolvenz*, p. 430; Baird, *Elements of Bankruptcy*, p. 70; Kübler/Prütting/Otte, *InsO*, § 217 marg. no. 11.

13. From a German perspective it is interesting to note that the equity receivership procedure is nothing else than the '*übertragende Sanierung*' (transferring of assets) as developed by K. Schmidt (K. Schmidt, *ZIP*, 1980, 328, 336); see: Braun/Uhlenbruck, *Unternehmensinsolvenz*, p. 431.

14. Act of July 1, 1898, ch. 541, § 12b, 30 Stat. 541, 549 cited after Baird, *Elements of Bankruptcy* p. 70 footnote 9; see as well Braun/Uhlenbruck, *Unternehmensinsolvenz*, p. 430; Kübler/Prütting/Otte, *InsO*, § 217 marg. no. 12.

15. Fleischmann & Devine Inc. v. Saul Wolfson Dry Goods Co. Inc., 299 F.2d 15 (5th Cir. 1924); Adler v. Jones, 109 Fed. 967, 48 C.C.A. 761.

With Chapter X the first reorganisation procedure had been codified, whereas the Germans needed exactly a 100 years longer for their first codified reorganisation procedure by means of a procedure known as an insolvency plan.[16]

Through the reform of the Bankruptcy Code of 1978 the procedures of Chapters X and XI of the National Bankruptcy Act were consolidated in a uniform reorganisation procedure, regardless of the size and the legal form of the company within Chapter 11 BC, whereas Chapter 7 BC provides the primary provisions for liquidation of the debtor's estate.

2. *The absolute priority rule*

A central principle of today's corporate reorganisation in Chapter 11 BC is the absolute priority rule,[17] whose foundation was already laid within the receivership proceeding. In *Northern Pacific Railway Co. v. Boyd*[18] the Supreme Court held that senior creditors where not allowed to dismiss the interests of junior creditors arbitrarily or even unilaterally. The court stated that a freezeout of a junior creditor's interests was invalid, and held at the end of its opinion what later became to be known as the "fair and equitable" standard: it is not possible for senior creditors together with the previous management of the bankrupt corporation to stipulate new participation rights in the rescue company at the expense of junior creditors.

Today the absolute priority rule has a substantive and a procedural component, both set out in § 1129(b) BC. Firstly, it is a source of substantive rights. Creditors with rights against the assets in the rescue company receive a participation according to the priority they held within the previous company. Secondly, it provides procedural protection to all junior participants in a reorganisation whose rights are compromised in the procedure.[19]

B. Germany

The German insolvency law has been amended and recodified effective from 1 January 1999. § 1 of the new Insolvency Code ("*Insolvenzordnung*", or abbreviated *InsO*) codifies the purpose of the insolvency process and states that the process is supposed to jointly satisfy the creditors of the debtor through selling the debtor's property and distributing the proceeds among the creditors or through the adoption of an insolvency plan for the rehabilitation of the business. The new Insolvency Code represents a major reform of German insolvency law. Predecessors of this law had been the Bankruptcy Act ("*Konkursordnung*", dating back to 1877), the Composition Act ("*Vergleichsordnung*", dating back to 1935), and the Joint Execution Act ("*Gesamtvollstreckungsordnung*", passed in 1975 and amended in 1990, which regulated insolvencies in the area of the former German Democratic Republic).

16. Braun/Uhlenbruck, *Unternehmensinsolvenz*, p. 431; Nehrlich/Römermann/Braun, *InsO*, Vor § 217 marg. no. 39 and especially footnote 4.

17. The second core principle is the discharge of old debts, ruled in § 1141 BC.

18. 228 U.S. 482; 33 s. Ct. 554; 57 L. Ed. 931; 1913 U.S.

19. Braun/Uhlenbruck, *Unternehmensinsolvenz*, pp. 430 and 506; Baird, *Elements of Bankruptcy*, pp. 71, 72 and 81.

1. The need for reform

The *InsO*, a completely new code for insolvency proceedings, was enacted in 1994. The reform process included an extensive study of existing bankruptcy regimes; in particular, the US Bankruptcy Code was used as a model. The reform was necessary as Germany's former insolvency system had failed to provide a functioning system to deal with a dramatically increasing number of business insolvencies. Three out of four cases were not even opened as there had not been enough assets to cover the procedural costs of conducting the insolvency, and a further 10% of the opened cases had been suspended immediately afterwards. Most of the insolvent companies had simply been liquidated. If, however, an asset distribution was achieved the average dividend paid to unsecured creditors was less than 5%. The composition instrument, regulated in a special code, the Composition Act, was nearly never used. Less than 1% of cases ended in such an agreed-upon composition.[20] Kilger created the slogan of the bankrupt bankruptcy.[21]

2. Lack of a codified reorganisation procedure

The lack of a reorganisation instrument or a procedure to reorganise insolvent businesses has been fatal to deal with insolvencies. The idea of a reorganisation procedure has developed very slowly in Germany over the decades. The predecessor of the *InsO* the "*Konkursordnung*" (Bankruptcy Act) was created within the environment of economical liberalism: only free competition between participants on the market should prove who would succeed and who would fail. Even if the German legal system has overcome its attitude to imprisonment of debtors some years ago, Germany has only recently overcome its liking for the near-lifelong possibility of debt enforcement of 30 years, within the recent reform of the German law of obligations which came into force on 1st January, 2002.[22]

In contrast to the US point of view with its philosophy of a fresh start, debtors in Germany are frequently considered to be villains.[23] However, the economic reality seemed to need an instrument besides the simple liquidation of the debtor's assets. For their own interests, the creditors found that a total or at least partial maintenance of the business could be a better use of the assets than simple liquidation, especially if certain values such as the worth of a company's name, technical knowledge, know-how, and a rapport with the company's customers could only be used in a profitable way by keeping the business intact.[24] The instruments provided by German law had proven useless. Hence legal practice developed a procedure which was first introduced by K. Schmidt and is very similar to the US equity

20. Nehrlich/Römermann/Braun, *InsO*, Vor § 217 marg. no. 24; Bork, *Insolvenzrecht*, marg. no. 8; Collier, *International Business Insolvency*, 23.01.[2][a]; Ziechmann 16-FEB Am. Bankr. Inst. J. 10; Kamlah 70 Am. Bankr. L.J. 417.

21. Kilger, *KTS*, 1975, p. 142.

22. *Gesetz zur Modernisierung des Schuldrechts* BGBl. 2001 I S. 3138.

23. Braun/Uhlenbruck, *Unternehmensinsolvenz*, pp. 423, 424.

24. Schwehr, *Probleme bei der Verwertung des insolventen Unternehmens*, pp. 37 et seq.

receivership, a reorganisation by way of transferring the assets ('*übertragende Sanierung*').[25] This procedure has been used in Germany for at least 25 years and has proven successful. Its main characteristic is that the assets of the bankrupt business are separated from the debtor as a legal entity and transferred to a new legal entity, created only for the purpose of taking over these assets. As only the assets are transferred, the old bankrupt business is left as a lifeless shell with all the debts. This shell was liquidated whereas the new entity could be operated free of debts. Creditors were satisfied from the proceeds of the transfer.[26]

German insolvency law was understood as a law exclusively orientated towards the creditors. If the debtor or the debtor's business could be used to pay off the creditors it would be done. A separate enforceable, negotiable legal position for the debtor on his own or the debtor's own business was not provided by law.[27]

However, this attitude changed during the ongoing debate on the reform process. One of the main objectives of the new insolvency law was to provide three pari passu treatments of the debtor's assets—liquidation, transferring of the assets and reorganisation. None of these three treatments of the debtor's assets should be given any preference over one of the other paths. By way of stating this, the new law is supposed to eliminate the tendency of the former law to liquidate the debtor's assets.[28] Hence the new German insolvency law provides a qualified reorganisation proceeding, the centrepiece of which is the insolvency plan, which has been described as the heart of the new German insolvency law.[29]

III. The Processes of Reorganisation

A. The process of the Chapter 11 plan of reorganisation

The US plan of reorganisation process comprises four phases: the development or formation of the plan of reorganisation; the voting of impaired classes; the phase of obtaining confirmation of the plan by the court and the consummation of the plan.

The proceedings usually begin by a voluntary petition filed by the corporate debtor. There is no requirement of insolvency as there is under German law.[30]

1. The formation of the plan

A successful Chapter 11 proceeding generally results in a reorganisation plan which can be described as a business plan for the bankrupt entity in order to reorganise it, so that it will emerge as a profitable entity.

25. K. Schmidt, *ZIP*, 1980, 328, 336; K. Schmidt, *Wege zum Insolvenzrecht*, p. 138.
26. Collier, *International Business Insolvency*, 23.05.[2]; Smid/Rattunde, *Der Insolvenzplan*, marg. no. 42; Braun/Uhlenbruck, *Unternehmensinsolvenz*, pp. 424, 425.
27. Braun/Uhlenbruck, *Unternehmensinsolvenz*, p. 425.
28. Allg. Begründung zum RegE, Uhlenbruck, *Das neue Insolvenzrecht*, p. 231.
29. Kübler/Prütting/Otte, *InsO*, § 217 marg. no. 1.
30. Westbrook (1990), *Insolvency Law & Practise*, pp. 86–90; the German law requires a permissible reason for the commencement of insolvency proceedings which is either illiquidity, impending illiquidity or overindebtedness, §§ 17–19 InsO.

a. The parties to the proceeding

Besides the parties mentioned in § 1109 (b) BC: debtor, trustee, all committees, all creditors and equity security holders, the court is able to name further parties who should participate in the procedure, since the term is set up as a flexible concept offering the judges space for interpretation.

aa. The debtor: In general, the debtor of a Chapter 11 case can be either an individual person, a general or limited partnership or a corporation, § 109 BC.[31]

The corporate debtor under Chapter 11 usually becomes a debtor in possession. The debtor remains in possession of all his property and is therefore allowed to operate the bankrupt business during the bankruptcy proceeding, unless and until the court orders the appointment of a trustee.[32] From a German point of view it is interesting to note that this leads to the effect that the former management of the debtor remains in position and continues to run the business. However, the debtor in possession has fiduciary duties towards the creditors and where relevant towards equity shareholders.[33]

bb. The trustee, the US trustee and the examiner: The trustee has to be distinguished from the US trustee. The latter is an administrative officer of the US Department of Justice. The US trustee supervises the administration of bankruptcy cases. Its purpose is to relieve the bankruptcy court from certain administrative duties, especially oversight functions.[34] The former can be appointed by the court to run the business instead of the debtor in possession.

Similarly to the trustee, the examiner is appointed on request of a party in interest or the US trustee. The examiner does not replace the debtor as a debtor in possession and simply investigates cases of fraud, dishonesty, incompetence, mismanagement or irregularity in the debtor's affairs.

cc. The creditors: The bearer of a filed (§ 501 BC) or allowed (§ 502 BC) claim can take part in the procedure, if the claim provides a right to payment, § 101 (5) BC. According to Rule 3003 (b) (1)

> [t]he schedule of liabilities filed pursuant to [§ 521 (1) BC] shall constitute a prima facie evidence of the validity and amount of the claims of creditors, unless they are scheduled as disputed, contingent or unliquidated.

In relation to this, the participating creditors can be divided into roughly three different categories:

31. Governmental units are excluded from the definition of persons who can be a debtor.

32. Collier, *International Business Insolvency*, 3.03.[3][c]; Cowans, *Bankruptcy Law and Practice*, § 20.6; for the trustee see the following subchapter: III.A.1.a.bb. infra.

33. Collier, *International Business Insolvency*, 3.03.[4].

34. Collier, *International Business Insolvency*, 3.03.[2].

- secured creditors, who have a granted security interest in assets of the debtor collateralising the obligation amounting to the value of the claim
- unsecured creditors, who have claims without collateral security
- equity holders, e.g. shareholders

The US trustee has freedom in the composition of the committee. However, according to § 1102 (b) (1) BC the committee (whatever kind of committee, creditors or equity holders) shall "ordinarily consist of the persons, willing to serve, that hold the seven largest claims against the debtor of the kinds represented by the committee" or a pre-filing committee that was "fairly chosen" and "is representative of the different kinds of claims to be represented".

In addition, the US trustee must appoint a committee of creditors holding unsecured claims as soon as practicable after the order for relief. The US trustee may also appoint equity holders' committees and/or additional committees of creditors, which is done especially in larger cases, § 1102 (a) (1) BC. In small business cases the court may for cause, and on request of a party in interest, order that no creditor committee is appointed, § 1102 (a) (3) BC. Although the committee has few formal powers it plays a major role within the reorganisation procedure. The committee functions as a counterpole to the management of the debtor. The members of the committee have extensive consultation and supervision rights in all matters and influence court decisions; they are involved in the proposal of the reorganisation plan and have to examine if the company is a going concern.[35]

b. The right to file the plan

§ 1121 (b) BC defines a 120-day period after the filing date of the petition during which the debtor in possession has the right to propose and file a plan of reorganisation with the court (exclusivity period). Within a second period of a further 60 days the proposed plan needs to be accepted.[36]

The court can either reduce or extend the exclusivity period up to 180 days, § 1121 (d) BC. The exclusivity period is very important for the debtor, as it provides him with the opportunity to control the process of proposing a reorganisation plan. Courts frequently extend the exclusivity period as they understand that it normally takes longer than 120 days to effect certain improvements to the debtor's operations, which are essential to put forward the plan.[37] This leads to the most frequently raised complaint about the Chapter 11 process, namely, that the courts are too keen to extend the exclusivity period and hence provide the debtor with an unfair bargaining advantage.[38] As a solution to this problem, Congress has enacted a new rule within its Bankruptcy Reform Act of 1994. Creditors now have

35. For a detailed catalogue of powers and duties of the committees see: § 1103 BC.
36. The acceptance of the plan has to be distinguished from the confirmation of the plan.
37. Collier, *International Business Insolvency*, 7.02.[1][b].
38. Collier, *International Business Insolvency*, 7.02.[1][b].

the right to appeal against the court orders increasing or decreasing the exclusivity period.[39]

If a trustee has been appointed, or the debtor has not filed the plan within the exclusivity period or a proposed plan has not been accepted, any party in interest can file a plan.

c. *The contents of a plan*

§ 1123 BC contains mandatory and optional provisions of a plan of reorganisation. However, since the reorganisation procedure should achieve a settlement of conflicting interests, all participants have some margin of negotiation which they use widely in practice. The legal rules in the BC provide the participants more with competencies and authorities than attempting to restrict them.[40]

Mandatory components are regulated by § 1123 (a) BC. The plan must designate the classes of claims and classes of interests. The plan must differentiate explicitly between classes of claims or interests that are not impaired and those which are impaired under the plan, and it must state how the plan will satisfy the impaired classes.[41] Further, the plan must contain the proposed catalogue of measures to achieve the reorganisation. In addition the plan should contain only provisions that are consistent with the interests of creditors and equity security holders and with public policy in the event that an officer, director, trustee or any successor of such is selected.[42]

An optional path, and therefore left to the discretion of the issuer of the plan, is the selection of the classes, the determination of contracts to be accepted or rejected and the selection of proposed measures, § 1123 (b) BC.[43] As a result the issuer of the plan retains a high degree of flexibility with his proposal of the reorganisation plan. The Bankruptcy Code only guarantees that the proposed reorganisation is feasible, and that a sensible scheme for the realisation of the concept exists.[44]

d. *The classification*

The classification of creditors and interests into different groups plays an important role in the distribution of the estate to creditors and interest holders under a Chapter 11 plan.[45] Note that claims and not creditors must be classified.[46] Since voting to accept or reject the reorganisation plan is by classes,[47] claims and interests need to be placed into classes. The issuer of a reorganisation plan is allowed to place a

39. Cowans, *Bankruptcy Law and Practice*, § 20.22 (p. 239); Collier, *International Business Insolvency*, 7.02.[1][b]; Fassbach, *Die cram down power*, p. 22.

40. Fassbach, *Die cram down power*, p. 23; Westbrook in: H.H. Rajak, *Insolvency Law: Theory & Practice* (1991), p. 347, 359.

41. For the concept of impairment see: III.A.2. infra.

42. For a detailed commentary on these rules see: Cowans, *Bankruptcy Law and Practice*, § 20.21 (p. 223–231); Collier, *International Business Insolvency*, 7.03.

43. For a detailed commentary on these rules see: Cowans, *Bankruptcy Law and Practice*, § 20.21 (pp. 231–239); Collier, *International Business Insolvency*, 7.04.

44. Terhart, *Chapter 11*, p. 133.

45. Miller/Bienenstock/Rapisardi/Goldman/Wolk, 738 *PLI/Comm* 227, 233.

46. Miller/Bienenstock/Rapisardi/Goldman/Wolk, 738 *PLI/Comm* 227, 235.

47. For the process of voting see: III.A.2. infra.

claim or interest in a particular class, if it is "substantially similar" to other claims or interests in the class, § 1123 (a)(1) and § 1122 (a) BC. According to § 1123 (a)(4) BC each claim or interest within one class must be treated equally, unless a claim holder or interest holder agrees to less favourable treatment. By stating that similar claims must be classified together § 1122 BC guarantees that the rights of creditors are protected. In addition to the best-interests-of-the-creditors-test the creditors therefore enjoy protection by way of classifying their claims, as their interests are equal to those of creditors with similar interests. The central idea of § 1122 BC is that each claim in a class must be sufficiently similar to the others so that the vote of the majority reflects the interests of the class as a whole.[48]

e. The disclosure statement

Before the plan of reorganisation can be accepted by the creditors and thereafter confirmed by the court, it is necessary to inform all the parties directly involved about the plan. This is vital as the parties cannot agree or disagree on a plan if they are not provided with all the essential information, 1125 BC. The disclosure statement has to be authorised by the bankruptcy court after a hearing over the disclosure statement. However, the court approves if "adequate information" is included in the disclosure statement and not the plan itself. The fact that the approval of the disclosure statement does not include any kind of valuation has been described as critical,[49] since a creditor does at least need to know if he will be treated better than under a liquidation. But this knowledge necessarily requires a form of valuation.

2. The process of voting and acceptance of the plan impairment of claims or interests concept

The next step in the formal procedure of a Chapter 11 case is the acceptance of the reorganisation plan, which is regulated by § 1126 BC. The voting process under a Chapter 11 plan can only be understood in connection with the concept of impairment, which is regulated in § 1124 BC. The importance of distinguishing between classes of claims or interests which are impaired and those which are not impaired is obvious as soon as one sees this regulation in conjunction with § 1126 BC. If a class is unimpaired by a plan, it is "conclusively presumed to have accepted the plan", § 1126 (f) BC. Thus the holders of claims or interests in unimpaired classes are not entitled to vote on a plan. Furthermore such a class cannot get the protection offered under the rules regarding the confirmation of the plan.[50] Equally, a class which does not receive anything under a plan, is deemed to have rejected the plan and does not need to be asked for their votes, § 1126 (g) BC. The general idea of non-impairment is that creditors with claims or interests that will not be affected by the plan should not have the right to vote, as they have no dispute.[51] Apart from

48. Baird, *Elements of Bankruptcy*, p. 246.
49. Baird, *Elements of Bankruptcy*, p. 254.
50. For the process of confirming the plan see: III.A.3. infra.
51. Baird, *Elements of Bankruptcy*, p. 252.

the opportunity of using its cram down power, the court is only able to confirm a reorganisation plan if all the classes have accepted the plan or the class is not impaired under the plan, § 1129 BC.[52] Hence the concept of impairment has been included in the BC to reduce the necessity of cramming down opposing classes.[53]

§ 1124 BC defines two different types of non-impairment. The first type of non-impairment involves a class that is not impaired, because the plan leaves legal, equitable, and contractual rights to which such claim or interest entitles the holder of such claim or interest, unaltered, § 1124 (1) BC (unaltered classes). The second type of non-impairment is known as the reversing acceleration. It requires that the plan of reorganisation gives the debtor the right to heal pre- or post petition defaults that triggered an acceleration clause. This right would not exist without the plan. Such a provision needs to grant that the debtor cures the default and compensates the creditor for all damages incurred due to his actions that caused the default.[54] In addition, the plan is not allowed to alter the claim in any other way. With respect to court decisions such as *Re Barrington Oaks Gen. Partnership*, a claim is impaired in the event that "any modification of rights [. . .] regardless of whether the value of the rights are enhanced" exists.[55]

Creditors holding allowed claims or interests are entitled to vote upon the plan, § 1126 (a) BC. Besides the creditors there are some other groups of persons entitled to vote, e.g. equity security holders.[56] A class of claims accepts the plan, as ruled by § 1126 (c) BC, if a majority in number and two-thirds in value of holders of claims, who actually vote, accept the plan. According to § 1126 (d) BC a class of interest holders accepts the plan, if at least two-thirds in value of allowed interests who vote, do that in favour of the plan.

3. *The confirmation of the plan*

The confirmation of the plan could be described as the climax of the procedure.[57] After a mandatory confirmation hearing[58] the court must decide whether to confirm the plan or not. A plan can be confirmed in two different ways, depending on whether it is consensual or non-consensual. Whereas a plan is consensual if each class accepts the plan or is unimpaired, a plan is non-consensual if any impaired class of creditors or interest holders does not accept the plan.

a. *Consensual plan*

The court will confirm a consensual plan, if the issuer demonstrates, that the 13 confirmation standards set out in § 1129 (a) BC are fulfilled. However, confirmation is

52. For the cram down power of the bankruptcy court see: III.A.3.b. infra.
53. Fassbach, *Die cram down power*, p. 29, especially footnote 148.
54. Collier, *International Business Insolvency*, 7.03.[2][c][i]–[iii].
55. Re Barrington Oaks Gen. Partnership, 15 B.R. 952, 956 (Utah 1981).
56. For a detailed list see: Cowans, *Bankruptcy Law and Practice*, § 20.25 (p. 254).
57. Fassbach, *Die cram down power*, p. 31.
58. Collier, *International Business Insolvency*, 7.08.[1].

not automatic even if all requirements are met. The BC in this sense is just setting a minimum standard.[59] Worth pointing out are two "tests": the feasibility test and the best-interests-of-the-creditors-test, which both form the economic standards of the requirements of § 1129 BC. To meet the best-interest-of-the-creditors-test the issuer of the plan must prove that each holder of a claim or interest who has not accepted the plan will receive at least as much under the plan, as he would receive in a liquidation under Chapter 7 BC, § 1129 (a) (7) BC.[60] The second economic standard is that the plan must be feasible. Thus a plan should not be "likely to be followed by a liquidation, or the need for further financial reorganisation", § 1129 (a) (11) BC. This is done by means of an expert appraisal testifying that the debtor's cash flow will be sufficient to pay its operating expenses and the payments proposed in the plan.[61]

b. Non-consensual plan/cram down

If one or more impaired classes have objected to the plan, the proponent of a plan can request confirmation by means of a procedure known as cram down, if at least one impaired class of claims has accepted the plan. In addition to the confirmation standards, two further requirements must be met to confirm a plan under the cram down provision. If the plan does not discriminate unfairly against dissenting classes and treats dissenting classes in a fair and equitable way, the consent of the objecting class is not required, § 1129 (b) BC. The meaning of the term fair and equitable involves the application of the absolute priority rule and means generally that a senior class is paid or satisfied in full before a junior class receives anything.[62] There is an exception to this rule known as the new value exception: even if secured creditors are not paid in full, equity holders of the "old debtor" can keep the equity by making contributions equal to the value of that equity. Thus the equity holders are permitted to retain interest in the reorganised firm.[63]

c. Legal effects of the confirmation

The confirmation of the plan by the courts is regulated in § 1141 BC. All parties in interest—even those who voted against the plan, and those who have not filed their claims[64]—are bound by the confirmation of the plan, as the plan acts as a composition in bankruptcy. Probably the most important effect of confirming the plan is the discharge of the debtor from all the claims against him that arose at

59. Cowans, *Bankruptcy Law and Practice*, § 20.26 (p. 258); re Ambanc La Mesa Ltd. Partnership, 115 F.3d 650 (9th. Cir. 1997).
60. See: II.A.1. supra.
61. Collier, *International Business Insolvency*, 7.09.[11].
62. See: II.A.2. supra.
63. Baird, *The Elements of Bankruptcy*, p. 259 et seq.; Bank of America National Trust & Savings Association v. North LaSalle Street Partnership, 526 US 434, 119 S.Ct. 1411, 143 L.Ed. 2d 607 (1999).
64. Only those debtors who did not receive notice about the plan procedure or have not been send a ballot paper by the court will not be bound by the confirmation of the plan.

any time before the confirmation,[65] to enable him a fresh start.[66] This refers to all corporations and partnerships.[67] The property dealt with by the plan is unencumbered by and clear from all claims and interests of creditors and owners, § 1141 (b) and (c) BC.

4. The consummation of the plan

With the confirmation of the plan the last state of the plan procedure begins. The court still has to observe the consummation of the plan and has to supervise the measures implemented, such as the distributions to creditors and interest holders as provided by the plan. However, the court is not supposed to interfere into the management of the debtor. As soon as the measures provided in the plan are essentially complied with (substantial consummation) the court issues the final decree to conclude the procedure, with the effect that the debtor in possession and the trustee, if appointed, are relieved. At the same time the court supervised administration of the estate comes to an end.[68]

B. The German Insolvenzplanverfahren

The key innovation in the new *InsO* is the addition of the procedure for reorganisation, namely the insolvency plan. The plan is supposed to provide means of reorganising rather than liquidating the insolvent business. According to the statutory system of the *InsO* the procedure can be divided into three phases. Firstly, §§ 217–234 *InsO* set out the requirements for drawing up the plan. Within the second phase (§§ 235–253 *InsO*) rules for the acceptance and confirmation of the plan are specified and §§ 254–269 *InsO* finally deal with the effects of a confirmed plan and the supervision of compliance.

1. The formation of the plan

German insolvency law differentiates between two different periods of insolvency proceedings. The first period, known as the interim insolvency procedure, begins with the filing of the petition and is supposed to allow the court to collect all necessary information to establish if the prerequisites for the commencement are met, i.e. determines if there are sufficient assets to cover the costs. The actual liquidation/reorganisation process is initiated by the court order of commencement and forms the second period of the insolvency procedure. The actual reorganisation process under court supervision begins if the creditors decide during the report meeting that the business should be kept intact and that an insolvency plan should be implemented.

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65. Including those debts that arose during the case.
66. For the concept of a fresh start see: II.A. supra.
67. For individual debtors, see Chapter 7, § 523 BC.
68. Fassbach, *Die cram down power*, p. 36.

a. The parties to the proceeding

aa. The debtor: The insolvency procedure applies equally to private persons (such as individuals and entities without a corporate body) and legal entities (any corporate body such as private limited partnerships, joint stock companies, associations or other legal forms of commercial entities), § 11 *InsO*. In general the debtor loses his management powers. The debtor is not allowed to dispose of any of his assets when the court opens the insolvency proceedings. The right to administrate the estate passes over to the trustee, § 80 *InsO*. Although the *InsO* contains a section dealing with self-management, §§ 270–285 *InsO*, only 10% of the 64 filed insolvency plans have been implemented by means of self-management of the debtor.[69]

bb. The trustee: Once the case is opened upon the court's order, the court appoints a trustee[70] to manage the debtor's business. Usually it is the same person as that appointed by the court within the first period of the insolvency proceeding, who is in charge of securing and maintaining the debtor's assets and running the business (the interim trustee). However, he has to obtain the creditors' consent for certain disposals, such as the sale of the business as a whole, § 160 *InsO*.

cc. The creditors: The *InsO* divides creditors into different categories following the order for the distribution:

- creditors with the right to segregation of assets, who can claim that an asset does not constitute part of the debtor's estate and thus not participate in the insolvency proceeding, § 47 *InsO*
- creditors with the right to separate satisfaction, who are secured by collaterals and form part of the estate and therefore participate in the insolvency proceeding, §§ 49, 51 *InsO*
- creditors of estate, who have unsecured claims, but will nevertheless be satisfied primarily (e.g. administrative costs), §§ 53–55 *InsO*
- insolvency creditors, who have unsecured claims that had been established against the debtor at the time of the commencement of the insolvency proceeding, § 38 *InsO*
- subordinated insolvency creditors are unsecured creditors with the lowest priority among the claims (e.g. interest claims running since the commencement of the insolvency proceeding), § 39 *InsO*

The insolvency plan procedure is characterised by the principle of creditor autonomy.[71] Hence the creditors have wide-ranging influence over the course of the proceeding, as they decide how the estate should be dealt with to satisfy their claims, reflected in certain provisions such as the creditors' assembly and the creditors committee. The creditors' assembly is a meeting forum of the creditors called

69. RA Wutzke, "Report on the insolvency plan procedure on the occasion of the ZInsO—conference" (24./25. 05. 2002 in Berlin).

70. The term under German insolvency law is '*Insolvenzverwalter*' which can be translated either trustee, receiver, insolvency practitioner or insolvency administrator.

71. Herzig, *Das Insolvenzplanverfahren*, pp. 18 et seq.

by the court, §§ 74 et seq. *InsO.* The right to participate is held by creditors with a right to separate satisfaction, the insolvency creditors and the subordinated insolvency creditors. The creditors' assembly decides, for example, whether the debtor's business should be terminated or continued and if a reorganisation plan should be implemented. Furthermore a claim must be registered and examined by the creditors' assembly in order to enter into the insolvency table which is necessary for a claim to be recognised in the proceeding. Since the creditors' assembly is a large body and reflects several different interests, it is not particularly flexible and hence not really suitable to accompany the ongoing procedure.[72] Therefore the court can, together with the creditors assembly, appoint a creditors' committee, 68 *InsO.* Its members include creditors with a right to separate satisfaction, the insolvency creditors with the largest claims and the small creditors. The function of the creditors' committee is to assist and supervise the trustee in carrying out his functions, § 69 *InsO.* According to § 72 *InsO* resolutions of the creditors committee are valid, if the majority of its members have participated in the vote and the majority (per capita) of the voting members have voted in favour of the resolution. In contrast to the US Bankruptcy Code, the *InsO* provides only one creditors' committee and does not take into consideration the specific assembly of claims.[73]

b. The right to present the plan

Only the trustee and the debtor have the right to propose an insolvency plan to the court for approval. The debtor may submit a plan when filing for insolvency, § 218 para. 1 clause 2 *InsO.* The trustee can be given the mandate to propose an insolvency plan by the creditors' assembly, §§ 157 clause 2, 218 para. 2 *InsO.* If a proposal of the plan is done through the trustee, the creditors' committee, the debtor and representatives of the workers participate in drafting the plan by means of consultation, § 218 para. 3 *InsO.* Hence the right to present the plan is given to the debtor and the creditors—through their right to mandate the trustee with preparing a plan.[74] A direct right for certain creditor groups or even singular creditors to propose a plan, is not provided by the *InsO.*

c. The contents of the plan

The insolvency plan consists of a factual and a constitutive part[75] and if the requirements of the §§ 229, 230 *InsO* are met several appendices, § 219 *InsO.*[76]

The main purpose and objective of the insolvency proceeding is the optimal satisfaction of the creditors, § 1 *InsO.*[77] To meet this aim the participants should build up the details of the insolvency procedure by means of negotiation. Hence the plan should leave some flexibility to the participants. According to this objective

72. Bork, *Insolvenzrecht*, marg. no. 77.
73. Gottwald/Braun, Vor § 217 marg. no. 103.
74. Herzig, *Das Insolvenzplanverfahren*, p. 41.
75. factual part = *darstellender Teil*/constitutive part = *gestaltender Teil.*
76. Braun/Uhlenbruck, *Unternehmensinsolvenz*, pp. 475; Häsemeyer, *Insolvenzrecht*, marg. no. 28.18.
77. See: II.B. supra.

the §§ 220 et seq. *InsO* shape only the outline with very few mandatory rules to be complied with.[78]

The factual part describes the concept of the plan, hence gives a detailed description of the basics and the effects of the plan. Required are all those details that inform the creditors and create confidence in order to gain approval to the plan.[79]

The constitutive part needs to show all the measures of the plan which alter the legal rights of the parties, § 221 *InsO*. These measures include terminations and notices of repudiation of contracts as well as obligations and disposing legal transactions.[80] The term "parties" comprises the creditors with the right to separate satisfaction, the insolvency creditors and the debtor, § 217 *InsO*. Thus the insolvency plan cannot interfere with the rights of creditors with rights to segregation of assets and those of creditors of estate.[81]

d. *Formation of creditors groups and the principle of equal treatment*

A mandatory requirement of the plan is the formation of creditor groups with the same legal position, § 222 *InsO*. Through the formation of creditor groups it is possible to consider the special natures of interests of creditors involved within the plan.[82] According to § 222 para. 1 *InsO* the plan needs to divide creditors into three different groups known as compulsory groups. Firstly, the creditors' group with right to separate satisfaction, if their rights will be affected by the provisions of the plan, § 222 para. 1 no. 1 *InsO*; secondly, the insolvency creditors' group, § 222 para. 1 no. 2 *InsO* and thirdly, the subordinated creditors' group, § 222 para. 1 no. 3 *InsO*, if those claims are not regarded as released.[83] In addition a separate group has to be formed for employees, if those are involved as insolvency creditors with a considerable value of claims.[84] Further subgroups for creditors with equal economic interests are possible, if the groups are properly delimited.[85] The reason for this is the reasonable application of the principle of equal treatment. An insolvency law, which forces realisation serves the guarantee of equal treatment of creditors. Equal treatment in this sense means jointly, equally and pro rata satisfaction of the creditors.[86] However, if objective reasons for a differentiated treatment of creditor claims exists, such claims of creditors can be combined in different groups. But within one group an unequal treatment of claims is not permitted.[87]

78. Kübler/Prütting/Otte, *InsO*, § 219 marg. no. 3, 4.
79. Kübler/Prütting/Otte, *InsO*, § 220 marg. no. 3.
80. Häsemeyer, *Insolvenzordnung*, marg. no. 28.19.
81. Kübler/Prütting/Otte, *InsO*, § 221 marg. no. 3; Bork, *Insolvenzrecht*, marg. no. 320; for a detailed description of the contents of the constitutive part see: Smid/Rattunde, *Der Insolvenzplan*, marg. no. 312–323.
82. Braun/Uhlenbruck, *Unternehmensinsolvenz*, p. 475.
83. According to § 225 *InsO* subordinated claims of creditors are regarded as released, if the plan does not provide for something else, as those creditors normally do not take part within the distribution of the proceeds and therefore can not be impaired by the plan; see: Bork, *Insolvenzrecht*, marg. no. 327.
84. Häsemeyer, *Insolvenzordnung*, marg. no. 28.25; Kübler/Prütting/Otte, *InsO*, § 222 marg. no. 6; Bork, *Insolvenzrecht*, marg. no. 321; Smid/Rattunde, *Der Insolvenzplan*, marg. no. 435 et seq.
85. Kübler/Prütting/Otte, *InsO*, § 222 marg. no. 6; Bork, *Insolvenzrecht*, mar. no. 321.
86. Herzig, *Das Insolvenzplanverfahren*, p. 24; see the same for a detailed description of the principle of equal treatment and the problems thereof.
87. Häsemeyer, *Insolvenzordnung*, marg. no. 28.24; Bork, *Insolvenzrecht*, marg. no. 322.

2. *Acceptance and confirmation of the plan*

a. *Preliminary examination by the court*

The second stage begins with a preliminary examination ("*Vorprüfung*") by the court, where it carries out a first examination of the plan. § 231 *InsO* provides for two different proceedings of that examination, depending on whether the plan was submitted by the trustee or the debtor; in the latter case the extent of the examination is enhanced. If a plan is submitted by a debtor the court will reject the plan in the event that the plan has no chance of being accepted by the creditors, or if it is clear that the claims to which the parties to the plan are entitled to, cannot be satisfied.[88] If the court accepts the plan, it will forward the plan to the creditors' committee, the debtor, the representatives of the employees and the trustee (if the trustee has not submitted the plan himself) to give them the opportunity to comment on the plan within a certain period of time, § 232 para. 1 *InsO*.

b. *Acceptance of the plan by the creditors*

If the plan has proven admissible according to § 231 *InsO*, the court will set a date for a hearing in which the plan will be discussed and voted upon, § 235 para. 1 *InsO* ("*Erörterungs- und Abstimmungstermin*"). The right to vote upon the plan has been given only to the impaired insolvency creditors, if no objections to their claims have been raised, §§ 237, 77 *InsO* and to impaired creditors with the right to separate satisfaction, but only to the extent that their claims exceed the value of their right to separate satisfaction, §§ 237, 41, 77 *InsO*. Voting is by groups of creditors, § 234 *InsO*. In order to be accepted it is necessary that, within each group, the majority (pro capita) of creditors vote in favour of the plan and that the total value of their claims constitutes more than 50% of the total value of all claims of the creditors actually voting, § 244 *InsO*.[89] Hence the plan is accepted if all groups of creditors, and not only the majority of the groups, have accepted the plan and within each group a majority of members and a majority of aggregate has been achieved.

c. *Prohibition of obstruction*

§ 245 *InsO* is headed "*Obstruktionsverbot*" which can be translated as prohibition of obstruction. This provision should prevent an economically reasonable plan failing because of the opposition of single creditors.[90] If the required majority is not attained, the necessary majority within one group will be deemed to have accepted the plan, if certain requirements are met, which can be traced back to principles of German insolvency law: the principle of maintenance of value and the principle of

88. Bork, *Insolvenzrecht*, marg. no. 333; Herzig, *Das Insolvenzplanverfahren*, pp. 41 et seq.; Kübler/Prütting/Otte, *InsO*, § 231 marg. no. 4 et seq.

89. Häsemeyer, *Insolvenzordnung*, marg. no. 28.33; Bork, *Insolvenzrecht*, marg. no. 336.

90. Maus in: *Kölner Schrift zur Insolvenzordnung, Der Insolvenzplan*, p. 931 et seq., marg. no. 86; Bork, *Insolvenzrecht*, marg. no. 337; Herzig, *Das Insolvenzplanverfahren*, p. 58.

equal treatment.[91] To deem the consent of the dissenting creditors three requirements must be met. Firstly, at least a majority of the groups who actually voted must have agreed to the plan, § 245 para. 1 no. 3 *InsO*. Secondly, the dissenting creditor groups must not be disadvantaged to a greater extent than they would be without the plan, § 245 para. 1 no. 1 *InsO*. This requirement corresponds to the best-interests-of-the-creditors-test within the BC.[92] The third requirement is that the dissenting creditors are to receive a reasonable share of the economic value to be distributed to the interested parties, § 245 para. 1 no. 2 *InsO*.[93]

d. Debtor's consent/replacement of debtor's consent

In addition to the consent of the creditors, the debtor has to accept the plan, § 247 *InsO*. However, similarly to the rule in § 245 *InsO*, his power to obstruct the plan is limited, as his consent will be deemed, if certain requirements are met. Similarly to § 245 *InsO*, § 247 para. 2 *InsO* requires that the debtor must not be disadvantaged to a greater extent by the plan than he would be without it or that no creditor receives more than the face value of his claim.[94]

e. Confirmation by the court

As soon as the creditors and the debtor have given their consent to the plan, the court needs to review whether the requirements have been met to confirm the plan, § 248 *InsO*. The court will deny the confirmation if the plan does not comply with the requirements set out in the plan itself and if the legal requirements of the confirmation are not met. First of all precise compliance with the procedural rules is necessary. To protect minorities the court must deny the confirmation on demand of any individual creditor if he has objected to the plan no later than the hearing for discussion and voting ("*Erörterungs- und Abstimmungstermin*")[95] and such a creditor is put in a position where he is treated less favourably than he would be without the plan. Thus the *InsO* protects even those creditors who have been outvoted or did not have a right to vote, § 251 *InsO*. In contrast to the BC the *InsO* requires no feasibility test, hence the court cannot deny confirmation simply because it thinks that the plan will not work.[96]

f. Legal effects of the confirmation

As soon as the plan comes into force all parties, even those who voted against the plan and those who have not filed their claims, are bound by the provisions of the

91. Bork, *Insolvenzrecht*, marg. no. 338.
92. Smid/Rattunde, *Der Insolvenzplan*, marg. no. 586.
93. Häsemeyer, *Insolvenzordnung*, marg. 28.38-28.40; Kübler/Prütting/Otte, *InsO*, § 245 marg. no. 7 et seq., 16 et seq. and 22 et seq.
94. Häsemeyer, *Insolvenzordnung*, marg. 28.41; Kübler/Prütting/Otte, *InsO*, § 247 marg. no.4.
95. See: III.B.2.b. supra.
96. Kamlah, III.3.2.b., 70 Am. Bankr. L.J. 417; see as well: Herzig, *Das Insolvenzplanverfahren*, p. 32 et seq.

plan, § 254 para. 1 clause 1 *InsO*. The debtor is now discharged from all debts except those required to be paid pursuant to the plan and the obligations outlined by the plan are now accrued.[97]

The court will order the termination of the insolvency proceedings and the debtor regains his right to manage the estate and dispose of assets, §§ 258 and 259 *InsO*.

3. *Supervision of compliance with the plan*

The insolvency plan may provide for supervision of compliance of the plan. However, such supervision is not part of the insolvency procedure, hence the court will terminate the insolvency proceeding in any event, § 258 para. 1 *InsO*. If the debtor is not given a totally free hand to manage the business, the parties can agree to provide for a supervision within the constitutive part of the plan, § 260 *InsO*.[98] Such supervision is seen especially in cases where the debtor continues to run the business and the creditors will be satisfied by means of its proceeds.[99] The duty of supervision goes to the trustee, if the plan does not provide for anything else, who himself will be supervised by the court and the members of the creditors' committee. For this purpose, the trustee and the members of the creditors' committee continue to be in charge, § 261 para. 1 *InsO* until the court decides to terminate the supervision, § 268 *InsO*.[100] The duties of the trustee amount to nothing more than observing the debtor; he is not allowed to infringe into the functions of the management. However, if certain provisions of the plan are not fulfilled by the debtor, the trustee must promptly notify the creditors' committee and the court.[101] The trustee's supervision normally does not change the debtor's ability to manage the business and dispose of assets, nonetheless, the plan may provide opportunities for rejection, § 263 *InsO*.[102]

IV. **Similarities and Differences**

The drafters of the German insolvency law made reference to foreign legal systems, in particular the bankruptcy law of the US, as enacted within the Bankruptcy Reform Act of 1978. Especially Chapter 11 served as a model for the new German insolvency plan procedure. However, even critical voices of the American procedure—especially those of Blum, Jackson and Baird—have been acknowledged. Starting out from an essay published by Blum in 1950, Jackson and Baird reproached the American reorganisation procedure with the accusation that a fictional reorganisation value is used as a standard for the redistribution of assets. By

97. Bork, *Insolvenzrecht*, marg. no. 344.
98. Häsemeyer, *Insolvenzordnung*, marg. no. 28.54.
99. Bork, *Insolvenzrecht*, marg. no. 350.
100. Maus in: *Kölner Schrift zur Insolvenzordnung, Der Insolvenzplan*, p. 931 et seq., marg. no. 117.
101. Bork, *Insolvenzrecht*, marg. no. 351.
102. Bork, *Insolvenzrecht*, marg. no. 352.

means of doing this, the creditors only received as a minimum what they would be entitled to anyway (by way of liquidating the assets).[103] It is interesting to note that legislators in both countries have reacted to the criticism of Blum, Baird and Jackson. The US legislator enacted the Bankruptcy Reform Act of 1978 requiring only the best-interests-of-the-creditors-test instead of a detailed determination of the reorganisation value and introduced an enhanced right of information for the creditors,[104] whereas the drafters of the German *InsO* condemned their idea of a preliminary reorganisation and introduced instead the possibility of a well-ordered self-reorganisation procedure for a corporate entity, within the three methods of utilising the debtor's assets—liquidation, transfer of assets and reorganisation, which are now of equal status.[105]

Bearing this in mind, it is interesting to examine which elements and basic structures of the German and American system correspond and where differences could be found.

A. Differences between the German and the American procedure

The character and foundations of the American bankruptcy law is extraordinarily divergent with the German insolvency law.[106] The basic principle of German insolvency law is to enforce the debtor's liabilities. The joint satisfaction of the creditors is the major objective of the procedure,[107] whereas the Bankruptcy Code emphasises the basic idea of protecting the debtor and giving him the possibility of a fresh start by way of discharge.[108]

Where Chapter 11 establishes an independent procedure which results from the contrast to the Chapter 7 liquidation procedure, the insolvency plan procedure in Germany serves as one option within a uniform insolvency procedure. Another peculiarity of Chapter 11 BC is the exclusive right of the debtor to propose and file the plan within 120 days, plus the fact that after that period, third parties such as the creditors' committees or even equity shareholders, are entitled to file a plan, whereas § 218 *InsO* entitles only the debtor and the trustee to file the plan and the German creditors' committee is only able to instruct the trustee to file the plan.[109]

Chapter 11 plans are usually plans to rehabilitate the debtor, hence they are rehabilitation plans. Liquidation and reorganisation are conventionally understood as two separate concepts of carrying out the bankruptcy proceeding, which exclude each other.[110] § 217 *InsO*, though, allows in general all those plans that regulate the satisfaction of creditors by distribution of the estate, consequently liquidation plans

103. Blum, *U.Chi.L.Rev.* Vol. 17 (1950) no. 4, pp. 565 et seq. especially pp. 567 et seq.; Baird/Jackson 51 *U.Chi.L.Rev.* 97 (1984); Baird/Jackson 55 *U.Chi.L.Rev.* 738 (1988); Jackson, *The Logic and Limits of Bankruptcy Law* (1986, Harvard U.P.), pp. 209 et seq. especially pp. 218 et seq.; see as well: Braun/Uhlenbruck, *Unternehmensinsolvenz*, pp. 426, 427; 432, 433; Nehrlich/Römermann/Braun, *InsO*, Vor 217, marg. no. 46; Smid/Rattunde, *Der Insolvenzplan*, marg. no. 552.

104. Braun/Uhlenbruck, *Unternehmensinsolvenz*, p. 434.

105. Braun/Uhlenbruck, *Unternehmensinsolvenz*, p. 427.

106. Smid/Rattunde, *Der Insolvenzplan*, marg. no. 551.

107. See: II.B. supra.

108. Baird, *The Elements of Bankruptcy*, pp. 24, 55; T.H. Jackson, *The Logic and Limits of Bankruptcy Law*, (1986, Harvard U.P.) pp. 7, 209, 225.

109. Braun/Uhlenbruck, *Unternehmensinsolvenz*, pp. 434, 435.

110. Fassbach, *Die cram down power*, pp. 23, 24.

are possible.[111] However, a Chapter 11 plan may provide for the sale of all or least of substantially all of the property of the estate and the distribution of the proceeds to creditors or interest holders.[112] Hence, the §§ 1123 (a) (5) (B), 1123 (b) (4) BC allow to liquidate the assets within a reorganisation plan.

The judicial position is fundamentally different in so far as Chapter 11 BC provides generally for a procedure without a trustee, based on the concept of debtor in possession. Hence normally the debtor stays in charge to run the business and is allowed to transfer assets, and only in exceptional cases a trustee is appointed to manage the estate. The German *InsO* to the contrary knows in principle only a procedure with a trustee involved, and only as an exception may the debtor apply for self-management. However, even if the court will allow self-management of the debtor, he will still be supervised by the trustee. A procedure with no involvement of a trustee at all, as is the general rule in the BC, is unknown to the *InsO*.[113]

Both codes provide judicial restraints within the reorganisation procedure. § 231 *InsO* for example states that the court has to reject the plan if it has no chance of being accepted by the creditors, or if it is clear that the claims to which the parties are entitled by the plan cannot be satisfied. In addition the insolvency court cannot confirm the plan if a creditor has objected to the plan with respect to § 250 *InsO*. Hence the German *InsO* appoints the court with fundamental decisions. In comparison to these regulations, those provided within the BC are more extensive, especially those relating to the requirements of fairness between the creditors.[114]

In contrast to the Bankruptcy Code, the filing of an insolvency petition does not itself provide the debtor with any automatic protection from creditors, such as the automatic stay does under § 362 BC. Yet, once the case is filed the court may issue an interim order it considers suitable in order to protect the estate.[115]

B. Elements adopted from Chapter 11 BC

Although both procedures are considerably different, especially in terms of their basic foundations and objectives, Chapter 11 served as a model for the German insolvency plan procedure and many elements have been adopted from Chapter 11 BC.[116]

First of all, the overall structure of the plan has been adopted from Chapter 11 BC. Both plans are to be filed by an entitled party within an insolvency/bankruptcy procedure, they are absolutely effective and carried by a majority of votes. Both plans are designed as an economically or financially obligating proposal to form a plan that alters legal relationships.

111. Herzig, *Das Insolvenzplanverfahren*, pp. 76 et seq., especially pp. 69 et seq.
112. Weintraub/Resnik, *Bankruptcy law Manual*, 8.19. [3][C], at 8–56 & 8–57; cited after Fassbach, *Die cram down power*, p. 24, especially footnote 122.
113. Braun/Uhlenbruck, *Unternehmensinsolvenz*, p. 438; see as well Smid/Rattunde, *Der Insolvenzplan*, marg. no. 551.
114. Braun/Uhlenbruck, *Unternehmensinsolvenz*, p. 436.
115. Kamlah, 70 Am. Bankr. L.J. 417.
116. See for the following: Braun/Uhlenbruck, *Unternehmensinsolvenz*, pp. 437, 438.

The extensive information requirement, embodied in the disclosure statement, § 1125 (a)(1) BC is adopted from Chapter 11 BC, which can be found as § 220 para 2 *InsO* in the German law.

Also adopted is the principle of classification of creditors into different groups of interest. Creditors within these groups decide whether to confirm or dismiss the plan. In both procedures classification is by claims and not by creditors. Hence it is possible that a single creditor is a member of several groups according to his several claims (§ 1122 BC and § 222 *InsO*).

In addition the question of carrying the plan through, even against dissenting classes is solved identically, § 1129 BC and § 245 *InsO*. Even the requirements necessary to confirm a plan under these provisions are similar. The absolute priority rule, set out in § 1129 (b) BC corresponds to § 245 para. 2 no. 2 and 3 *InsO*. Both rules allow passing over dissenting creditors only if the creditors receive rights against the estate according to their priority they held within the previous company. Hence a more junior creditor will only be satisfied, if the creditor more senior to him is satisfied in total.[117] Another requirement to be found in both codes is the compliance with the best-interests-of-the-creditors-test (§ 1129 (a)(7) BC and § 245 para. 1 no. 1 *InsO*). This is identical to the German principle of protecting minorities according to § 245 para. 1 no. 1 *InsO*, which relates to groups of creditors and § 251 para. 1 no. 2 *InsO* relating to single creditors.[118] However, the power to initiate this means of cram down or prohibition of obstruction is different. Whereas in the US the debtor has the power to initiate the cram down, the German prohibition of obstruction is issued ex officio, since the insolvency plans as the insolvency procedure's preliminary purpose is to satisfy the creditors.[119]

C. Summary and evaluation

As pointed out before, both insolvency/bankruptcy regimes have totally different basic premises. Whereas the US bankruptcy law focuses on the need of protecting the debtor and the debtor's business, which is given a fresh start discharged of any debts, the German law, however, centres on satisfaction of the creditor.[120] The adoption of elements from Chapter 11 by the German law must therefore inevitably create severe fractures within its system.[121] Whenever a single rule needs to be interpreted this has to be done in the light of the basic principle of the underlying law, which is considerably different in Germany than it is in the US from which those rules have been adopted, hence there will be a need for certain amendments of the German law.[122]

117. Northern Pacific Railway Co. v. Boyd 228 U.S. 482 (1913); see in detail: II.A.2. supra.

118. Braun/Uhlenbruck, *Unternehmensinsolvenz*, p. 438.

119. Smid/Rattunde, *Der Insolvenzplan*, marg. no. 554.

120. Smid/Rattunde, *Der Insolvenzplan*, marg. no. 26; Flessner, *Sanierung und Reorganisation*, pp. 33 et seq. and 139.

121. Smid/Rattunde, *Der Insolvenzplan*, marg. no. 26.

122. Smid/Rattunde, *Der Insolvenzplan*, marg. no. 27; Kübler/Prütting/Otte, *InsO*, § 217 marg. no. 54.

V. **The Problem of Manipulating the Classification**

A major problem that has occurred under Chapter 11 BC regards the system of classification. § 1122 (a) BC determines that only claims that are substantially similar can be placed in one class, but this does not mean that substantially similar claims must be placed in one class.[123] Since the debtor can classify substantially similar claims in different groups, the danger occurs that he might try to influence the acceptance of a plan by way of manipulating the classification of similar claims. If he spreads the claims to the greatest possible extent he is virtually assured that at least one class of impaired creditors will accept the plan and thereby make it eligible for a cram down consideration by the court.[124] The holders of big claims will be classified in separate classes, if their consent is unlikely. Through such an "isolation" at least the consent of a single class might be achieved.[125]

In *Phoenix Mutual Life Insurance Co. v. Greystone III Joint Venture*[126] for example the US Court of Appeals, Fifth Circuit, held that a plan cannot separate claims of unsecured creditors for the deficiency without a good reason from other unsecured claims. In an earlier case the US Court of Appeals, Sixth Circuit, held in a similar way, that:

> There must be a limit on a debtor's power to classify creditors [. . .]. The potential for abuse would be significant otherwise. Unless there is some requirement of keeping similar claims together, nothing would stand in the way of a debtor seeking out a few impaired creditors (or even one such creditor) who will vote for the plan and placing them in their own class.[127]

Hence if classification cannot be justified on the character of the claim itself and the connected treatment within the reorganisation, such a classification must be referred to as arbitrary or as an attempt to manipulate in order to help the debtor's plan to succeed. It is not sufficient for a classification into separate classes, that the creditors have different economic interests relating to the assets of the debtor, like reorganisation on the one side and liquidation on the other.[128]

The system of classification in Germany is set up with a similar provision in § 222 para. 2 *InsO*. The German drafters of the *InsO* have not provided any control mechanisms within the classification process, although US experience[129] with the problem of classification could easily been used as an opportunity to do so.[130]

123. Hirte/Otte, *ZIP*, 1994, p. 1493, 1494, 2nd. column.

124. Fassbach, *Die cram down power*, p. 26; Hirte/Otte, *ZIP*, 1994, p. 1493, 1494, 2nd. column; In re US Truck Company, Inc. 800 F. 2d 581 (Teamsters Nat'l Freight Insus. Negotiating Comm. v. US Truck Co.).

125. Hirte/Otte, *ZIP*, 1994, p. 1493, 1494, 2nd column.

126. 948 F. 2d 134 (5th Cir. 1991) republished as corrected at 995 F. 2d 1274.

127. In re US Truck Company, Inc. 800 F. 2d 581 (6th Cir. 1986).

128. Hirte/Otte, *ZIP*, 1994, p. 1493, 1494, 2nd column.

129. Although none of the sources I have used, provide empirical evidence of such manipulatory classification (only figures determining the number of cases using the cram-down provision could be found, for example: LoPucki/Whitford, found that approximately 50% of the plans have used the cram-down provision: "Bargaining over equity's share in the bankruptcy reorganisation of large, publicly held companies', (1990) 139(1) *University of Pennsylvania Law Review*, 125–196; cited after Carapeto, *Essays on Chapter 11*, p. 40) several such cases have occurred during previous years and found the attention of commentators.

130. Smid/Rattunde, *Der Insolvenzplan*, marg. no. 455.

VI. Conclusion

Whereas the US looks back on a long tradition of reorganisation procedures and stated as early as 1904 in *Wetmore v. Markoe*[131] that a system of bankruptcy needs to provide a means of discharge for the debtor in order to give him the opportunity for a fresh start, Germany can only look back to a very recent attitude of recognising a reorganisation procedure as a way of debt enforcement.

Both procedures show considerable similarities, especially concerning the overall leading structure of the reorganisation procedures, which can be explained by the fact that the Chapter 11 procedure served as a model for the German reorganisation procedure by means of an insolvency plan.

It has been stated that the basic objectives of the bankruptcy/insolvency regimes are fundamentally different. The US system focuses on the possibility of giving the debtor a fresh start, whereas the German system centres on the satisfaction of the creditors. These basic aims are driven by two different cultural value preferences: individualism as it can be found in the US as opposed to communitarianism to be found in European countries.[132]

However, the German attitude towards insolvency has developed towards a more "US-like approach" of focusing on the possibility of reorganisation as well as a more debtor-friendly approach[133] within recent years. The *InsO* explicitly refers to three different methods of debt enforcement which should be considered as equally valid options:

- liquidation
- transferring of assets ('*übertragende Sanierung*') and
- reorganisation

Notwithstanding this recent movement, the overall attitude between both systems is fundamentally different. Since the German drafters have adopted the basic idea and structure of the Chapter 11 reorganisation plan procedure regardless of these differences, problems will inevitably occur within the German plan procedure, which only recently became evident in court cases.[134]

Since the new German Insolvency Code has been in place only for a relatively short time, it is not yet possible to assess whether the plan procedure will satisfy the expectations of the economic and legal community. However, one reason for the low number of plan procedures filed within the last few years might be that the German insolvency procedure is mainly controlled by large creditors like the principal

131. 196 US 68; 25 S. Ct. 172, 176, 49 L.Ed. 390 (1904).

132. For this see (although in the different context of corporate finance): Jeswald W. Salacuse, Corporate governance, culture and convergence: corporations American style or with a European touch? Lecture given on the occasion of the London Summer Programme in International Banking and Finance Law, 6 June 2002, *London Forum for International Economic Law and Development at the Centre for Commercial Law Studies, Queen Mary, University of London*, to be published in 2003.

133. With the *InsO* for the first time in Germany's history of insolvency the possibility of a discharge for the debtor was introduced, §§ 1 clause 2 and 286 et seq. *InsO*.

134. AG Mühldorf am Inn, *NZI*, 1999, pp. 422 et seq.; LG Traunstein, *ZInsO*, 1999, pp. 577 et seq.; see also: Smid, *InVo*, 2000, 1 et seq. as a commentary of the case brought before the LG. Traunstein.

lender banks. The creditors' assembly decides how the insolvency procedure should commence, and hence if a plan should be implemented or not.[135] Those creditors with a majority in amount within the creditors' assembly do not wish to depend upon the pro capita majority within creditors' groups, which is necessary for the voting within the plan procedure. To the contrary, they will try to implement their preferred way of distributing the assets within the estate without the relatively difficult and burdensome procedure of an insolvency plan.[136]

It is easier to assess the US system's efficiency. Most markedly in recent years, a significant number of commentators have criticised the features of the Chapter 11 procedure.[137] It can be stated that the US system is not very successful with respect to its intention to provide a reorganisation system to restructure the debtor's obligations since very few companies find the way back to independence without the necessity to file for bankruptcy again. This is particularly the case if one bears in mind that the Chapter 11 procedure is costly and time consuming.[138]

135. See: III.B.1.a.cc. supra.
136. Terhart, *Chapter 11*, p. 356 et seq.
137. See for example: Bradley/Rosenzweig (1992) 101 *Yale Law Journal*, 1043; Boshkoff (1993) 2 *International Insolvency Review*, 173; Smid/Rattunde, *Der Insolvenzplan*, preface page VI, VII.
138. See this in more detail: Terhart, *Chapter 11*, pp. 51–159, who examines the Chapter 11 procedure with regard to the several US studies (i.e. LoPucki, LoPucki/Whitford, Hotchkiss, and many others).