



**CREDITORS' RIGHTS AND CRAMDOWN IN REORGANIZATION —
A COMPARATIVE STUDY OF US LAW AND GERMAN LAW**

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Abstract

This thesis evaluates the different approaches to reorganization in the US and Germany with the focus on plan confirmation and cramdown provisions. It points out the different requirements for these provisions in both jurisdictions and analyzes why the success rate of reorganization proceedings in the US is much higher than in Germany. The thesis first builds a foundation for its evaluation by examining the approach to reorganization and cramdown under the US Bankruptcy Code. Then it analyzes the legal framework in Germany in direct comparison to the US system by drawing attention to similarities and differences between the two. Subsequently, it discusses possible reasons for the different success rate based on its findings and proposes a solution to increase the number of successful reorganizations in Germany. This thesis finds that reorganization is more successful in the US due to the lack of stigma hanging over the debtor, which as a result gives the debtor more power and more trust in its abilities. It proposes to reform the insolvency law regarding plan confirmation and cramdown in Germany in order to provide for an easier reorganization and make way for the possibility of removal of the bankruptcy stigma.

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Abbreviations

BC	US Bankruptcy Code
ct	Dollar cent
Ed.	Edition
ESUG	Gesetz zur weiteren Erleichterung der Sanierung von Unternehmen (reform statute with the purpose to ease the reorganization of companies)
FN	Footnote
InsO	Insolvenzordnung (Insolvency Statute)
p./pp.	Page/Pages
para(s).	Paragraph(s)
Sec.	Section
USD	US Dollar
v	versus

Introduction

Where there is business there is bankruptcy.

Not every endeavor is bound to succeed, some fail. The standard approach to handle this failure is to liquidate the debtor's assets and distribute the obtained amount among the creditors. The satisfaction of the creditors' claims is always at least one of the main goals – if not the sole purpose of bankruptcy proceedings.¹ Liquidating the debtor is therefore in many cases the cheapest and fastest way to achieve this goal and satisfy the open claims in at least part.

However, many systems also offer the possibility to reorganize the debtor and keep it operating instead of liquidating it. While liquidation leads to the complete elimination of the debtor, reorganization allows the debtor to get back on its feet. The latter aims to rescue and rehabilitate the bankrupt. In this kind of proceeding the debtor develops a plan on how to proceed in the future so that liquidation can be avoided. Through restructuring and reorganizing the company the debtor gets a second chance to succeed.

The idea behind reorganization is that the value of continuing the corporation exceeds the value of liquidating it.² Thus, it might be more lucrative – or at least provide for fewer losses on a long-term basis – for the creditors to keep the debtor in operation.³ The reorganization procedure to keep the debtor operating – simplified – goes as follows. Once the bankruptcy petition is filed a plan is proposed on how to restructure the debtor in a way that will satisfy the creditors and allow the debtor to continue business. The creditors will then vote on the acceptance of the plan. If accepted the plan has to be approved by the court after which it comes into force with all rights and obligations it imposes on all involved parties.

However, the way a bankruptcy is handled and the bankrupt debtor is treated differs depending on the applicable legal system. A legal system reflects what society perceives as the

¹ For instance in Germany this purpose is expressly stated in § 1 InsO.

² Gräwe, *Der Ablauf des US-amerikanischen Chapter 11-Verfahrens*, ZInsO 2012, 158.

³ Tabb & Brubaker, *Bankruptcy Law*, 67-68 (2003).

appropriate method to a certain set of circumstances. Some societies see bankruptcy just as a part of doing business, a risk that simply manifested. Some see bankruptcy as a failure and the once bankrupt businessman has to live on with the stigma of failing. These differences in mentality are reflected not only by the conception of the bankruptcy law itself but also by the way it is applied. Because of the different ways bankruptcy is perceived the consequences for the debtor differ as well. Even where legal systems offer the same legal tools and possibilities for the debtor the outcome still varies due to the difference in perception. For instance, in the US many bankrupt businesses file for reorganization under Chapter 11 of the US Bankruptcy Code (BC). Out of 26 983 business filings in the US in the year 2014 did a total number of 6 093 file under Chapter 11.⁴ In Germany⁵ the vast majority of bankrupt companies is liquidated. In the year 2012 only in 231 out of 30 009 proceedings was a plan submitted.⁶

At first glance this statistic seems surprising as both systems offer almost identical instruments. In both, the US and Germany, the debtor⁷ has the choice between liquidation and reorganization. In either system exists the possibility to compile a reorganization plan that will be accepted if the majority of the creditors vote to accept it. Lastly – and most importantly – both bankruptcy systems have mechanisms in place in order to get a plan approved even without the consent of all creditors.⁸ This tool has become known as ‘cramdown’.⁹

Cramdown can be considered the “centerpiece of reorganization”.¹⁰ In case of cramdown a court can decide to confirm a plan despite creditors voting to reject it. Therefore the existence

⁴http://www.uscourts.gov/uscourts/Statistics/BankruptcyStatistics/BankruptcyFilings/2014/1214_f2.pdf.

⁵ https://www.destatis.de/DE/Publikationen/Thematisch/UnternehmenHandwerk/Insolvenzen/Insolvenzen2020410141114.pdf?__blob=publicationFile.

⁶ Smid, Rolf, Rattunde & Martini, *Der Insolvenzplan*, 0.20 (2014).

⁷ If not expressly stated otherwise “debtor” only refers to companies not natural persons.

⁸ Sec. 1129(b) US Bankruptcy Code and § 245 InsO.

⁹ See Wittig, *Obstruktionsverbot und Cram Down*, ZInsO 1999, 373-379.

¹⁰ *In re Mattson* 210 B.R. 157, 159 (Bankr. D. Minn. 1997), as cited in Adler et al., *Bankruptcy*, 655 (2007).

of a tool like cramdown in a bankruptcy system should make it easier for the debtor to confirm the proposed reorganization plan. Consequently, this begs the question why the concept shows much less success in the German society.

This thesis will analyze the different approaches to reorganization and cramdown in the US and Germany. The author will evaluate the different policies behind the legal systems and the consequences of those policies on bankruptcy proceedings, especially in regard to plan confirmation and cramdown in reorganization.

The first chapter will analyze the purpose and procedure of reorganization in the US. It will briefly show the debtors role and then move on to the creditors' rights with focus on voting rights on the reorganization plan and plan confirmation without unanimous consent of all creditors. The emphasis here will lie on the elements of the cramdown provision.

The second chapter will introduce the plan proceedings in Germany and shortly describe the history of the equivalent to the cramdown provision. The author will then analyze the similarities and differences of the procedure in comparison to the US system.

The third chapter will explain why reorganization and especially cramdown are more successful in the US. It will examine whether the lack of success is due to the stigma of bankruptcy in the German society or due to the statutory differences in the procedure and creditors' rights. The author will then propose a solution on how to increase the number of successful reorganization proceedings in Germany.

Chapter I - Reorganization in the US

In this chapter the author will briefly describe the purpose of Chapter 11 BC, the statute on reorganization in the US, and its underlying policies. This will be followed by a description of the reorganization procedure and the debtor's role in reorganization. Afterwards the focus will lie on the approval of the reorganization plan including the voting rights of the creditors, the division into classes and especially the elements of cramdown.

1.1 Policy and Purpose of Chapter 11 BC

In the US we can find that society is more open to risk taking and is accepting of the fact that failure is part of the road to success.¹¹ As a consequence, the US bankruptcy law is treating the bankrupt debtor quite forgivingly.¹² Main objectives under the BC are the equal treatment of the creditors, relieving the debtor of its debts and ensure the best possible satisfactions of the creditors' claims.¹³ For bankrupt companies this basically can be achieved by liquidation under Chapter 7 BC or by reorganization under Chapter 11 BC.

The origins of Chapter 11 BC go back to railroad reorganizations in the late nineteenth century.¹⁴ It is based on the idea "that a business is worth more alive than dead"¹⁵ or, in other words, that the value of continuing the corporation is exceeding the value of liquidating it.¹⁶ With rescuing the debtor through reorganization it shall be rehabilitated in order to reenter the

¹¹ Priebe, *Chapter 11 & Co.: Eine Einführung in das US-Insolvenzrecht und ein erster Rückblick auf die Jahre 2007 – 2010 der Weltwirtschaftskrise*, ZInsO 2011, 1676, 1677.

¹² Priebe, *Chapter 11 & Co.: Eine Einführung in das US-Insolvenzrecht und ein erster Rückblick auf die Jahre 2007 – 2010 der Weltwirtschaftskrise*, ZInsO 2011, 1676, 1677.

¹³ Meyer-Löwy, Poertzgen, & Eckhoff, *Einführung in das US-amerikanische Insolvenzrecht*, ZInsO 2005, 735, 736.

¹⁴ See Baird, *The Elements of Bankruptcy*, 62-64 (2010)

¹⁵ Tabb, *The Future of Chapter 11*, 44 S.C.L. Rev. 791, 804 (1993) in: Tabb & Brubaker, *Bankruptcy Law*, 595 (2003).

¹⁶ Gräwe, *Der Ablauf des US-amerikanischen Chapter 11-Verfahrens*, ZInsO 2012, 158.

market.¹⁷ A main goal of a proceeding under Chapter 11 is therefore the continuation of the company in question and it thus combines the satisfaction of the creditors with the endeavor to continue.¹⁸ *Gräwe* notes that Chapter 11 BC has its main focus on how to divide the costs of the debtor's inability to pay among the creditors in order to save the debtor.¹⁹ Though this is a quite cynical view on reorganization it is not far from reality as the creditors are the ones that will have to bear the losses as the debtor is allowed to continue existing. However, the bearing these losses might be an acceptable cost when it comes to saving the debtor.

1.2 Reorganization Procedure

Saving the debtor starts by filing a petition for bankruptcy under Chapter 11 BC with the bankruptcy court. Usually it is the debtor who files a voluntary petition under Sec. 301 BC, however, proceedings can also be set in motion by an involuntary petition by one or more creditors, Sec. 303 BC. Though, due to the lack of knowledge on the financial situation of the debtor and the risk to bear the costs of the application proceedings creditors rarely will apply for reorganization for the debtor.²⁰

Filing of the petition brings several immediate consequences. One effect of filing is that all of the debtor's assets and interests become the bankruptcy estate.²¹ Furthermore, filing is followed by automatic stay, Sec. 362, 1121 BC. The automatic stay protects the estate by preventing creditors from enforcing their claims individually and putting ongoing proceedings

¹⁷ Priebe, *Chapter 11 & Co.: Eine Einführung in das US-Insolvenzrecht und ein erster Rückblick auf die Jahre 2007 – 2010 der Weltwirtschaftskrise*, ZInsO 2011, 1676, 1684.

¹⁸ Gräwe, *Der Ablauf des US-amerikanischen Chapter 11-Verfahrens*, ZInsO 2012, 158, 159.

¹⁹ Gräwe, *Der Ablauf des US-amerikanischen Chapter 11-Verfahrens*, ZInsO 2012, 158, 159.

²⁰ Gräwe, *Der Ablauf des US-amerikanischen Chapter 11-Verfahrens*, ZInsO 2012, 158, 160.

²¹ Mallon & Waisman, *The Law and Practice of Restructuring in the UK and the US*, 217 (2011).

on hold.²² It stays in force until the end of the reorganization proceeding and can only be interrupted by court ordered relief.²³ Another, very important consequence is that the debtor will become what is called the debtor in possession, Sec. 1107(a) BC; in other words, control and management stay with the debtor.²⁴ However, upon sufficient cause the debtor in possession may be replaced by a trustee if so requested by an interested party or the US trustee, Sec. 1104(a) BC.²⁵

After the petition is filed the debtor in possession is now obliged under Sec. 1121(a) BC to file a reorganization plan. If the debtor does not present a so called pre-packed plan²⁶ together with its petition it has 120 days to propose a plan, Sec. 1121(b) BC. This period can be prolonged by 60 days.²⁷ In case the debtor fails to file a plan within this time the other interested parties such as the creditors may do so, Sec. 1121(c) BC.

Gräwe considers the reorganization plan the ‘heart’ of Chapter 11 BC as this is what it regulates the restructuring of the debtor.²⁸ This is so far conclusive as there can be no reorganization without a reorganization plan. Since the plan is ultimately an agreement between the parties involved it can basically contain anything.²⁹ However, the BC provides for a certain minimum content that needs to be addressed in the plan. Generally a plan should provide the

²² Epstein, Nickles & White, *Bankruptcy*, Vol. 1, Sections 1-1 to 6-45, 77 (1992); Mallon & Waisman, *The Law and Practice of Restructuring in the UK and the US*, 218 (2011).

²³ For a detailed commentary on automatic stay see Epstein, Nickles & White, *Bankruptcy*, Vol. 1, Sections 1-1 to 6-45, 77-375 (1992).

²⁴ Tabb & Brubaker, *Bankruptcy Law*, 598 (2003).

²⁵ This cause may be based on fraud, dishonesty, incompetence, or gross mismanagement of the affairs of the debtor by current management, Sec. 1104((a)(1) BC; see Epstein, Nickles & White, *Bankruptcy*, Vol. 3, Sections 10-1 to End, 16 (1992).

²⁶ In this case a reorganization plan has already been negotiated and agreed upon with the creditors before the petition is filed which leads to a shorter and less costly bankruptcy proceeding, for more information and case law examples see Mallon & Waisman, *The Law and Practice of Restructuring in the UK and US*, Oxford University Press, 205-209 (2011).

²⁷ Gräwe, *Der Ablauf des US-amerikanischen Chapter 11-Verfahrens*, ZInsO 2012, 158, 161.

²⁸ Original wording is “Herzstück”, Gräwe, *Der Ablauf des US-amerikanischen Chapter 11-Verfahrens*, ZInsO 2012, 158, 159.

²⁹ Tabb & Brubaker, *Bankruptcy Law*, 647 (2003).

designation of classes of claims and interests³⁰, state which classes of claims and interests remain unimpaired, and stipulate the proposed treatment of any impaired class.³¹

Before the holders of claims and interests can vote on the plan, they need to be provided with a disclosure statement as dictated by Sec. 1125(b) BC.³² The disclosure statement must contain “adequate information” concerning the affairs of the debtor to enable a creditor or an interest holder “to make an informed judgment about the plan”, Sec. 1125(a)(1) BC. After the disclosure statement has been approved it will be transmitted – usually together with the plan and information regarding the timetable and the voting procedure³³ – to the holders of claims and interests, Sec. 1125(b) BC.

Once these formalities have been dealt with follows the crucial part – voting. The claim and equity holders vote in classes – as they have been divided into by the plan.³⁴ However, it is ensured that only those classes vote that are actually affected by the plan.³⁵ On the one hand, under Sec. 1126(f) BC a class is presumed to have accepted the plan when it is not impaired under the plan. On the other hand, a class that will receive nothing at all under the plan is deemed to have rejected it, Sec. 1126(g) BC. Consequently, neither class is required to vote since only the impaired classes cast the relevant votes.³⁶

³⁰ In this context a “claim” is a “right to payment”, Sec. 101(5) BC, and “interest” is namely equity, shares in a corporation, see Tabb & Brubaker, *Bankruptcy Law*, 650 (2003).

³¹ Epstein, Nickles & White, *Bankruptcy*, Vol. 3, Sections 10-1 to End, 32 (1992); Sec. 1123(a) BC; unless the plan satisfies the conditions set forth in Sec. 1124 BC a class is considered impaired.

³² Unless the court deems it unnecessary to provide a separate disclosure statement, Sec. 1125(f)(1) BC.

³³ <http://www.uscourts.gov/FederalCourts/Bankruptcy/BankruptcyBasics/Chapter11.aspx>.

³⁴ Sec. 1126(c),(d) BC.

³⁵ Gräwe, *Der Ablauf des US-amerikanischen Chapter 11-Verfahrens*, ZInsO 2012, 158, 163.

³⁶ In this context “impaired” can only be understood as “partially impaired” as correctly pointed out by Tabb & Brubaker, *Bankruptcy Law*, 650 (2003) since totally impaired classes who receive nothing are presumed to have rejected the plan.

The requirements for acceptance of the plan differ depending on whether it is a class of claim or equity holders. On the one hand, under Sec. 1126(c) BC, a class of claim holders has accepted the plan when the creditors voting to accept “hold at least two-thirds in amount and more than one-half in number of the allowed claims”. The condition to have majority both in number *and* in amount shall ensure balance between holders of big and holders of small claims.³⁷ On the other hand, a class of equity holders has accepted a plan when holders of at least “two-third in amount of the allowed interest of such class” vote to accept, Sec. 1126(d) BC. Since under this provision there is no majority requirement for numbers acceptance can be reached easier. Considering the fact that the higher the amount of interest in the debtor is the more losses and risk does the holder of such interest undertake which lets it seem reasonable to only require a qualified majority in amount.

Following the voting the bankruptcy courts needs to confirm the plan. It shall only do so if the requirements under Sec. 1129 BC are met. This includes that each holder of a claim in an impaired class either has accepted the plan or would receive at least what he would have received under liquidation under Chapter 7 C, Sec. 1129(a)(7)(A) BC.³⁸ Moreover, the plan will only be confirmed when the impaired classes have accepted the plan, Sec. 1129(a)(8) BC – except in a case of cramdown³⁹. However, at least *one* impaired class *always* needs to accept the plan in order to have it confirmed, Sec. 1129(a)(10), (b)(1) BC. Furthermore, when deciding whether to confirm a plan or not, the court also has to consider the feasibility of the plan.⁴⁰

³⁷ Gräwe, *Der Ablauf des US-amerikanischen Chapter 11-Verfahrens*, ZInsO 2012, 158, 163; on the one hand, if only the amount was decisive the holders of small claims would ultimately be deprived of their vote as it would not weigh into the decision; on the other hand, if only the number of claims would count holders of big claims could be outnumbered by holders of small claims, which would lead to inadequate results considering they are major creditors.

³⁸ This is the so called best-interest-test, see Epstein, Nickles & White, *Bankruptcy*, Vol. 3, Sections 10-1 to End, 34-35 (1992).

³⁹ See section. 1.5 of this chapter.

⁴⁰ Epstein, Nickles & White, *Bankruptcy*, Vol. 3, Sections 10-1 to End, 32 (1992).

Confirmation of the plan discharges the debtor from any debt preceding the confirmation, Sec. 1141(d)(1) BC. The debtor and the creditors – whether or not they are impaired or voted for the plan – are now bound by the provisions of the reorganization plan and must follow the new payment obligations that replaced the former claims.

1.3 Debtor’s Role in Reorganization and Content of the Reorganization Plan

Chapter 11 usually starts with a voluntary petition by the debtor. The debtor is most aware of its own financial situation and knows when it cannot continue as it is. However, when the debtor files for reorganization under Chapter 11 the court will not screen whether the company is actually indebted or unable to pay its debts, Sec. 301, 303 (h) BC.⁴¹ This brings the risk of misuse as the debtor might just file for bankruptcy under Chapter 11 in order to get rid of creditors.⁴²

Once the petition is filed the debtor is given 120 days in which it has the exclusive right to propose the reorganization plan. According to *Tabb and Brubaker* this “initial period of exclusivity” balances the power in a reorganization proceeding.⁴³ On the one hand, if the exclusivity to propose a plan would lie only with the debtor it would be given too much leverage over the creditors; on the other hand, a debtor would likely be hesitant to file for reorganization knowing anyone had the right to propose.⁴⁴ Therefore, giving the debtor and initial exclusive right and eventually allowing other parties to propose as well balances this power struggle.

During this period the debtor stays in control as the debtor in possession. Unlike in liquidation proceedings no trustee will take over the management of the debtor under Chapter

⁴¹ Podewlis, *Zur Anerkennung von Chapter 11 in Deutschland*, ZInsO 2010, 209, 210.

⁴² Gräwe, *Der Ablauf des US-amerikanischen Chapter 11-Verfahrens*, ZInsO 2012, 158, 160.

⁴³ Tabb & Brubaker, *Bankruptcy Law*, 648 (2003).

⁴⁴ Tabb & Brubaker, *Bankruptcy Law*, 648 (2003).

11 BC. Consequently, all the rights and powers that would belong to a court appointed trustee under Chapter 7 BC stay with the debtor, Sec. 1106, 1107 BC, including the “fiduciary obligation to maximize the value of the estate for the benefit of creditors and interest holders”⁴⁵. In other words, the management of the debtor usually stays in power and is entitled to continue to lead the company autonomously.⁴⁶ The idea behind this concept is that the current management is most familiar with the debtor’s business and better equipped to lead the debtor back to solvency.⁴⁷ In the author’s view this concept bears a certain irony considering that the current management probably lead to the debtor’s crisis in the first place. However, in practice, due to the fact that the management will stay in control after filing it is more likely to initiate proceedings than if it were removed as consequence of filing.⁴⁸ Thus, actually making it possible to rescue the debtor. The management will remain in its controlling position unless replaced by a trustee⁴⁹ or until the plan is confirmed – if this plan provides for the appointment of a new management.⁵⁰

Formulating and confirming a plan of reorganization is according to *Epstein, Nickles and White* the “debtor’s ultimate goal in Chapter 11 proceedings”.⁵¹ Since the debtor stays in possession and is given a period of exclusivity to propose a plan it is, in fact, usually the debtor

⁴⁵ Mallon & Waisman, *The Law and Practice of Restructuring in the UK and the US*, 219 (2011).

⁴⁶ Gräwe, *Der Ablauf des US-amerikanischen Chapter 11-Verfahrens*, ZInsO 2012, 158, 161.

⁴⁷ *Official Comm. Of Unsecured Creditors of Cybergenies Corp. V. Chinery* (Re Cybergenies Corp.) 330 F3d 548, 573 (3rd Cir. 2003), as cited in Mallon & Waisman, *The Law and Practice of Restructuring in the UK and the US*, 217 (2011).

⁴⁸ Mallon & Waisman, *The Law and Practice of Restructuring in the UK and the US*, 218 (2011).

⁴⁹ When there is sufficient cause and a request, see Sec. 1104 BC and *In re Ionosphere Clubs, Inc.* 113 B.R. 164 (Bankr. S.D.N.Y. 1990), as cited in Tabb & Brubaker, *Bankruptcy Law*, 599 (2003).

⁵⁰ Gräwe, *Der Ablauf des US-amerikanischen Chapter 11-Verfahrens*, ZInsO 2012, 158, 161 who notes that there is a connection between the replacement of the management and the subsequent success of the debtor.

⁵¹ Epstein, Nickles & White, *Bankruptcy*, Vol. 3, Sections 10-1 to End, 28 (1992).

who proposes the plan.⁵² When formulating the plan the debtor is rather free as the plan can provide for almost anything as long as the involved parties agree in the end.⁵³ However, the Bankruptcy Code provides for some mandatory requirements that need to be addressed in the plan. Only when the plan complies with the minimum requirements set out in Chapter 11 BC will the court confirm the plan, Sec. 1129 BC. As Sec. 1123 BC dictates, the plan – among other things – shall designate classes and specify which classes are impaired and how they will be treated. Since the plan will be voted on in these designated classes the debtor can try to divide classes in such a way that will improve the likelihood of acceptance of the plan – or at least the likelihood of a confirmation by cramdown.⁵⁴

1.4 Creditors' Role – Voting on the Acceptance of the Plan⁵⁵

Despite the possibility of cramdown, reorganization under Chapter 11 BC is based on consent of the parties.⁵⁶ Without the involvement and the approval of the creditors reorganization cannot go forward. Giving them the power to decide on a reorganization plan is protecting their interests. Therefore, even though – or especially because – it is the debtor who proposes the plan it is the creditors – claim and interest holders – that will vote whether the plan is accepted or not.

The creditors, however, will not vote individually. The plan divides creditors into classes of claims and interests and the creditors have will then vote in these classes. Under Sec. 1129(a)(8) BC the court shall confirm the plan when all impaired classes accepted the plan.

⁵² Epstein, Nickles & White, *Bankruptcy*, Vol. 3, Sections 10-1 to End, 32 (1992).

⁵³ Tabb & Brubaker, *Bankruptcy Law*, 647 (2003).

⁵⁴ Gräwe, *Der Ablauf des US-amerikanischen Chapter 11-Verfahrens*, ZInsO 2012, 158, 162-163.

⁵⁵ Due to the limited scope of this paper the role creditors play in committees and the creditors' assembly will be omitted. For an overview of the committees see Epstein, Nickles & White, *Bankruptcy*, Vol. 3, Sections 10-1 to End, 21-28 (1992).

⁵⁶ Tabb & Brubaker, *Bankruptcy Law*, 648 (2003).

Only the vote of the class is relevant in determining the acceptance of the plan. If the majority of a class votes to accept the plan all members of this class are bound by the vote including those that voted to reject the plan.⁵⁷ This prevents creditors from blocking the plan.⁵⁸ However, there are two sides to this coin. On the one hand, the debtor can use this mechanism to secure more acceptances by dividing dissenting creditors in such a way that they will be outvoted by the majority of the class they are in.⁵⁹ On the other hand, voting in classes may also protect the bona fide creditors from those who may just wish to undermine the debtor because of entirely unrelated interests.⁶⁰ Consequently, by stipulating a voting procedure in classes the BC, once again, provides for a balance between the interests of debtor and creditors.

When designating the classes the debtor – or any plan proponent – does not enjoy absolute freedom. Sec. 1122(a) BC dictates, “a plan may place a claim or an interest in a particular class *only* if such claim or interest is *substantially similar* to the other claims or interests of such class” [emphasis added]. Similarity depends on priority of the claim or the rights to payment against the debtor.⁶¹ However, it is not the amount of the claims but their “nature”⁶² that determines whether they are similar or not. This namely comes into play in respect to secured and unsecured creditors as they, consequently, must not be placed in the same class.⁶³ Moreover, interest holders also have to be in their own class.⁶⁴ However, it is

⁵⁷ See Sec. 1126(c), (d) BC; however, the non-consenting creditor may challenge the plan on the grounds of the so called “best interest” test under Sec. 1129(a)(7) BC.

⁵⁸ Epstein, Nickles & White, *Bankruptcy*, Vol. 3, Sections 10-1 to End, 34 (1992).

⁵⁹ White, *Bankruptcy and Creditors’ Rights*, 285 (1985); Gräwe, *Der Ablauf des US-amerikanischen Chapter 11-Verfahrens*, ZInsO 2012, 158, 162, 163.

⁶⁰ Westbrook et al., *A Global View of Business Insolvency Systems*, 156 (2010).

⁶¹ Tabb & Brubaker, *Bankruptcy Law*, 649 (2003).

⁶² White, *Bankruptcy and Creditors’ Rights*, 285 (1985).

⁶³ Gräwe, *Der Ablauf des US-amerikanischen Chapter 11-Verfahrens*, ZInsO 2012, 158, 162; Tabb & Brubaker, *Bankruptcy Law*, 649 (2003).

⁶⁴ It seems to the author that this is nowhere expressly stated as it is too obvious and already stems from the fact that classes of claims and classes of interests have different regulations regarding when a class has accepted the plan, Sec. 1126(c), (d) BC.

important to realize that not the creditors that are divided but the claims. Therefore, for instance, it is allowed to place the holders of claims that are all secured by the same mortgage in the same class even if some of them are also interest holders.⁶⁵ Cause for discussion in this regard is the fact that Sec. 1122 BC only dictates that only substantially similar claims *may* be placed together. It does not, however, clarify whether similar claims *must* be placed together.⁶⁶ *Gräwe* is of the opinion that as long the division is not ‘unfair’ the debtor may place similar claims in different classes,⁶⁷ though he does not give an explanation on when the division would be considered unfair. *Tabb and Brubaker* point out that according to “current judicial thinking” the debtor is only allowed to separate similar claims when it can give “good business reason”.⁶⁸ However, separation for the sole purpose of confirming the plan does not qualify as “good business reason”. Therefore, in order to avoid challenge of the classification the debtor has to execute its freedom with care.⁶⁹

Furthermore, the plan must not only contain the designation of the classes but also specify which classes are unimpaired, Sec. 1123(a)(2) BC. Determining which classes are impaired is relevant for two things: First, only the impaired classes need to vote to accept the plan since all unimpaired classes are deemed to have accepted it.⁷⁰ Second, in order for the court to confirm the plan – even under cramdown – at least one impaired class must accept the plan, see Sec. 1129(a)(10) BC.⁷¹ A class is impaired under the plan when the members in this class will not receive what they are entitled to under their claims and interests, Sec. 1124(1) BC. Since the

⁶⁵ *In re Martin’s Point Limited Partnership*, 12 B.R. 721, 727 (Bkrcty. Ga.1981), as cited in White, Bankruptcy and Creditors’ Rights, 285 (1985).

⁶⁶ Tabb & Brubaker, Bankruptcy Law, 649 (2003).

⁶⁷ Gräwe, *Der Ablauf des US-amerikanischen Chapter 11-Verfahrens*, ZInsO 2012, 158, 162 who uses the term “unbillig” that is translated to “unfair” by the author of this paper.

⁶⁸ Tabb & Brubaker, Bankruptcy Law, 649 (2003).

⁶⁹ White, Bankruptcy and Creditors’ Rights, 286 (1985).

⁷⁰ Sec. 1126(a)(8) BC.

⁷¹ For case law references see Epstein, Nickles & White, Bankruptcy, Vol. 3, Sections 10-1 to End, 33 (1992).

debtor would have – or should have – no reason to file for Chapter 11 BC if there were sufficient funds, at least one class will always receive less than what it is entitled to.⁷² Moreover, the plan has to clarify how the impaired classes are treated under the plan, namely how much they will be paid, and provide for the same treatment of all claims and interest holders within a class unless the creditor agrees to a less favorable treatment, Sec. 1123(a)(3)(4) BC.

An impaired class has accepted the plan when the majority of this class votes to accept. What is required to be a majority of the class depends on whether it is a class of claim or interest holders. A class of claims accepts the plan when creditors who hold at least two thirds of the amount and more than half of the number of claims voted to accept.⁷³ For example, a class consists of four unsecured creditors, A, B, C, and D. A, B and C are each holder of a claim in the amount of USD 1000 while D holds a claim of USD 6000, so together they hold a total sum of USD 9000. If A, B and C now vote to accept the plan and D rejects it there only the majority requirement regarding the numbers is met not the one regarding the amount. In the same example acceptance would also fail if D were the only one with an affirmative vote. Even though he holds two thirds of the amount of the claims of the class his one vote does not satisfy the requirement of the majority in numbers. Therefore, a class like this can only accept the plan if D and two of the others vote for the plan. Acceptance by a class of interest holders just requires an affirmative vote by two thirds in amount.⁷⁴ If the class in the example would be a class of interest holders for acceptance of that class an affirmative vote of just D would be sufficient. In either case the relevant majority is not an absolute one but only of the claim and interest holders that actually voted.⁷⁵ Moreover, some unsecured creditors might just go with the reorganization attempts as they would end up empty handed under liquidation anyways and

⁷² Epstein, Nickles & White, *Bankruptcy*, Vol. 3, Sections 10-1 to End, 33 (1992).

⁷³ Sec. 1126(c) BC.

⁷⁴ Sec. 1126(d) BC.

⁷⁵ Tabb & Brubaker, *Bankruptcy Law*, 650 (2003).

therefore have nothing to lose.⁷⁶ Once the majority requirements are met all members of a class that casts an affirmative vote are bound by this vote, including the ones that did not consent to the plan.⁷⁷

A non-consenting creditor “may not individually raise his voice to challenge the plan on the grounds that it is not fair and equitable, or that it unfairly discriminates against him. He is bound by the vote of the other members of his class.”⁷⁸ However, dissenting creditors are protected by so-called “best interest” test under Sec. 1129(a)(7) BC. Under this provision a plan cannot be confirmed if the *non-consenting* holder of a claim or interest would receive *more* in case of *liquidation* under Chapter 7 BC. If a hypothetical Chapter 7 analysis concluded that the creditor would receive more in liquidation than distributed to him under the plan the requirements of the “best interest” test are not satisfied and the court has to deny confirmation.⁷⁹ For instance, if an non-consenting unsecured creditor that holds a claim in the amount of USD 1000 would receive 5ct on one dollar of its claim in liquidation while the plan provides for a payout of USD 30 the “best interest” test is not satisfied. The test would also not be satisfied if the creditor would receive under the plan an installment payment in the total amount of USD 50 over the next 5 years as USD 50 today are more than USD 50 in five years.

In case an impaired class casts a non-affirmative vote the court may only confirm the plan via cramdown.

⁷⁶ Epstein, Nickles & White, *Bankruptcy*, Vol. 3, Sections 10-1 to End, 31 (1992).

⁷⁷ White, *Bankruptcy and Creditors' Rights*, 287 (1985).

⁷⁸ White, *Bankruptcy and Creditors' Rights*,

⁷⁹ Tabb & Brubaker, *Bankruptcy Law*, 650 (2003).

1.5 Cramdown under Sec. 1129(b) BC

Cramdown is called the “centerpiece” of reorganization.⁸⁰ This name seems accurate, as a number of reorganization proceedings are only successful because they are confirmed through cramdown. In larger reorganization proceedings it is unlikely that all the impaired classes accept the reorganization plan. In such proceedings the debtor should calculate with the possibility of cramdown from the beginning and formulate the plan and its class designations accordingly. In the end it will be cramdown that makes the reorganization of the debtor possible.

The provision on cramdown, Sec. 1129(b)(1) BC, stipulates that if all of the applicable requirements of Sec. 1129(a) BC – with exception of Sec. 1129(a)(8) BC⁸¹ – are met the court shall confirm “if the plan *does not discriminate unfairly*, and is *fair and equitable*, with respect to each class of claims or interests that is impaired under, and has not accepted, the plan” [emphasis added]. Sec. 1129(b)(2) BC then continues with what is “fair and equitable”⁸² with respects to secured claims (A), with respect to unsecured claims (B) and with respect to interests (C).⁸³ This order is clear representation of the “pecking order”⁸⁴ of claims dictated by Chapter 11: secured creditors, priority claims⁸⁵, unsecured creditors and – at the bottom – the shareholders. However, even secured creditors – who are on top of the chicken ladder – can be crammed down upon. *Westbrook and others* find the rational behind this provision in the idea

⁸⁰ *In re Mattson* 210 B.R. 157, 159 (Bankr. D. Minn. 1997), as cited in Adler et al., *Bankruptcy*, 655 (2007).

⁸¹ The provision that stipulates the court may only confirm the plan when all impaired classes accepted the plan.

⁸² *In re D&F Const. Inc.*, 865 F.2d 673 (5th Cir.1989) the court concluded that a plan that satisfied Sec. 1129(b)(2)(B) BC was not “fair and equitable”.

⁸³ In more detail discussed below.

⁸⁴ Epstein, Nickles, & White, *Bankruptcy*, Vol. 3, Sections 10-1 to End, 31 (1992).

⁸⁵ E.g. administrative expense claim, involuntary gap creditors, certain employee wage and benefit claims, certain claims against grain storage or fish storage and processing facilities, consumer deposit claims, and tax claims, see Epstein, Nickles, & White, *Bankruptcy*, Vol. 3, Sections 10-1 to End, 30 (1992).

that “creditors cannot claim “foul” if their recovery is at least as good as they would have received under if they had prevailed in having the enterprise liquidated.”⁸⁶

Regardless of which kind of class of creditors is crammed down upon the minimum requirement for a successful cramdown is always that *at least one* impaired class needs to accept the plan, Sec. 1129(a)(10) BC.⁸⁷ This, again, is expression of the balance of the power struggle between debtor and creditor in reorganization. The fact that not all the creditors’ consent is needed for plan confirmation protects the debtor’s interests.⁸⁸ *Epstein, Nickles and White* point out that “the threat of cramdown gives the debtor the most effective tool in its belt”.⁸⁹ The minimum requirement of one consenting class protects the creditors’ interest, additionally to the requirements of the “best interest” test for *individual* dissenting creditors and the “fair and equitable” standard for dissenting *classes*.⁹⁰

1.5.1 Fair and Equitable

The provision regulating what is “fair and equitable”, Sec. 1129(b)(2) BC, is complicated and difficult to comprehend without the help of case law and scholars’ commentary. *Epstein, Nickles and White* call attention to the fact that paragraphs (A), (B) and (C) of Sec. 1129(b)(2) are preceded by the verb “includes”.⁹¹ Therefore, the explanation of “fair and equitable” is not conclusive but only illustrative.⁹² It has been found by the Fifth Circuit, that a plan that does not satisfy the standards set out for the respective class cannot be “fair and equitable”, but at

⁸⁶ Westbrook et al., *A Global View of Business Insolvency Systems*, 155 (2010).

⁸⁷ Case law references in *Epstein, Nickles & White, Bankruptcy*, Vol. 3, Sections 10-1 to End, 33 (1992).

⁸⁸ *Smid, Rattunde & Martini, Der Insolvenzplan*, 18.4 (2014).

⁸⁹ *Epstein, Nickles & White, Bankruptcy*, Vol. 3, Sections 10-1 to End, 34 (1992).

⁹⁰ *Epstein, Nickles & White, Bankruptcy*, Vol. 3, Sections 10-1 to End, 33 (1992).

⁹¹ *Epstein, Nickles & White, Bankruptcy*, Vol. 3, Sections 10-1 to End, 35 (1992).

⁹² *Tabb & Brubaker, Bankruptcy Law*, 658 (2003).

the same time even a plan that complies with all the requirements has no guarantee to pass as “fair and equitable”.⁹³

Sec. 1129(b)(2)(A) BC stipulates three alternate standards that allow cramdown upon a class of secured creditors. Under the first standard cramdown is permitted when holders of secured claim retain their lien on the secured property and receive cash payment in at least the amount of the claim and a present value equal to the value of their security, Sec. 1129(b)(2)(A)(i) BC. This provision therefore allows for cramdown also when the property is transferred as long as the creditor retains its lien.⁹⁴ Another possibility for confirmation without the consent of a secured creditor is to provide that each claim holder will realize the “indubitable equivalent” of its claim, Sec. 1129(b)(2)(A)(iii) BC. It is questionable if such an equivalent can be given by other means than cash. The third standard⁹⁵ allows cramdown in case of sale of the property⁹⁶ “free and clear, with the creditor’s liens attaching to proceeds of the sale”.⁹⁷ The payment of the creditor must then either fulfill the present value standard under Sec. 1129(b)(2)(A)(i) BC or the indubitable equivalent standard under Sec. 1129(b)(2)(A)(iii) BC. *Westbrook and others* summarize the possibility to cram down on a class of secured creditors like this: “[C]ramdown against a secured creditor requires payment of the secured creditor’s collateral value plus a market rate of interest (thereby giving that creditor the equivalent of the “present value” of its collateral)”.⁹⁸

⁹³ *In re D & F Const. Inc.*, 865 F.2d 673 (5th Cir. 1989) as cited in Epstein, Nickles & White, *Bankruptcy*, Vol. 3, Sections 10-1 to End, 35 (1992).

⁹⁴ Epstein, Nickles & White, *Bankruptcy*, Vol. 3, Sections 10-1 to End, 36 (1992).

⁹⁵ Actually to be found in Sec. 1129(b)(2)(A)(ii) BC, however as it is referencing (i) and (iii) it must be considered the third standard.

⁹⁶ Sec. 363(k) BC.

⁹⁷ Epstein, Nickles & White, *Bankruptcy*, Vol. 3, Sections 10-1 to End, 37 (1992).

⁹⁸ Westbrook et al., *A Global View of Business Insolvency Systems*, 156 (2010).

Cramdown against classes of unsecured creditors and interest holders is under Sec. 1129(b)(2)(B), (C) BC only possible if the requirements of the so-called “absolute priority rule” are met. Under Sec. 1129(b)(2)(B)(ii) BC cramdown against a dissenting class of unsecured creditors is only possible if no holder of a claim or interest junior to the unsecured creditor receives anything unless the creditor receives value equal to its claim, Sec. 1129(b)(2)(B)(i) BC. In other words, as long as the dissenting unsecured creditors are not paid in full the equity owners will receive nothing, “so that the creditors effectively own the company.”⁹⁹ For instance, an unsecured creditor that holds a claim in the amount of USD 1000 must receive a value of USD 1000 under the plan before the equity holders are allowed to receive even one cent.¹⁰⁰ Sec. 1129(b)(2)(C) BC mirrors the standards under the preceding paragraph for the interest holder. A holder of a junior interest holder may only receive value on its interest when the interest holder is receives the full value. It is important to note that at the same time no class senior to the unsecured creditor or interest holder may be paid *more* than in full.¹⁰¹ A possible exception to the “absolute priority rule” is the “new value” exception. This exception allows interest holders to retain their interest if they contribute a new value to the debtor.¹⁰²

1.5.2 Unfair Discrimination

Additional requirement to the “fair and equitable” standard is the prohibition of unfair discrimination. The BC does not contain a definition of what is unfair discrimination.¹⁰³ However, the requirement that a plan for a successful cramdown shall not discriminate unfairly is designed to prevent the debtor from creating classes of the same legal rank and then provide

⁹⁹ Westbrook et al., A Global View of Business Insolvency Systems, 156 (2010).

¹⁰⁰ White, Bankruptcy and Creditors’ Rights, 287 (1985).

¹⁰¹ Tabb & Brubaker, Bankruptcy Law, 659 (2003).

¹⁰² For extensive discussion see, Tabb & Brubaker, Bankruptcy Law, 63-674 (2003); for a short overview see Epstein, Nickles & White, Bankruptcy, Vol. 3, Sections 10-1 to End, 40 (1992).

¹⁰³ Epstein, Nickles & White, Bankruptcy, Vol. 3, Sections 10-1 to End, 41 (1992).

one class with a less favorable treatment than another.¹⁰⁴ Therefore, whenever the debtor seeks to separate similar claims for whichever reason it needs to make sure that this will not lead to unfair discrimination. This shall be determined by comparing whether similar claims have been treated differently.¹⁰⁵

1.6 Chapter I Conclusion

The preceding examination of Chapter 11 shows that it consists of adequate tools for a successful reorganization of the debtor. By allowing the debtor to stay in control as the debtor in possession and giving it an initial exclusivity period to propose a plan there is sufficient incentive for the debtor to start the proceeding. Furthermore, the prospect that a reorganization plan may be confirmed without the consent of all creditors strengthens the debtor's position. Balance between the debtor's and the creditors' interest is accomplished by requiring that at least one impaired class votes in favor of the plan and, moreover, by providing for a "fair and equitable" plan that "does not discriminate unfairly".¹⁰⁶

¹⁰⁴ Tabb & Brubaker, *Bankruptcy Law*, 658 (2003); this view is supported by the legislative history of the provision as pointed out by Epstein, Nickles & White, *Bankruptcy*, Vol. 3, Sections 10-1 to End, 40 (1992)

¹⁰⁵ Epstein, Nickles & White, *Bankruptcy*, Vol. 3, Sections 10-1 to End, 42 (1992) with case law references in FN 7.

¹⁰⁶ Sec. 1129(b)(1) BC.

Chapter II – Reorganization and Cramdown in Germany

This chapter will start with a brief overview of plan proceedings in Germany and then continue with a short description of the German equivalent of the cramdown provision. This will be followed by an analysis of the similarities and differences between the German and the US approach.

2.1 Overview of Plan Proceedings in Germany

German law does not contain a separate procedure for reorganization. § 1 of the Insolvency Statute (Insolvenzordnung, InsO) stipulates “insolvency proceedings shall serve the purpose of collective satisfaction of a debtor's creditors by liquidation [...] or by reaching an arrangement in an insolvency plan, particularly in order to maintain the enterprise”.¹⁰⁷ Therefore, reorganization is possible within the scope of the plan proceedings regulated in §§ 217-269 InsO. § 217 InsO provides for the possibility to agree on an insolvency plan that regulates the debtor’s affairs different from what the InsO stipulates as the default procedure, which is liquidation. However, in practice plan proceedings are only seldom applied.¹⁰⁸

As in the US system proceedings only start with the filing of a petition to start proceedings by either the debtor or a creditor, § 13 InsO. However, other than in the US system the German debtor has an *obligation* to file for insolvency proceedings under certain circumstances and also needs an opening reason.¹⁰⁹ The debtor is obliged to file for insolvency in case of overindebtedness, § 19 InsO, or (imminent) insolvency, §§ 17, 18 InsO, which is the debtors inability to pay its debts. If the debtor fails to comply with this obligation the

¹⁰⁷ An English translation of the Insolvency Statute (InsO) is available at http://www.gesetze-im-internet.de/englisch_inso/englisch_inso.html#p0978.

¹⁰⁸ Podewlis, *Zur Anerkennung von Chapter 11 in Deutschland*, ZInsO 2010, 209, 212.

¹⁰⁹ Podewlis, *Zur Anerkennung von Chapter 11 in Deutschland*, ZinsO 2010, 209, 210; § 16 InsO requires the “existence of a reason to open” proceedings.

management may face criminal charges¹¹⁰ and can be held liable for damages¹¹¹ that occur to creditors due to belated filing.

Usually it will be already clear at the time of filing whether the debtor will be liquidated or reorganized – or at least aims to be reorganized.¹¹² However, other than in the US system, a petition is not filed for a certain procedure but generally for the opening of proceedings. Therefore, it can be decided during the proceeding whether the debtor shall be liquidated or restructured with the help of a reorganization plan.

Usually plan proceedings in Germany will be conducted under the supervision of an insolvency administrator, just see § 218 InsO. Once the petition is filed the court may open provisional proceedings and appoints a provisional administrator that will take control of the debtor.¹¹³ During the preliminary proceedings it will be examined if insolvency proceedings should be opened at all. In other words, it has to evaluate if there actually is reason to open proceedings and if there is sufficient estate to make it worth it. This is already a big difference to the US approach where proceedings are opened immediately with filing of the petition regardless of reasons. Another difference is that the debtor only has the possibility to stay in control if it (additionally) files for self-administration.¹¹⁴ If it fails to do so or the court declines the petition an administrator will be appointed to take over control and exercise the estate's rights. Self-administration is the equivalent of the debtor in possession. However, though it has been a possibility since the InsO came into force in 1999 it is rarely used.¹¹⁵ Courts often doubt

¹¹⁰ See § 15a InsO.

¹¹¹ See for example § 64 GmbHG for the limited liability company.

¹¹² Smid, Rattunde, & Martini, *Der Insolvenzplan*, 1.12 (2014).

¹¹³ § 21 (2) no. 1 InsO.

¹¹⁴ § 270 InsO

¹¹⁵ Self-administration is applied in less than 1% of all proceedings, http://www.ifm-bonn.org/studien/studie-detail/?tx_ifmstudies_detail%5Bstudy%5D=77&cHash=9c3cafff00107102009e39fd8df5cc01.

the debtor's business abilities and wont allow it to stay in control.¹¹⁶ Moreover, even if the court grants the petition it always has to appoint an insolvency monitor, who is a weaker version of the administrator.¹¹⁷ Debtor and monitor share the function of the administrator in a regular proceeding. In other words, the debtor in possession in Germany is much less free as the debtor in possession in the US.

On its face the InsO looks much more clearly in its provisions regarding the requirements on the formulation and confirmation of the plan. The regulations in respect of the insolvency plan are divided into three parts: establishment of the plan¹¹⁸, acceptance and approval of the plan¹¹⁹, and effects of the approved plan¹²⁰. For the purpose of this paper the focus will lie with certain provisions in context of establishment and acceptance of the plan.¹²¹ Under § 218 InsO the insolvency administrator and the debtor are entitled to submit a plan to the court. The plan shall consist of a declaratory and a constructive part, § 219 InsO. The declaratory part can be seen as an equivalent to the disclosure statement under the BC as it informs the parties the debtor's financial state.¹²² The constructive part contains the transformed legal rights of the parties involved.¹²³ In other words, this part is equivalent to the reorganization plan under the BC. The insolvency plan also needs to classify the claims and interests and state how each group is going to be treated. Originally the provisions on plan proceedings only dealt with the rights and interests of claim holders. But due to the reform under the ESUG¹²⁴ in 2012

¹¹⁶ Bork, *Rescuing Companies in England and Germany*, 253 (2012).

¹¹⁷ Uhlenbruck, *Insolvenzordnung*, § 275 para 1 (2010).

¹¹⁸ §§ 217-234 InsO.

¹¹⁹ §§ 235-253 InsO.

¹²⁰ §§ 254-269 InsO.

¹²¹ For a complete discussion of insolvency plan proceedings see Smid, Rattunde & Martini, *Der Insolvenzplan*, (2014).

¹²² Podewlis, *Zur Anerkennung von Chapter 11 in Deutschland*, *ZInsO* 2010, 209, 213; Gottwald, *Insolvenzrechts-Handbuch*, § 67 para 24 (2010).

¹²³ § 221 InsO.

¹²⁴ Which aimed at making reorganization of companies easier.

insolvency plan proceedings now also include regulations in respect of interest holders. This inclusion of the interest holders throughout the entire regulations on insolvency plan proceeding blurred the strict line between insolvency law and company law.¹²⁵ This merger has mostly been perceived positive.¹²⁶

The InsO provides for a more express regulation than the BC in respect of the classification of claims in § 222 InsO. This gives the debtor less freedom when it comes to dividing the claims but also more security in regards to the question, which divisions are allowed and which aren't. As a general rule § 222 (1) InsO stipulates, "groups shall be formed when the parties concerned have different legal status"¹²⁷. Furthermore, it expressly regulates that a distinction shall be made between certain kinds of creditors, § 222 (1) no 1-4 InsO. Newly introduced in the reform of the InsO in 2012 is the stipulation under § 222 (1) Nr. 1 InsO that interest holders must be a separate group.¹²⁸ Additionally, this provision allows that claims with equal legal status may be separated into groups with "equivalent economic interests". However, the criteria for the separation need to be indicated in the plan. The InsO, therefore, unlike the BC expressly allows for the separation of similar claims. Such a possibility shall increase the economic effectiveness of the plan and ease negotiations between the involved parties.¹²⁹ Nonetheless, it must be noted that the requirement of "equivalent economic interest" is narrower than the "good business reason" that allows separation of similar claims under Chapter 11 BC.

¹²⁵ Simon & Merkelbach, *Gesellschaftsrechtliche Strukturmaßnahmen im Insolvenzplanverfahren nach dem ESUG*, NZG 2012, 121.

¹²⁶ See Ulrich Haas, *Mehr Gesellschaftsrecht im Insolvenzplanverfahren*, NZG 2012, 961.

¹²⁷ Translation available at http://www.gesetze-im-internet.de/englisch_inso/englisch_inso.html#p0978.

¹²⁸ Deutscher Bundestag: Drucksachen und Protokolle [BT] 17/5712 (Ger.) available at <http://dip21.bundestag.de/dip21/btd/17/057/1705712.pdf>.

¹²⁹ Braun, *Insolvenzordnung*, § 222 para 2 (2014).

The InsO further states explicitly the what content the plan needs to provide for regarding the rights, of creditors entitles to separate satisfaction, insolvency creditors, lower-ranking insolvency creditors and shareholders.¹³⁰ Within a group all parties must receive equal treatment unless a party agrees to the distinct treatment, § 226 InsO. This provision is the equivalent to Sec.1123(a)(4) BC.

The creditors will then – as they do under the US approach – vote on the plan in groups, § 243 InsO. Creditors and shareholder “whose claims are not impaired by the plan shall have no voting right.”¹³¹ In this regard is the German statute stricter than the BC as under Sec. 1126(f) BC unimpaired classes are simply deemed to have to have accepted the plan. The end result is ultimately the same since only impaired classes are entitled to cast a relevant vote. However, expressly depriving creditors of the right to vote may add to the negative association with the German insolvency plan proceeding.

For the acceptance of an insolvency plan it is required under § 244 InsO that each group accepted the plan. A group accepts the plan when the majority of the creditors back the plan and these creditors hold more than half of the sum of claims within this group. This provision surprises. Under the BC the class acceptance requires a majority of two thirds of the amount so that – in theory – acceptance of plan seems to be easier in Germany as only half of the amount must vote for the plan. Therefore, the answer to the question why reorganization is less popular in Germany does not lie with this provision.

2.2 Prohibition to Obstruct under § 245 InsO in Comparison to Cramdown

The author will now examine the German equivalent to the cramdown provision in order to determine whether the reason for the unpopularity of reorganization lies within this concept.

¹³⁰ §§ 223-225a InsO.

¹³¹ §§ 237 (2), 238 (2), 238a (2) InsO.

§ 245 InsO is the German way to deal with dissenting creditors by combating abusive behavior.¹³² When German bankruptcy law was fundamentally reformed in 1999 the legislator modeled § 245 InsO after Sec. 1129(b) BC and called it “prohibition of obstruction” (Obstruktionsverbot).¹³³ Since § 245 InsO is based on the US statute it is easy to find similarities between the two provisions. However, when the legislator adopted § 245 InsO it also significantly deviated in certain aspects from its inspiration. What now follows is a closer look at similarities and differences between § 245 InsO and Sec. 1129(b) BC.

§ 245 (1) InsO stipulates that “a voting group shall be deemed to have consented” if certain requirements are met. Therefore, the level on which the cramdown happens differs between the US and Germany. While in the US a court may confirm the plan under Sec. 1129(b) despite the dissent of an impaired class, in Germany the consent of such class is simulated under § 245 InsO and this class consequently counted as if it had in fact accepted the plan. However, the end result is the same as both approaches lead to confirmation as if all classes had accepted the plan.

In order to find that a group is deemed to have accepted the plan § 245 (1) InsO dictates three requirements that need to be met. It must be unlikely that the members of the dissenting group are placed at a disadvantage under the plan, there must be a reasonable participation to the economic value, and the majority of the voting classes have to back the plan. The first requirement, the prohibition to be placed at a disadvantage, is very similar to the “best interest” test under Sec. 1129(a)(7) BC. The court has to examine whether the plan provides for at least that what the group member would have received in liquidation.¹³⁴ When determining if a

¹³² Bork, *Rescuing Companies in England and Germany*, 254 (2012).

¹³³ *Be Deutscher Bundestag: Drucksachen und Protokolle [BT] 12/2443*, 208 available at <http://dip21.bundestag.de/dip21/btd/12/024/1202443.pdf>; Bork, *Rescuing Companies in England and Germany*, 253 (2012)

¹³⁴ Kübler et al., *Kommentar zur InO*, § 245 para 10 (2013).

group member is placed at a disadvantage the court does not only take a look at the hypothetical liquidation, but also at the feasibility of the plan.¹³⁵

Under the second requirement creditors must “participate to a reasonable extent in the economic value devolving on the parties”. As with the condition for a plan to be “fair and equitable” under Sec. 1129(b)(1) BC in the subsequent paragraph so does § 245 (2) and (3) InsO provide for when a “reasonable participation” shall exist for creditors and shareholders. This provision dictates three conditions that all have to be fulfilled in order to cram down on claim holders.¹³⁶ Firstly, no other creditor is allowed to “receive economic values exceeding the full amount of his claim”. In other words, no creditor must receive more than it is entitled to. This condition also needs to be met for a cramdown on shareholders, § 245 (3) no. 1 InsO. Secondly, neither lower-ranking creditors nor the debtor or its shareholders is allowed to receive something under the plan. This standard corresponds to the “absolute priority rule” that guarantees that a creditor will receive a hundred percent of its claim before junior classes or interest receive anything. It should be noted at this point that § 245 InsO makes no distinction between secured and unsecured creditors but only between claim holders and interest holders. In consequence, the equivalent of the “absolute priority rule” also applies to secured creditors. However, it does not apply to shareholders. Thirdly, no creditor of the same rank receives an advantage under the plan. The express stipulation of this requirement can be deemed necessary as the InsO allows for classes of the same rank to be separated. In order, to prevent abuse of this possibility this condition can be justified. This last condition also applies to shareholders under § 245 (3) no. 2 InsO. If all three conditions – or in case of shareholders all two conditions – are met under the plan, a class of creditors is considered to have received a “reasonable participation”.

¹³⁵ Kübler et al., Kommentar zur InsO, § 245 para 14 (2013).

¹³⁶ Braun, Insolvenzordnung, § 245 para 7 (2014).

Most significant difference – in the author’s view – to Sec. 1129(b) BC is found in § 245 (1) No.3 InsO. While under the BC cramdown is possible if already *one impaired class* accepted the plan, German law requires that the *majority of the voting groups* actually accepted the plan. Originally the German legislator considered to follow the US example and let one affirmative group vote be enough to allow cramdown.¹³⁷ However, in the end it was found that just one consenting group is too weak as foundation for a reorganization plan.¹³⁸ This deviation could be the source for the lack of successful cramdown in Germany. Imagine the following scenario. The debtor proposes a plan that divides the creditors into three groups that are all impaired under the plan. For a successful cramdown under Sec. 1129(b) BC it is enough if one of them accepts the plan with the necessary majorities. In Germany, however, the plan can only be crammed down on one dissenting class when the two other classes voted to accept. This difference has consequences in how the debtor divides classes. A US debtor might try to have as many classes as possible in order to have at least one of them approve the plan. A German debtor on the other hand might try to keep the number of groups to a minimum.¹³⁹ In any case, different tactics need to be applied when it comes to classification in US and Germany.

2.3 Conclusion Chapter II

As the preceding analysis of the German plan proceeding shows the debtor is equipped with very similar tools as under the US system. The InsO provides for the possibility to submit a reorganization plan that the creditors vote on. There is the possibility of a debtor in possession, however this kind of proceeding is only applied rarely and still demands the

¹³⁷ Deutscher Bundestag: Drucksachen und Protokolle [BT] 12/2443, 208 available at <http://dip21.bundestag.de/dip21/btd/12/024/1202443.pdf>

¹³⁸ Kübler et al, Kommentar zur InO, § 245 para 2 (2013).

¹³⁹ Riggert, *Das Insolvenzplanverfahren*, WM 198, 1521, 1524 as cited in Kübler et al, Kommentar zur InO, § 245 para 2 (2013).; though the commentator casts doubt on this idea as the number of groups does not reflect on their voting behavior.

appointment of an insolvency monitor. Therefore, plan proceedings, including reorganization plans, are conducted under the supervision of an insolvency administrator. Moreover, approval of a plan without the consent of all creditors has higher demands than its counterpart in the US. Most significant deviation in this regard is the requirement to have consenting majority of groups.

Chapter III – Author’s Analysis and Solution

Chapter III will now pinpoint what are the reasons in the author’s view for the difference in success of reorganization and cramdown between the US and Germany. The author will then propose a solution on how to increase the number of successful reorganization proceedings in Germany.

The difference in bankruptcy stigma – or the lack thereof in case of the US – obviously plays its role when it comes to the success of reorganization. Society and courts don’t trust a debtor that already managed to run its business into the ground. This clearly reflects in the insolvency law. Because the debtor went bankrupt it is not allowed to manage itself once it filed for bankruptcy; there always needs to be some court appointed supervision by either the insolvency administrator or monitor. Because of such regulation we end up in a stigma spiral. Because of the stigma – because a once bankrupt debtor cannot be trusted – the debtor is not allowed to continue its business on its own through out the proceedings. Because the debtor is not allowed to manage itself it is perceived as it should not be allowed to do that and the stigma stays – deepens even. For the same reason a debtor is not trusted to be reorganized instead of liquidated. Who failed once will fail again. Consequently, a large portion of the lack of success of reorganization in Germany is due to stigma.

However, the direct stigma is not the only reason why reorganization is less successful. In the author’s opinion the fact that § 245 (1) No. 3 InsO requires for a successful cramdown that the majority of the voting groups accepted the plan plays a crucial role. In some way this is also a result of the stigma. When the legislator in 1999 decided to demand more than just the affirmative vote of one class it did so because it wanted a more solid foundation for the plan. This is an reflex to the thought – or more likely unconscious feeling – that a debtor cannot be trusted and, consequently, a plan proposed by said debtor, must be approved by more than one

group of creditors. In any case, the fact that cramdown and with it the approval of a reorganization has such high requirements prevents it from being successful in Germany.

Reorganization in the US shows more effectiveness because there is a balance provided between the powers of the debtor and the creditors. The creditors power lies with the voting. The debtor's powers under Chapter 11 BC arise from the fact that the debtor is not replaced by a trustee and can have its plan confirmed if only one class accepted it. From power arises trust – at least to some extent. If a party is given certain powers it is perceived that it deserves to exercise these powers and the other parties will trust it, at least so far they are not given the chance to challenge decisions as they have no other choice. Because creditors need to trust the debtor there is no room for stigma. By balancing the parties' powers in such a way the US approach gives a better groundwork for successful reorganization.

In the author's opinion reorganization will only ever be as successful in Germany as it is in the US when there is no stigma, since stigma is the direct and indirect cause for the difference in success. For that the circle of stigma needs to be broken. Historically follows what is perceived as the best approach in society. However, given the current legal groundwork in Germany society has no reason to change its opinion on the bankruptcy stigma as it does only confirm the skepticism against the debtor's ability. For that reason the author proposes to change society's perception by changing the law. If cramdown and with it reorganization would be easier than this could lead to more success in reorganization proceedings. More success in reorganization would – possibly – lead to more trust in the debtor. Which – maybe, eventually – can help remove or at least lessen the bankruptcy stigma.

A reform of the law would have to include provisions that give the debtor more powers, for instance the possibility to stay in control without supervision in reorganization proceedings. Especially the cramdown provision should be revised and allow cramdown with only one

affirmative class vote as it exists in the US and was originally considered to be implemented in Germany. Given the globalization of markets and that companies chose place of establishment also on the ground of the available bankruptcy proceedings it is time for the German law to assimilate in this regard.

To summarize, in the author's view the lack of success of reorganization in Germany is direct and indirect consequence of the bankruptcy stigma. On the one hand, a debtor is not to be trusted to continue to run its business and, on the other hand, the strict requirements of plan confirmation under cramdown prevent successful plan proceedings. The author, therefore, proposes to change the German insolvency law by making cramdown easier in hope that this way reorganization will be more successful and in time the bankruptcy stigma removed.

Conclusion

As Chapter I revealed the Chapter 11 BC – even though complicated and difficult to comprehend – provides reorganization tools that achieve a balance between the debtor’s and the creditors’ interest. The debtor is given an incentive to initiate proceedings, as it will stay in control as the debtor in possession and has an initial exclusivity period to propose a plan. The possibility of confirmation of the plan even when the majority votes against it further strengthens the debtor’s position. The creditors’ interests are protected by given them voting rights and providing for satisfaction of the “best interest” test and that the plan be “fair and equitable” and “does not discriminate unfairly”. By dividing the rights and powers this way the US approach gives the debtor enough power to be trusted and the creditors enough protection to trust. This balance provides for successful reorganization.

Chapter II made clear that the same cannot be said for the German approach. Even though German law also provides for reorganization through a plan the execution differs. There is no incentive to file for bankruptcy as an administrator or monitor will be appointed in any case, but there is only an obligation to file that can even lead to criminal charges when disregarded. Additionally the creditors are provided with more rights when it comes to cramdown as it required that the majority of groups accepts the plan. In other words, the creditors are overprotected and the debtor is not trusted, and consequently, successful reorganization proceedings are rare.

Chapter III showed that in the author’s view the reasons for these different outcomes lie with the bankruptcy stigma that prevails through out society and the InsO. The stigma prevents trust in the debtor’s abilities to turn the failed business around and is the reason for the high threshold regarding the plan confirmation without unanimous consent. In consequence, the author proposed that the stigma be removed by reforming the insolvency law, especially with regards to cramdown and plan confirmation.

Considering the fact the German insolvency law has lived through a number of reforms in the last years, that all failed to so drastically change the approach to reorganization plans, such a reform probably will not happen in the near future. However, the ESUG that had the purpose of making reorganization easier has not yet fulfilled its success. There is no significant increase in successful reorganization proceedings since the ESUG came into force. That is why in the author's opinion a more drastic approach needs to be taken. In order to compete with the US approach on reorganization and make the continuation of business more popular in Germany the idea of the debtor with a stigma needs to be left behind. It is the author's belief that this aim can only be achieved by overthinking the concept of plan proceedings in Germany especially in regards to confirmation of the plan. Bankruptcy cannot be avoided, however, the way society and legal frameworks approach and handle bankruptcy can – and should – be changed.

Where there is business there is bankruptcy; and with bankruptcy should come a second chance.

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