CRAMDOWN IN CHAPTER 11 OF THE US BANKRUPTCY LAW:

LESSONS FOR BOSNIA AND HERZEGOVINA

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ABSTRACT

Cramdown or nonconsensual confirmation of reorganization plan is not a novelty for many bankruptcy laws in the world. As being a powerful tool of implementing the fresh start philosophy, cramdown is a complex legal device bearing various possibilities. Many jurisdictions having it, however, are not familiar with its application. Another common point between many of them is the low number of reorganizations. This thesis tends to examine whether the two are in correlation by comparing the US and Bosnia and Herzegovina.

Due to the lack of experience with the application of cramdown which is a part of its bankruptcy laws, Bosnia and Herzegovina faces uncertainties. As the legal system with the longest tradition of fresh-start-oriented bankruptcy law and the system where the cramdown was invented, the United States is a jurisdiction to look upon in order to clear many of them.

This thesis first analyzes different philosophies of reorganizations in Chapter 11 of the US Bankruptcy Code and bankruptcy laws of Bosnia and Herzegovina. After juxtaposing the main steps of reorganization proceedings in both jurisdictions, the thesis focuses on the experiences related to the application of cramdown in Chapter 11.

The findings of this thesis endeavor to be valuable for Bosnia and Herzegovina's developing bankruptcy law, as the following findings are applicable beyond just cramdown They indicate that the legal framework of bankruptcy laws of Bosnia and Herzegovina is not only non-fresh-start oriented, but that it also disrupts interests of creditors in bankruptcy proceedings.

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INTRODUCTION

If a business entity gets into financial difficulties, there are several resorts it can opt for in order to get rescued. One of them is a business reorganization provided by both bankruptcy laws of Bosnia and Herzegovina (hereinafter BiH) and the United States (hereinafter US). Reorganization has become universally accepted by legislators worldwide as a good solution both for creditors and debtors. Numerous reasons may make reorganization attractive to creditors, yet perhaps the most important is that their claims will be repaid, whereas debtors will get the opportunity to continue to exist, the opportunity to have a "fresh start".[1]

The benefits of reorganization reach beyond satisfaction of interests of creditors and debtor in a particular bankruptcy proceeding. An entire society benefits from it since fewer liquidations means that workers keep their jobs and businesses can contribute to growth of the economy. Also, creditors as well as other stakeholders incur fewer losses and thereby are able to assist in the growth process.[2] For these reasons, the US law is increasingly looked at by other jurisdictions as a model. More and more systems would like to understand and learn how reorganizations work in the US. In light thereof, this thesis aims to focus on one important building block of the US law on reorganizations only - cramdown.

As a feature of the United States bankruptcy law, cramdown can be understood to bear different meanings. „In one sense, it simply means that if the necessary majority within a class approves a plan then the plan becomes binding on the other class members. But it can also be

[1] Clifford S. Harris, A Rule Unvanquished: The New Value Exception to the Absolute Priority Rule, 89 Mich. Law Rev. 2301 (1991): "The premise of a business reorganization is that assets that are used for production in the industry for which they were designed are more valuable than those same assets sold for scrap.... If the business can extend or reduce its debts, it often can be returned to a viable state. It is more economically efficient to reorganize than to liquidate, because it preserves jobs and assets."

[2] Gerard McCormack, Business restructuring law in Europe: making a fresh start, 17 J. Corp. Law Stud. 170 (2016).

used in the sense of cramming down a dissenting class in its entirety, i.e., forcing a majority of the class to accept a scheme against their wishes.[3]" Also, it can be defined as an authority of court to impose a reorganization plan over the creditors. The court would exercise this power in order to impose a reorganization plan over those creditors whose would be impaired under a proposed reorganization plan, which means that their claims would not be repaid in total according to the plan. In this work, cramdown is understood as a legal device which allows creditors to render the plan binding for dissenting classes as well as the authority of the court to confirm such a plan if statutory requirements have been met.

Due to the complex constitutional system of BiH, power to enact bankruptcy legislation is borne by two entities, namely the Federation of Bosnia and Herzegovina (hereinafter FBiH) and the Republic of Srpska (hereinafter RS), and Brcko District. All three jurisdictions have considerably similar bankruptcy legislation. What is also common to all three is that they do not set out business reorganization as a special and separate bankruptcy proceeding. Thus, business reorganization is deemed as an optional resort for creditors who might decide to reorganize debtor/debt rather than proceed with liquidation.[4]

There are slight differences among entities' and Brcko District legislation, however. Whereas bankruptcy laws of FBiH and Brcko District set out only one bankruptcy proceeding (liquidation and reorganization as an option within it), RS amended its Bankruptcy Law February 2016, by adding provisions on debt restructuring and therefore introduced the second bankruptcy proceeding distinguishing itself from the other two legislations. It ought to be added as well that exactly while this thesis is being written, the Federation of Bosnia and

[3] Gerard MacCormack et al., Study on a new approach to business failure and insolvency: comparative legal analysis of the Member States' relevant provisions and practices: tender no. JUST/2014/JCOO/PR/CIVI/0075 245 (2016).

[4] See Commercial laws of Bosnia and Herzegovina - An assessment by the European Bank for Reconstruction and Development 28 (2014): "There is no separate or fast-track reorganization procedure; ordinary bankruptcy proceedings must be converted into reorganization proceedings, although the debtor may file a reorganization plan together with its proposal to open bankruptcy proceedings. Where time is of the essence, the absence of a separate reorganization procedure may give rise to undue delays."

Herzegovina is preparing a new body of legislation on bankruptcy proceedings and the proposal is already in the legislative process. It is foreseen to derogate from the current Bankruptcy Laws as well related to reorganizations.

In the thesis, the focus will be on the analysis of the cramdown provisions of Federation of Bosnia and Herzegovina and Republic of Srpska, as the two major jurisdictions in BiH, in comparison to the model enshrined in Chapter 11 of the US Bankruptcy Code (hereinafter BC) . Since the vast majority of bankruptcy proceedings in Bosnia and Herzegovina end up in liquidation[5], both creditors and debtors usually remain unsatisfied. The present laws' main shortage is that reorganization is the option reserved exclusively for creditors who, however, do not deem it a reliable solution.[6] Thus, a debtor does not have the option to initiate business reorganization under the bankruptcy law in force. Moreover, creditors are not willing to file for reorganization proceedings due to the lack of faith in debtors' rehabilitation.

Turning back to the central topic – cramdown – as an important element of the US reorganization system, it is indicative that BiH bankruptcy laws operate only with a limited functional equivalent: the prohibition to obstruct. This is the only legal tool of bankruptcy laws of BiH by which the court is authorized to impose a reorganization plan over dissenting creditors. While functionally it is an equivalent to the cramdown under the Chapter 11 of the US Bankruptcy Code, in reality it is no more than a very restricted kin. Requirements for its application differ to some extent from the preconditions prescribed for the cramdown, but the *ratio legis* is the same.

Chapter 11 of the US Bankruptcy Code differs from the equivalent legislation in BiH not only with respect to the cramdown, but also the other devices and understandings of the law that

[5] Only ten reorganizations in BiH (in all three jurisdictions) were succesfully ended from 2003 until 2007. See Nedeljko Milijević, Stečaj poslovnih subjekata u Bosni i Hercegovini, 12 Pravni Život 303,310 (2007).
[6] Supra note 4, at 28: "Although these core areas performed exceptionally well, the EBRD's assessment reveals that there is still some room for improvement of the Insolvency Law …the law is generally weak in the area of reorganization proceedings."

make it unique. Cramdown is, however, certainly one of its peculiarities. The legitimate question which arises is how and to what extent does cramdown contribute to the success of reorganizations? In other words, what is the reason that the prohibition to obstruct under the bankruptcy laws of BiH does not yield more incentives for creditors to opt for reorganization whereas the cramdown under US Chapter 11 BC does?

The thesis attempts to answer this question by analyzing the differences in provisions on cramdown between Chapter 11 and Bankruptcy law of BiH, and assessing the differences in the understanding of bankruptcy proceedings in the United States and Bosnia and Herzegovina. The findings of the thesis research are unfortunately limited because it appears not to be any scholarship dealing with the cramdown in BiH *per se* available, whereas I managed to find only one court case.

The first Chapter presents a "fresh start" as the underlying policy of Chapter 11 of the US Bankruptcy Code. It comprehensively impacts all bankruptcy proceedings along with its building blocks. For the proper understanding of how is cramdown planned to operate and what purposes should it fulfill, the understanding of fresh- start policy is necessary. The second Chapter provides an overview of the bankruptcy proceedings in the Chapter 11 US Bankruptcy Code and bankruptcy laws of BiH. It tends to situate cramdown and its equivalent in BiH to the exact phase of the proceedings, as well as to demonstrate the importance of other phases and aspects of proceedings for a cramdown itself. The third Chapter discusses the rules on cramdown in both jurisdictions. It will be asymmetric, as the scholarship and case about the cramdown in the US law is peerless. This chapter will demonstrate both the US law and issues arising from its practice, in order to provide lessons for BiH and all legal systems inexperienced in application of cramdown.

CHAPTER 1 – Philosophy of bankruptcy reorganizations in the US and BiH

1.1. Philosophy of bankruptcy reorganizations

Any business entity facing financial distress has different options and legal system may provide it with different legal solutions to rehabilitate. In respect to that issue, jurisdictions differ on the basis of how they perceive bankruptcy law. The essence of the debate can be put philosophically: "why should a person incur costs just so some other people can benefit?"[7]

One approach is that bankruptcy ought to serve the interests of creditors[8] irrespective of the perhaps fatal consequences the bankruptcy proceedings may cause to the debtor. The other approach is that bankruptcy law ought to satisfy creditors and also to provide the possibility for a debtor's fresh start, because a business failure is deemed as a misfortune and something that may happen even to the prudent businessman. The second approach is tempting for its critics given that the interests of creditors and a debtor are in a number of cases intertwined, hence the reorganization of business means the satisfaction of both interests to a greater extent.[9]

Bankruptcy proceedings are not, however, panacea for any given issue. Thus, bankruptcy proceedings should not be a strategically preferable choice for creditors or a debtor in every situation. A renowned US expert of bankruptcy law stated: "There is a distinction between business failure and the problems bankruptcy law is designed to solve."[10] As a remedy, a bankruptcy can be very useful in cases where there are numerous creditors with a common problem, and not when they have different interests and consequently the opposite ideas on what should be the fate of a debtor and how its assets should be utilized.

[7] David Gray Carlson, Philosophy in Bankruptcy, 85 MICH. LAW REV. 1341, 1343 (1987).
[8] Terms creditors and claimants will be used interchangeably in this work.
[9] See, e.g., G. Stanley Joslin, The Philosophy of Bankruptcy-A Re-Examination, 17 U. Fla. L. Rev. 189, 189-195 (1964).
[10] Thomas H. Jackson, The Logic and Limits of Bankruptcy Law 209 (2001).

From the perspective of creditors, bankruptcy proceedings are the avenues through which they can articulate interests in respect of the debtor and achieve the commonly acceptable outcome. If there is a single creditor, on the other hand, bankruptcy proceedings may not be *per se* a favorable resort. For example, the commencement of the bankruptcy proceeding could attract all other creditors which could cause myriad challenges to the collection of a debt. From the perspective of the debtor, the answer to the question whether the bankruptcy would resolve its financial difficulties depends on the circumstances of each case individually.

Sometimes a business failure could be simply a failure and the different utilization of the assets as the option provided by bankruptcy law might not be useful to save the business. A mere fact of the existence of liabilities does not mean that a business shall opt for a bankruptcy. Issues in doing business vary and remedies for them vary as well. Bankruptcy proceedings are designed to provide a relief only when "there are numerous creditors and a potential common pool problem".[11]

The Bankruptcy Code of the United States strongly favors a fresh-start philosophy.[12] A business entity may file a bankruptcy petition under Chapter 7 (liquidation) or Chapter 11 (reorganization). Liquidation in its essence means that after a trustee collects all available and non-exempt assets of a debtor into a bankruptcy estate, he must sell them and distribute proceeds to creditors. The end of liquidation proceedings thus means the end of the existence of the debtor. This is certainly not the apt solution for businesses which still have a going concern value higher than its liquidation value[13].

The resort to the businesses dealing with failure offered by the US Bankruptcy Code is the business reorganization under Chapter 11. The ability of Chapter 11 to "preserve the going

[11] Id.
[12] About the role of fresh-start philosophy in the US bankruptcy law see, e.g., see Katherine Porter & Deborah Thorne, The Failure of Bankruptcy's Fresh Start, 92 Cornell L. Rev. 67, 68 (2006).
[13] Mark S. Scarberry, Business reorganization in bankruptcy: cases and materials 3 (3 ed. 2006).

concern value not only of small family enterprises but also of companies whose survival is critical to the economy as a whole"[14], to preserve the value of business relationships and its name[15] and save the jobs of workers were widely recognized.

Bankruptcy laws of FBiH and RS were drafted with the assistance of German experts of the *Deutsche Gesellschaft für Technische Zusammenarbeit* (GTZ). The laws were thus highly influenced by German Insolvency Law (*Insolvenzordnung*) of 1999 and comply with its conception and features. Not only the black letter of law had been transplanted from Germany[16], but also the understanding of a reorganization expressed through the spirit of the law.[17]

The second chance policy does not prevail when creditors choose otherwise. Bankruptcy laws of FBiH and RS[18] proclaim as the purposes of the bankruptcy proceedings satisfaction of creditors and maintenance of debtor's business operations. However, the other provisions of law which will be addressed in the following chapters yield only the satisfaction of creditors, since the reorganization is the option that creditors hardly ever use.

Admittedly, reorganization is often not opted for because of the strong presence of a bankruptcy stigma, i.e. creditors do not place reliance on the possibility that a debtor who failed in doing business could be able to recover and duly meet its obligations imposed by reorganization plan. In short, it can be argued that bankruptcy legislation of FBiH and RS do not have as their legitimate function „to maintain inefficient firms where such maintenance is not in the interest of creditors, to protect the debtor from its creditors, or to replace the rigor of

[14] Christopher Mallon and Shai Y. Waisman, The Law and Practice of Restructuring in the UK and the US 214 (2011).
[15] Mark S. Scarberry, Business Reorganization in Bankruptcy 2 (3 edition ed. 2006).
[16] Marija Vidić, Nikolina Maleta and Jelena Zovko, Stečajni plan, Zbornik radova Aktualnosti građanskog i trgovačkog zakonodavstva i pravne prakse, 429,451 (2012).
[17] See Bianca Schwehr, Corporate Rehabilitation Proceedings in the United States and Germany, 12 Int. Insolv. Rev. 12,15 (2003): "In contrast to the US point of view with its philosophy of a fresh start, debtors in Germany are frequently considered to be villains."
[18] Section 2 of Bankruptcy Law of FBiH and Section 2 of Bankruptcy Law of RS.

general private and commercial law with vague judicial equity"[19]. Statistics shows that in 2015 in the United States, 38% of a total number of filing Chapter 7 liquidation and Chapter 11 reorganization were the latter.[20] In FBiH, from 2011 to 2013 only 1% of all bankruptcy proceedings ended up in reorganization[21], which demonstrates the discrepancy between the jurisdictions in respect of the utilization of the reorganization.

Apart from the cramdown which will be upon the focus in following chapters, the differences in philosophy of bankruptcy legislation may be recognized through the following examples:

1.1.1. Commencement of bankruptcy proceedings

Bankruptcy proceedings in both United States and Bosnia and Herzegovina may commence either by filing a voluntary or involuntary petition. The prerequisites for commencement of bankruptcy proceedings in the two jurisdictions are different, however. The bankruptcy proceedings in the United Stated do not require insolvency of the debtor as a prerequisite for commencement of proceedings. The illiquidity of debtor is required only in a case of municipalities' debt restructuring under Chapter 9 of the Bankruptcy Code.[22] Hence, liquid companies may file a voluntary petition.

As a matter of the policy, Chapter 11 guarantees open access to the bankruptcy proceedings. It has been said that the rationale for the open access policy is "to provide access to bankruptcy relief which is as open as access to credit economy.[23] This policy allows a debtor not to wait until it becomes bankrupt to commence the proceedings. Rather, Chapter 11 provides it with the possibility to prevent an inevitable failure and enters the market as a fresh-starter. In order

[19] Gabriel Moss, Comparative Bankruptcy Cultures: Rescue or Liquidation: Comparison of Trends in National Law--England Symposium: Bankruptcy in the Global Village, 23 BROOKLYN J. INT. LAW 115–138 (1997).
[20] Bankruptcy filings data table: U.S. Bankruptcy Courts Business and Nonbusiness Cases Commenced, by Chapter of the Bankruptcy Code, During the 12-Month Period Ending December 31, 2015, at http://www.uscourts.gov/statistics/table/f-2/bankruptcy-filings/2015/12/31
[21] Džemail Ćibo, Reorganizacija stečajnog dužnika, University of Sarajevo Master Thesis 98 (2015).
[22] Chapter 9 regulates the adjustment of debts of a municipality.
[23] In Re Johns-Manville Corp., 36 B.R. 727 (1984).

to prevent the abuse of Chapter 11, court may dismiss the case if filing a petition has been in bad faith[24].

On the other hand, laws in BiH set out that bankruptcy proceedings shall commence only in a case of debtor's inability to meet its obligations as they fall due (illiquidity) or its imminent illiquidity.[25] Illiquidity is presumed if a debtor is unable to make payments or fails to pay its outstanding payment liabilities for a period of 30 days.[26] Imminent illiquidity could be inferred if, according to projections, a debtor will not be capable of meeting its obligations when they become outstanding.[27] In a case of imminent illiquidity, only a debtor is entitled to file a petition.

Different triggers of the bankruptcy proceedings yield different incentives for a debtor to file a petition. In the US, the bankruptcy is an option for a debtor whose ongoing business is still viable and bankruptcy proceedings may save the business. For example, such a standpoint was expressed by Michel E. Levine, who argued that the panacea for forecasted collapse of General Motors was reorganization under Chapter 11 that would allow it to renegotiate contracts with dealers, terminate pension plans and health benefits, and to cut the web of bad relationships wherever it was needed.[28] A company from Bosnia may see domestic bankruptcy legislation differently. Since it is not allowed to file a petition until the illiquidity or imminent illiquidity occurs, it may not see the bankruptcy proceedings as the chance to rebuild itself because the going concern value may not exist anymore.

[24] SGL Carbon Corporation 200 F.3d 154 (1999).
[25] An effort is being undertaken by entities' governments to change this. The aforementioned restructuring (a second bankruptcy proceeding present only in the law of RS) encourages debtors to file a petition before they become insolvent, since the restructuring „trigger“ is debtor's imminent insolvency. Similar legislation is currently being prepared by the government of FBiH.
[26] Bankruptcy Law of RS sets out the period of 60 days.
[27] Bankruptcy Law of RS does not give definition of imminent illiquidity. However, it prescribes that a time period in which can be projected that illiquidity will occur is limited to 12 months.
[28] Michael E. Levine, Why Bankruptcy Is the Best Option for GM, Wall Street Journal, November 18, 2008, http://www.wsj.com/articles/SB122688631448632421 (last visited Nov 22, 2016).

1.1.2. Typology of bankruptcy proceedings

Bankruptcy law of FBiH sets out only one bankruptcy proceeding. Different proceedings as prescribed by different Chapters of the United States Bankruptcy Code are not available. After the commencement of proceedings whether by voluntary or involuntary petition filing, the same set of procedural rules apply. Moreover, the proceeding follows the same procedural rules regardless of the expected or preferred outcome of the proceedings.

As stated above, after the commencement of the proceedings creditors may opt either for liquidation or reorganization of the debtor. "This is why the proceedings are entirely creditor-driven and why the debtor has no right to impose its will upon the creditor's interest or to play with the money of creditors."[29]

RS enacted new Bankruptcy law in 2016. The law generally follows the same approach as the Bankruptcy law of FBiH, but a pertinent novelty is the introduction of a debt restructuring as the separate bankruptcy proceeding. The bankruptcy proceeding from the previous law (liquidation with reorganization as an option) was retained. It is worth mentioning that only business entities can be debtors in both bankruptcy proceedings. Since the law was enacted recently, it seems to be no available data on the enforcement of debt restructuring or the relationship between the two existing bankruptcy proceedings.

1.1.3. Debtor-in-possession

After the commencement of reorganization, the issue of who shall manage the debtor's affairs emerges. Creditors are interested in keeping the reorganization costs at a minimum. They will be concerned with the cancelation of burdensome contracts and collection of all available assets. The expeditious and economical readjustment of the debtor so it can repay all debts is their main and often only object. The object may be achieved by appointing a trustee or

[29] Manfred Balz, Market Conformity of Insolvency Proceedings: Policy Issues of the German Insolvency Law, 23 Brook. J. Int'l L. 167, 180 (1997).

allowing a debtor to remain in possession. Both of the options could be appropriate in respect of the peculiarities of a situation. "An independent trustee is more desirable in case involving a reorganization of a corporate debtor having substantial indebtedness and publicly held securities. At the other end of the spectrum is the closely held corporate debtor whose existing management is essential to the continued operation".[30]

Chapter 11 allows both possibilities. The court shall appoint a trustee in a case of a fraud, negligence, mismanagement or similar cause if that is in interest of creditors, any equity security holders, and other interests of the estate.[31] Chapter 11 does not require the debtor to be insolvent in order to qualify for reorganization, and it includes a strong presumption favoring retention of management throughout the reorganization process.[32] A debtor-in-possession (hereinafter DIP) has substantially similar scope of the authority as a bankruptcy trustee and because thereof is sometimes called "quasi-trustee"[33].

The transformation of the debtor into the DIP has a twofold significance; its power in respect of some creditors increases, on one hand, whereas it decreases in respect of the others. A DIP is obliged to act in favor of the interests of creditors. However, the creditors are entitled to influence its actions if they notice deviations. Moreover, the court may veto certain acts if it assesses that they would deviate from the norm. On the other hand, a DIP may have increased leverage over some other creditors. The authority of a DIP in respect of the avoidance powers are the same as of a bankruptcy trustee. It allows a DIP to defeat the claims to the bankruptcy

[30] Report of the Comm'n on the Bankruptcy Laws of the United States, H.R. Doc. No. 137, 93d Cong., 1st Sess., pt. 1, at 252-53 (1973), in Edward S. Adams, Governance in Chapter 11 Reorganizations: Reducing Costs, Improving Results, 73 B.U. L. Rev. 581, 591 (1993).
[31] Section 1104 of BC.
[32] Michael Bradley & Michael Rosenzweig, The Untenable Case for Chapter 11, 101 YALE LAW J. 1043–1095 (1992); Also, the impact of the DIP has been explained in John Kong Shan Ho; Raymond Siu Yeung Chan, Is Debtor-in-Possession Viable in Hong Kong, 39 Comm. L. World Rev. 204, 207 (2010):
"The DIP concept is regarded as a motivating factor for directors of many companies in the US. They know that filing for Chapter 11 protection will safeguard their position as well as provide them with the exclusive right to propose a restructuring plan. In other words, early filing in the US is encouraged by the carrot of retaining control of the company and acquiring the DIP status."
[33] John Kong Shan Ho; Raymond Siu Yeung Chan, Is Debtor-in-Possession Viable in Hong Kong, 39 Comm. L. World Rev. 204, 218 (2010)

estate and hence protect both the interests of creditors and its own interests in property. Thus, a DIP is vested in powers that would otherwise be unavailable out of bankruptcy proceedings.

Under the Bankruptcy laws of FBiH and RS, in contrast, the appointment of a trustee is a *sine qua non* step in bankruptcy proceedings.[34] After the commencement of a bankruptcy proceeding, the court shall appoint a trustee who shall manage and administer the bankruptcy estate.[35] Even though there might be valid justifications for skepticism of the debtor-in-possession concept, the fact that BiH has no such concepts demonstrates that it places no reliance on a financially distressed debtor and thus that it follows the different philosophy that favors creditors over debtors in spite of different factual pattern of a particular case.[36]

This chapter demonstrates an overview of different philosophies of the subject jurisdictions embodied in various legal solutions and devices of bankruptcy law through analyzing some of the focal points of bankruptcy law. In such a mosaic of legal devices and building blocks, cramdown, which will be addressed in the following chapters, appears to be a device apt for favoring second chance philosophy and a chance for recovery of a debtor.

As in a case of the addressed focal points, the mere prescription of cramdown by the laws does not mean that they champion second chance policy, despite the opposite explicit declaration by the laws themselves.

[34] Section 3 of Bankruptcy Law of FBiH and Section 64 of Bankruptcy Law of RS.
[35] See Šefkija Čović, Poslovno Pravo 126,128 (2003).
[36] Germany, which fashions similar bankruptcy philosophy as BiH, introduced a DIP concept in Bankruptcy Law of 1999. However, the DIP concept applies in less than 1% of all bankruptcy proceedings. Thus, a sole introduction of a DIP concept does mean that it will be used in practice. See http://www.ifm-bonn.org/studien/studie-detail/?tx_ifmstudies_detail%5Bstudy%5D=77&cHash=9c3cafff00107102009e3

CHAPTER 2 – Synopsis of reorganization proceedings in the US and BiH

2.1. Understanding of reorganization as negotiations

This Chapter tends to describe reorganization proceedings under Chapter 11 of Bankruptcy Code and Bankruptcy laws of BiH. The common characteristic of reorganization regardless of jurisdiction is that it is an active process wherein many stakeholders pursue different interests. Behind the reorganization is a bulk of complex nexuses between various stakeholders involved.[37]

The key of a successful reorganization is in the negotiating skills of stakeholders and the quality of their positions. What exactly is beneficial for a stakeholder has to be determined on a case-by-case basis since it depends on various variables.[38]

Secured creditors enjoy priority in the collateral over all other creditors. That is an additional safeguard to the aforementioned possibility to obtain a relief from the automatic stay. Contingent upon the facts of the case, a secured creditor may have different interests in the plan negotiation process. He will likely seek to obstruct the reorganization efforts if the value of collateral may decline, if a likelihood of a successful reorganization is low[39] or if the creditor is merely undersecured. On the other hand, a creditor might want to discharge a debt and obtain an equity interest in the debtor in return, or it may believe in the success of the reorganization and hence that he will receive more than in liquidation.[40]

The aforementioned scenario is realistic if a debtor is a prosperous business whose assets, including the patents and intellectual property rights, justify the secured creditor's risk. In priority ranking, BC thoroughly lists all claims behind secured claim holders by their priority rank, such holders of certain unsecured claims for support obligations, administrative expense

[37] David G. Epstein et al., Bankruptcy, 28, 32 (1992).
[38] Id.
[39] John Kong Shan Ho; Raymond Siu Yeung Chan, Is Debtor-in-Possession Viable in Hong Kong, 39 Comm. L. World Rev. 204, 218 (2010)
[40] Id.

claims, employee wage and benefits claims, tax claims, consumer deposit claims etc.[41] (bankruptcy laws of BiH set out very similar priority ranking[42]). In general, holders of this type of claim do not plan vital role in plan negotiations. The third group consists of the unsecured claim holders. Their holders might easily be adversely affected by liquidation because it is not atypical that all assets in liquidation are distributed to secured creditors and creditors who enjoy priority. Therefore, it is even more so in their interest to achieve a beneficial plan even more so. A beneficial plan does not necessarily mean that the unsecured creditors shall be repaid after the plan comes into force or that they shall be repaid in full. If they would receive nothing under liquidation, virtually any value they may receive under the reorganization plan seems beneficial.[43]

The last stakeholders that are formally recognized by law are in the priority ranking system shareholders. They will usually receive no value, even though it is possible that after a successful reorganization they can receive a certain value. The two categories of actors play pertinent role even though they are not recognized formally as the actors – management and attorneys.[44] In reorganization, management owes fiduciary duty not only to shareholders but also to all estate creditors. Moreover, the motivation of management to preserve the jobs and professional reputation may be an additional motive for a successful reorganization. Lawyers may play substantial role in negotiations. If they are experienced in bankruptcy reorganizations, they can affect the position of their client in the plan negotiations and distribution of assets.[45]

[41] Section 507 of BC.
[42] Section 34 and Section 34 of Bankruptcy Law of FBiH and Section 87 and Section 88 of Bankruptcy Law of RS.
[43] David G. Epstein et al., Bankruptcy, 28, 32 (1992).
[44] Id.
[45] Id.

2.2. Reorganization under Chapter 11 of Bankruptcy Code

The reorganization begins with filing a petition to the court. Once a petition is filed, the automatic stay goes into effect automatically. It is an injunction „against all litigation and prevents the enforcement of judgments and of security without the leave of the court“[46]. It provides protection for debtors and creditors, i.e. debtor can focus on the opened bankruptcy proceedings and running business and thus ensure the repayment of its debts, while creditors are sure that the other creditors may not circumvent them and seize debtor's assets. The automatic stay is not absolute.[47] However, even if an action does not fall within the scope of the automatic stay, it might be possible to obtain an injunction according to the general rules governing the issuance of injunction.[48]

A secured creditor is not bound by the automatic stay without any exceptions. However, a secured creditor enjoys adequate protection[49] from the decrease of value of the collateral during the automatic stay.[50] In a case the value of the security is jeopardized, a secured creditor is entitled to seek one of the following: 1. periodic or one-time cash payment to the extent that the stay may cause value of property to decrease; 2. replacement lien or an additional lien; or 3. other type of relief that will result in “indubitable equivalent”[51] of his interest in property.

The adequate protection doctrine protects the interest in property of secured creditors and not all creditors in general. Moreover, even in a case of secured creditors, it should be understood as an exception to the general rule of the obedience to the automatic stay. The adequate protection doctrine rests "as much on policy grounds as on constitutional grounds. Secured

[46] Jennifer Payne, Debt Restructuring in English Law: Lessons from the US and the Need for Reform 21 (2014), https://papers.ssrn.com/abstract=2321615 (last visited Nov 22, 2016).
[47] Section 362(b) lists the exceptions to the stay.
[48] Kathryn R. Heidt, The Automatic Stay in Environmental Bankruptcies, 67 Am. Bankr. L.J. 69, 81 (1993).
[49] Section 361 of BC.
[50] David Gray Carlson, Philosophy in Bankruptcy, 85 Mich. Law Rev. 1341, 1389 (1987).
[51] Section 361(3) of BC.

creditors should not be deprived of the benefit of their bargain."[52] The second consequence of the commencement of bankruptcy proceedings is the creation of a bankruptcy estate. Even though a typical bankruptcy debtor under Chapter 11 will remain in possession of the property, after the commencement of the proceedings the property will be under the supervision of the bankruptcy court.[53] Bankruptcy estate comprises "all legal or equitable interests of the debtor in property as of the commencement of the case"[54].

Two possible options in respect of how the plan is to be drafted and accepted are available. In the first option, the debtor submits the plan and the statement regularly and the degree of uncertainty of the creditors' reaction is significant. Therein with this scenario, creditors are not familiar with the plan or its contents. The name of the aforementioned procedure is the free-fall bankruptcy. The other option is "pre-packed" bankruptcy. The debtor would negotiate the plan terms of reorganization with the creditors and ensure that they would confirm it once he proposes it to the court in a Chapter 11 bankruptcy. When he ensures it, the debtor files a petition and the bankruptcy proceedings commence. The advantage of this way of conducting a bankruptcy is the rapid pace of the proceedings, since there are no contested issues.[55] For example, the proceedings in pre-packed bankruptcy In re Fuller-Austin Insulation Co[56] lasted for two months only.

In the next stage, a debtor proposes a reorganization plan. He has an exclusive right to file not only a plan but also a statement that describes the reorganization plan within time period of

[52] S. REP. No. 989, 95th Cong., 2d Sess. 53 (1978), reprinted in 1978 U.S. CODE CONG. & AD. NEWS 5787, 5839; H.R. REP. No. 595, 96th Cong., 1st Sess. 339 (1977), reprinted in 1978 U.S. CODE CONG. & AD. NEWS 5963, in Douglas G. Baird & Thomas H. Jackson, Corporate Reorganizations and the Treatment of Diverse Ownership Interests: A Comment on Adequate Protection of Secured Creditors in Bankruptcy, 51 U. Chi. L. Rev. 97, 130 (1984).
[53] David G Epstein et al., Bankruptcy, 41 (1992).
[54] Section 541(a) of BC.
[55] Ronald Barliant et al., From Free-Fall to Free-for-All: The Rise of Pre-Packaged Asbestos Bankruptices, 12 Am. Bankr. Inst. L. Rev. 441, 472 (2004)
[56] In re Fuller-Austin Insulation Co., No. 98-02038 (Bankr. D. Del.)

120 days.[57] If he exceeds the time limit, the other interested parties such as creditors may file a plan. The plan has to have the minimum content.[58] A plan must contain the designation of every class that will not be impaired and those that would. Also, it must set out the proposed treatment of the impaired classes and provide that all holders of claims who fall into an impaired class receive the same treatment.

The plan must "provide adequate means for the plan's implementation". BC sets out requirements which are formally *sine qua non* of reorganization plan. In operation, however, the plan has to satisfy not only the formal requirements, but also requirements which creditors consider vital and without which there would be no acceptance of the plan[59] and requirements[60] without which the court would not confirm it.[61] The purpose of the plan is to create an order in which the creditors would get repaid.

The debtor does not have a full discretion in respect of how to create classes of creditors and designate the claims because he is bound by the general rule is that "classes are determined by grouping creditors by essentially equivalent claims."[62] Before voting, BC sets out that creditors must be provided with a plan and a disclosure statement.[63] A disclosure statement contains "adequate information" on the debtor and its business affairs. The purpose of this provision is to enable creditors get to know a debtor and the plan before voting.

The plan has to be accepted by creditors and confirmed by the court. Voting is conducted in each class separately. BC sets out two presumptions - the first is the acceptance of the class

[57] Section 1121(b) of BC.
[58] Subsection 1123(a) sets out mandatory provisions and Subsection 1123(b) describes permissive provisions which may but not required to be included in the plan. See more in Charles Jordan Tabb, The law of bankruptcy 1089 (3rd ed. 2014).
[59] Section 1126 of BC.
[60] Section 1129 of BC.
[61] David G. Epstein; Bruce A. Markell; Steve H. Nickles; Lawrence Ponoroff ,Bankruptcy: dealing with financial failure for individuals and businesses, West Academic Publishing 344 (2015).
[62] Gertner and Scharfstein, A Theory of Workouts and the Effects of Reorganization Law, 46 The Journal of Finance 1189,1222 (1991).
[63] Section 1125 of BC.

which is not impaired under the plan is deemed, and the second is the refusal of a class which would not receive anything (absolute impairment) under the plan.[64] Essentially, in means that only classes which are relatively impaired (they are to receive a value but not up to the total amount of their claims) ought to vote.

A class of claims accepts the plan by the votes casted by "the creditors that hold at least two-thirds in amount and more than one-half in number of the allowed claims". A class of interests accepts the plan by the votes casted by the holder "that hold at least two-thirds in amount of the allowed interests of such class". After the plan has been accepted, the bankruptcy court has to confirm it.

At this point, cramdown comes into play as the exception that entitles the court to confirm the plan in spite of the plan rejection by the impaired class.

As Justice Breyer pointed out in Casimir Czyzewski v. Jevic Holding Corp.[65], Chapter 11 case has three possible outcomes. "The first is a bankruptcy-court-confirmed plan. Such a plan may keep the business operating but, at the same time, help creditors by providing for payments, perhaps over time. … The second possible outcome is conversion of the case to a Chapter 7 proceeding for liquidation of the business and a distribution of its remaining assets. .... That conversion in effect confesses an inability to find a plan. The third possible outcome is dismissal of the Chapter 11 case. ....it aims to return to the prepetition financial status quo."

2.3. Reorganization under the Bankruptcy Laws of BiH

After the publication of the notification on the commencement of bankruptcy proceedings, many legal consequences of the commencement come into effect automatically. The purpose

[64]Ira Helene Miessler, Creditors' rights and cramdown in reorganization: a comparative study of US law and German law, CEU Legal Studies Department master theses 7 (2015).
[65] 580 U. S. ____ (2017)

of all of them is to ensure the integrity of the proceedings and prevent any interruptions or delays. They appear to be an equivalent of the automatic stay under the US Bankruptcy Code.

After the commencement of proceedings, the trustee assumes the control over the debtor and its assets. The proceedings stay all litigation and enforcement proceedings. Litigation proceedings remain stayed until the trustee decides whether to assume them or not. The debtor loses a right to interfere in the management or disposal of the property which constitutes the bankruptcy estate. The debtor is, however, not unvested from his property rights. The debtor continues to be the owner even though he cannot exercise his entitlements. If the debtor disposes of the property in spite of the prohibition, such actions may be avoided. Furthermore, a right to receive the obligations from all debtors of the bankruptcy debtors is conveyed to the bankruptcy trustee and the law imposes obligation of the debtors to act accordingly.

However, secured creditors do not fall within the purview of stay, since they are entitled to request a separate settlement of their claims out of the collateral.[66] If their claims remain unsatisfied after the collateral has been sold and proceeds have been distributed, they are entitled to demand the payment of the remainder of the claim, which will be treated as unsecured claims, under condition they have filed a proof of claim.[67]

Similarly to the US, the bankruptcy estate comprises all assets owned by a debtor in BiH as well. The laws provide third persons with a right to request a segregation of the property, which is in the debtor's possession but not owned by the debtor, from the estate. These persons are so called "extraction creditors".[68]

If the proceedings have been commenced voluntarily, the debtor has the right to file a reorganization plan along with the petition. After the commencement, both the debtor and the

[66] Section 148 of Bankruptcy Law of FBiH and Section 208 of Bankruptcy Law of RS.
[67] Section 110 of Bankruptcy Law of FBiH and Section 169 of Bankruptcy Law of RS.
[68] Christian Hönig & Christian Hammerl, Insolvency and Restructuring Law in Central & Eastern Europe: An Introduction For Practitioners 108 (2014).

trustee have the right to file a plan.[69] If a trustee has the duty to actually draft the plan, he acts upon instructions on the content of the plan stipulated by the creditors. As was previously mentioned, since the default outcome of the bankruptcy proceeding is liquidation, the proceedings will not be delayed nor suspended if no one of the participants files a plan. The court has authority to interpret such actions as participants' will to liquidate the debtor.[70]

The laws thoroughly list the content of the plan. The entire content is classified into two segments of the plan – declarative section and substantive section.[71] The declarative section includes the purposes and the effect of the plan, as well as the measures which have been undertaken or will be undertaken to achieve the purposes. The substantive section must describe "how the legal status of the bankruptcy debtor and other parties… will be affected by the plan"[72].

The bankruptcy court may reject the plan before the voting if the requirements of the filing or the content of the plan have not been met, if there is no prospect that the plan will be accepted by the creditors and confirmed by the court, and if the plan has been filed by the debtor and it is impossible that he will meet the requirements set out in the substantive section of the plan.[73]

The plan has to be accepted by the creditors and confirmed by the court. The creditors are grouped into classes. Each class separately votes on the plan. The plan is deemed accepted if the majority of creditors in each class have voted and the sum of the claims of creditors who have voted for the plan is greater than the sum of the claims of creditors who voted against the

[69] Section 143 of Bankruptcy Law of FBiH and Section 203 of Bankruptcy Law of RS.
[70] Christian Hönig & Christian Hammerl, Insolvency and Restructuring Law in Central & Eastern Europe: An Introduction For Practitioners 110 (2014).
[71] Section 145 and Section 146 of Bankruptcy Law of FBiH and Section 205 and Section 206 of Bankruptcy Law of RS.
[72] Christian Hönig & Christian Hammerl, Insolvency and Restructuring Law in Central & Eastern Europe: An Introduction For Practitioners 118 (2014).
[73] Section 156 of Bankruptcy Law of FBiH and Section 216 of Bankruptcy Law of RS.

plan.[74] The debtor must also accept the plan.[75] At this point, the prohibition to obstruct, the equivalent to cramdown of Chapter 11 US Bankruptcy Code, comes into play.

[74] Section 169 of Bankruptcy Law of FBiH and Section 229 of Bankruptcy Law of RS.
[75] Although the court can impose the plan upon dissenting debtor if he cannot prove that he is not placed in a less favorable position than his position without this plan, and if none of the creditors receives a benefit or any other accommodation that exceeds the full amount of its claim. This rule also applies to equity holders and holders any legal interest in the debtor. See Section 172 of Bankruptcy Law of FBiH and Section 232 of Bankruptcy Law of RS.

CHAPTER 3 – Cramdown requirements under Chapter 11 Bankruptcy Code and Bankruptcy Laws of BiH

3.1. Cramdown under Chapter 11 Bankruptcy Code

This section tends to outline the building blocks of cramdown. Professor Markell explicated so succinctly in the following words: "Nonconsensual confirmation, also known as 'cramdown', first requires that the plan satisfy all other confirmation requirements. Then, in lieu of creditor approval, the plan must provide for "fair and equitable" treatment of any dissenting class of creditors. In addition, the plan must not discriminate unfairly with respect to a dissenting class."[76]

Translated into the words of Chapter 11 BC, the building blocks of cramdown are expressed in a form of preconditions. All preconditions can be classified into three groups: 1. general; 2. impaired-class related; and 3. satisfaction of the absolute priority rule for unsecured and equity.

General requirements[77] apply in all reorganization proceedings regardless of whether the court has to confirm consensual or non-consensual plan. Impaired-class related requirements define

[76] Bruce A. Markell, Owners, Auctions, and Absolute Priority in Bankruptcy Reorganizations, 44 Stan. L. Rev. 69, 71 (1991).

[77] General requirements are listed in Section 1129(a) of BC, except Section 1129(a)(10) and Section 1129(a)(8) which prescribe the impaired-class related requirements. Section 1129(a) lists 16 requirements in total:

1. The plan complies with the applicable provisions of this title. Section 1129(a)(1).
2. The proponent of the plan complies with the applicable provisions of this title. Section 1129(a)(2).
3. The plan has been proposed in good faith and not by any means forbidden by law. Section 1129(a)(3).
4. Any payment made or to be made by the proponent, by the debtor, or person issuing securities or acquiring property must be approved by the court as reasonable. Section 1129(a)(4).
5. The identity of post-confirmation management is disclosed and is consistent with the interests of creditors and equity security holders and with public policy; and the identity of any insider that will be employed or retained by the reorganized debtor, and the nature of any compensation for such insider. Section 1129(a)(5).
6. Rate approvals issued by the governmental bodies are or will be obtained. Section 1129(a)(6).
7. Each holder of a claim or interest of an impaired class has accepted the plan or will receive under the plan a value that is not less than the amount that such holder would so receive if the debtor were liquidated under Chapter 7. Section 1129(a)(7).
8. Each class of claims or interests either has accepted the plan or is not impaired under the plan. Section 1129(a)(8).
9. Priority claims must be paid in full. Section 1129(a)(9).
10. If there are impaired classes, at least one of them accepted the plan, determined without including any acceptance of the plan by any insider. Section 1129(a)(10).

position and treatment of such classes: Cramdown can be exercised only if at least one impaired class voted for the plan[78] and each holder of a claim or interest of an impaired class has accepted the plan or will receive as under Chapter 7 liquidation.[79] Satisfaction of the absolute priority rule is a pure cramdown requirement, marked by rich history and "near scriptural status"[80], which will be briefly described in the following sections.

The reorganization plan in its essence is the agreement of various parties on how to distribute the assets of their common debtor. It includes the negotiations between various classes of claimholders who push their interests and bargain over the terms and conditions of the plan. Even though it resembles a contract, it should not be understood like that. Contract law stipulates that obligations under a contract may arise only for the parties who reached the agreement and assented to be bound by it. A reorganization plan, in contrast, departs from that rule and renders the accepted and confirmed plan binding to all claimants, regardless of whether they accepted it or not. A legal tool which allows such a departure from the rules of a contract law in the US bankruptcy law is cramdown.[81]

The effect of a cramdown is that a non-assenting class of creditors will be impaired by the plan, i.e. they will receive less than the full amount their claims, according to the reorganization plan. The cramdown provisions, however, do not only provide a leeway for

11. Confirmation of the plan is not likely to be followed by the liquidation, or the need for further financial reorganization, unless such liquidation or reorganization is proposed in the plan. Section 1129(a)(11).
12. All fees payable to the trustee have been paid or the plan provides for the payment of all such fees on the effective date of the plan. Section 1129(a)(12).
13. Retiree benefits, defined in Section 1114, will continue to be paid for the duration of the period the debtor has obligated itself to provide such benefits. Section 1129(a)(13).
14. Postpetition domestic obligation must be paid. Section 1129(a)(14).
15. In a case in which the debtor is an individual and in which the holder of an allowed unsecured claim objects to the confirmation of the plan, the debtor must pay all of his disposable income for a period not less than five years. Section 1129(a)(15).
16. Property conveyance must be in accordance with non-bankruptcy law that governs the transfer of property by corporation or trust that is not commercial, business or moneyed corporation or trust. Section 1129(a)(16).

[78] Section 1129(a)(10) of BC.
[79] Section 1129(a)(8) of BC.
[80] Stephen J. Lubben, The Overstated Absolute Priority Rule 1 (2015), https://papers.ssrn.com/abstract=2581639 (last visited Feb 23, 2017).
[81] Supra note 58, at 1056.

reaching the most favorable agreement between creditors to the detriment of impaired classes of creditors, but yields two important consequences. First, dissenting classes will enjoy protection from arbitrary impairment, as will be elaborated in the following sections. Second, the Code relies on the premise that the negotiations will be impacted by the strictness of cramdown rules which will render parties to refrain from impairing any classes due to the risk of a plan non-confirmation by the court, thus ancillary effect will be to yield a plan acceptable to all classes without impairment.[82]

Since the impaired-class related requirements and the absolute priority rule are exclusively related to the cramdown whereas general requirements impacts all Chapter 11 reorganizations, the focus of this thesis is on the former two sets of requirements.

3.1.1. Impaired-class related requirements

As mentioned above, there are two impaired-class related requirements:

1. Cramdown can be exercised only if at least one impaired class voted for the plan[83]; and

2. If each holder of a claim or interest of an impaired class has accepted the plan or will receive as under Chapter 7 liquidation.[84]

The subsection 3.1.1.1. tends to explain the meaning of the requirements through the concept of the impairment in Chapter 11, whereas the subsection 3.1.1.2. will not deal with any of the requirements *per se*, but the focus will be on the most common issues related to the impaired-class requirements – manipulation of the impairment and class creation.

[82] Kenneth N. Klee, All You Ever Wanted to Know About Cram Down Under the New Bankruptcy Code, 53 AM. BANKR. L.J. 134, 134 (1979).
[83] Section 1129(a)(10) of BC.
[84] Section 1129(a)(8) of BC.

3.1.1.1. Impairment

A significant factor in any reorganization is whether the plan proposes impairment of any class of creditors. The cramdown can be invoked only if there is at least one impaired class and if other requirements are met. BC stipulates that a class is impaired (1) if the plan does not alter the rights and interest of claimants or (2) if it cures any default, reinstates accelerated obligations and compensates for damages.[85]

Given that cramdown is an exception that ought to be carefully monitored by the court in order to protect dissenting classes, the consequence of the unimpairment is that such class lacks the protection. Thus, the unimpaired classes do not have right to vote on the plan. BC stipulates that unimpaired class have accepted the plan. Unlike them, impaired classes have right to vote. The prerequisite of cramdown, as mentioned before, is that at least one impaired class voted for the plan. Even though the reorganization plan is framed around the classes, an important consequence of the impairment protects individual members of an impaired class. Individual claimants are protected by "the best interest test"[86] which requires that has accepted the plan or will receive under the plan a value that is not less than the amount that such holder would so receive if the debtor were liquidated.

3.1.1.2. Gerrymandering of classes and rules on classification of claims

Questioning what in reality constitutes impairment could be a controversial. The wording of the provision governing impairment itself stipulates that a class is deemed impaired unless the two aforementioned conditions are met, which leads to conclusion that the impairment is a rule and unimpairment is an exception. Because of this, Melzer noted: "Impairment is an

[85] Section 1124 of BC.
[86] Section 1129(a)(7) of BC.

easily met standard. Virtually any alteration of a creditor's rights-no matter how minor-will suffice. Even enhancement of a claim constitutes impairment.[87]"

This creates the possibility of the manipulation of class creation process and to the extent that some creditors might be intentionally placed into an impaired class because the plan proponent is aware that such creditors will vote yes on the plan. Thus, the cramdown prerequisite of having at least one impaired class who voted for the plan would be satisfied. The interest of the debtor to create an impaired class in a case where such thing presumably is not going to happen without his intervention lies in the chance offered by Chapter 11 to avoid liquidation which can be sometimes inevitable, if the court does not confirm the plan. Some creditors, especially trade creditors ("a contractor consultant, or a vendor of heating oil, a gas utility"[88]) are willing to assent to be impaired because they will receive higher profits from the long-term relationship with the surviving debtor than if they are paid full in bankruptcy.

The intervention made for the purpose of creating assenting impaired class is called "gerrymandering of classes"[89] or „artificial impairment"[90]. The landmark case dealing with this issue is In re Windsor on the River Associates[91]. In this case, the court held that "a claim is not impaired if the alteration of rights in question arises solely from the debtor's exercise of discretion."[92] David Gray Carlson noted that the court meant that the court held that

[87] Peter E. Meltzer, Disenfranchising the Dissenting Creditor Through Artificial Classification or Artificial Impairment, 66 AM. BANKR. L.J. 281, 289 (1992).
[88] In re 266 Washington Assocs., 141 B.R. 275, 278 n.10 (Bankr. E.D.N.Y. 1992), in David Gray Carlson, Artificial Impairment and the Single Asset Chapter 11 Case, 23 Cap. U. L. Rev. 339, 378 (1994).
[89] Supra note 87, at 394.
[90] David Gray Carlson, Artificial Impairment and the Single Asset Chapter 11 Case, 23 Cap. U. L. Rev. 339, 378 (1994).
[91] 7 F.3d 127, 131-32 (8th Cir. 1993); Carlson, supra note 90 at 357, summarized the case as following: „The dominant secured creditor was oversecured by the time of the first confirmation hearing.7 A class of trade creditors, with only $13,000 in total claims, were to be paid sixty days after the effective date of the plan. The bankruptcy court ruled that this class of yes-voting trade creditors was impaired.73 Therefore, the court reasoned that the debtor had met the provisions of § 1129(a)(10). Nevertheless, Judge Morris Sheppard Arnold ruled that impairment was unnatural and artificial. As a result, Section 1129(a)(10) had not been met, and the plan could not be confirmed. 'The central question,' Judge Arnold wrote, 'is whether such impairment may be manufactured at the will of the debtor 'just to stave off the evil day of liquidation. We think the answer is no.'"
[92] Supra note 90, at 132.

impairment cannot be only a product of debtor's discretion (artificial impairment), but that it must be necessary.[93]

Other examples of "artificial impairment" can be found in the case law. In re Willows Convalescent Ctrs. Ltd. Partnership court[94] held that the claim of $1,400 held by the impaired class claimant was *de minimis* compared to the claims of other creditors in excess of $10 million. Because thereof, the single payment of the impaired claimholder, as opposed to payment in monthly installments set out in the plan, would have been negligible. The court thus ignored the yes-vote by the impaired claimholder because the impairment was artificial. In re Lettick Typografic, Inc.[95] court held that the plan, which originally left the creditor unimpaired and was amended to impair that creditor only because he would have been the only dissenting creditor, was designed for the sole purpose of creation of artificial impairment.

The other requirement that has to be met in order for the court to confirm such a plan is that rules on classification of claims were satisfied. A plan proponent does not have absolute freedom to create classes of claimants in order to achieve any goal, including meeting the requirements of cramdown. Chapter 11 BC sets out that "a plan may place a claim or interest in a particular class only if such claim or interest is substantially similar to the other claims or interests of such class". The court may, however, allow creation of a separate class of unsecured claims „for administrative convenience".[96] This means that rules are not concerned with secured claimants, and a rule of thumb is that typically each secured claim forms a separate class. The courts have discretion to determine what constitutes „administrative convenience" and which claims are „substantially similar" on a case-by-case basis. They can decide to prohibit a separation of claims by invoking the "substantially similar" standard. The

[93] Supra note 90, 356-359.
[94] 151 B.R. 220, 223 (D. Minn. 1991).
[95] 103 B.R. 32, 38 (Bankr. D. Conn. 1989).
[96] Section 1122 of BC.

courts of the US are divided vis-à-vis this: a common knowledge is that there are the strictest circuits, middle-ground circuits and flexible circuits.[97] There are two justifications for formation of separate classes of claims upheld in case law.

The first is a legitimate business reason. The plan proponent has to prove that separate class of claims will eliminate adverse effect on a debtor's business which would otherwise exist. In In re Chateaugay Corp[98], the court held that achievement of harmonious business relations was a legitimate business reason for a separate classification of unpaid workers' claims and paid workers' claims. The court in In Re Way Apartments, D.T.[99] deemed separate classification of unsecured claim held by the Department of Housing and Urban Development valid business justification. Creation of a class that would be paid full while the others only partially because that made infusion of new funds possible was legitimate business reason in In Re Atlanta Wat VI.[100]

The other reason justification for allowing a formation of separate classes of claims is the different nature of the claim. In other words, the court would allow creation of separate classes of claims if they are not "substantially similar". In In Re U.S. Truck Co.[101], the court found that it is justified to separate union member workers having a claim from a collective agreement in a different class from trade creditors. Or, In Re Bloomingdale Partners[102], warranty claims versus trade creditor claims were substantially dissimilar and thus separate classification was justified.

[97] The strictest circuits prohibits separate classification of similar claims, the middle-ground circuits permit separate classification after judicial scrutiny if a need or cause was demonstrated, and the most flexible circuits allow separate classification without qualification.
[98] 944 F.2d 997 (2nd. Circ. 1991).
[99] 201 B.R. 444 (5th Circ. 1996).
[100] 91 B.R. 620 (Bankr. N.D. Ga. 1988).
[101] 800 F.2d 581 (6th Cir. 1986)
[102] 170 B.R. 984, 997 (Bankr. N.D. Ill. 1994)

This subsection shows that impairment is related with possibility of manipulation of class-creation in order to satisfy preconditions for cramdown. However, there are rules on class-creation that curtail the plan proponent's discretion but not eliminate it completely.

3.1.2. The absolute priority rule

A cramdown is closely related to the absolute priority rule. In corporate reorganization many abuses by myriad of actors were present in the past. There was a need for a rule that would protect those who did not manage to conclude a favorable deal with other stakeholders of a debtor corporation. To protect them, the courts adopted the rule which was named the absolute priority rule.[103] The absolute priority rule entails that creditors with rights against the assets of a corporation receive interests in the corporation according to the priority they enjoyed under non-bankruptcy law. Therefore, a creditor who is entitled to be paid before another creditor outside of bankruptcy retains the same priority position in bankruptcy as well.[104]

This rule, however, was proved to be imperfect in practice and the need for its refinement and codification eventually arose. The solution in the US law was a set of rules that came to be known as 'cramdown', the departure from the absolute priority rule that affects corporate reorganizations under very strict conditions and only exceptionally.[105]

Under BC, the absolute priority rule[106] sets out a two requirements with respect to the reorganization plan:

1. The plan is fair and equitable; and

2. The plan does not discriminate unfairly.

[103] Douglas G. Baird, The Elements of Bankruptcy 71 (5th ed. 2010).
[104] Id.
[105] Supra note 58, at 1141.
[106] Section 1129(b) of BC.

Both requirements will be addressed in the following sections. Fair and equitable standard will be individually discussed with respect to secured creditors and unsecured creditors and equity holders. This approach follows the BC regulation which stipulates different meaning of the fair and equitable standard for secured creditors and unsecured creditors and equity holders. But first, the thesis addresses the history in order to present the purpose and the meaning of the absolute priority rule, and the following subsections will analyze the meaning of the absolute priority rule in present.

3.2.1.1. History of the absolute priority rule

Corporate reorganizations in the US began after the Civil War. First reorganizations were related to the railroads' debts. The law at the time was not codified in a form of statute. The courts created legal rules based on equity. They would appoint a receiver for the debtors who would collect the debtor's assets and sell it at foreclosure. Then, they would distribute the proceeds to creditors. In this era, dissenting creditors would be squeezed out of the deal and ranked between senior claim- and equity holders.[107] In other words, they were treated as unsecured creditors today.

That situation rendered the courts to reassess the priority scheme. The Supreme Court in Railroad Co. v. Howard[108], by invoking equity, held that the agreement between creditors under which dissenting creditors would be impaired was invalid against those creditors. This decision was the beginning of the new rule under which dissenting creditors had to be taken into account by the court who confirms the plan.[109] The established rule was confirmed in 1899, when the Supreme Court in Louisville Trust Co. v. Louisville, New Albany & Chicago Railway Co.[110] held that the contract between bondholders and stockholders on corporate

[107] Supra note 58, at 1140.
[108] 74 U.S. 392 (1869).
[109] Pamela Foohey, Chapter 11 Reorganization and the Fair and Equitable Standard: How the Absolute Priority Rule Applies to All Nonprofit Entities, 86 St. John's Law Review 31, 47 (2012).
[110] 174 U.S. 674 (1899).

debtor's reorganization is illegal if impairs the unsecured creditors. "In other words, if the bondholder wishes to foreclose and exclude inferior lienholders or general unsecured creditors… and stockholders, he may do so; but a foreclosure which attempts to preserve any interest or right of mortgagor in the property after the sale must necessarily secure and preserve the prior rights of general creditors thereof. This is based upon the familiar rule that the stockholder's interest in the property is subordinate to the rights of creditors."[111]

The US courts continued to champion this rule in the following period. The rule was definitely perfected after the landmark decision of the United States Supreme Court in Northern Pacific Railway Co. v. Boyd[112]. The issue of priority in a corporate reorganization once again emerged. The issue was the legality of the agreement between the shareholders and senior creditors under which the shareholders would receive shares of the corporation after the reorganization, whereas the unsecured creditors would be impaired. The observation of the Court in this case has been upraised almost to the level of a definition of the absolute priority rule, because the court addressed the issue most directly until then[113]:

"If the value of the road justified the issuance of stock in exchange for old shares, the creditors were entitled to the benefit of that value, whether it was present or prospective, for dividends or only for purposes of control. In either event it was a right of property out of which the creditors were entitled to be paid before the stockholders could retain it for any purpose whatever."[114]

The first statute on corporate reorganizations was the Bankruptcy Act, adopted in 1934.[115] Section 77B stipulated that the judge had the authority to confirm a plan if "it is fair and equitable and does not discriminate unfairly in favor of any class of creditors or

[111] Id. at 684.
[112] 228 U.S. 482 (1913).
[113] Harold G. Wren, The Valuation of a Railroad in Reorganization, 58 Columbia Law Rev. 316, 321-322 (1958).
[114] 228 U.S. 482 (1913), 508.
[115] Id.

stockholders". The Supreme Court in Case v. Los Angeles Lumber Products Co.[116] once again upheld the absolute priority rule, and explained that the absolute priority rule was embodied in Section 77B and the different phrasing used in the statute was "a term or art"[117]. In 1938 the Chandler Act was enacted. According to it, reorganization was divided into three Chapters: Chapter X - corporate reorganization, Chapter XI - arrangements, and Chapter XII – real property arrangements. The absolute priority rule embodied in the requirement that a plan must be fair and equitable to be confirmed by the court, was included only in Chapter X.

From the enactment of the Chandler Act in 1938 on, many shortcomings of the statute came to the surface. The greatest grievance was caused by Chapter X – corporate reorganizations, due to the strict requirements imposed by the absolute priority rule. Because of that, the reorganization tended to cluster around Chapter XI.

Dissatisfaction with Chapter X was based on the change of investment schemes. When the Chandler Act was enacted in 1938, the majority of investments were in public securities. The investment pattern had changed by 1938, because investors purchased shares and subordinated debentures more often.[118] That significantly affected their priority position in reorganizations – their claims became subordinated to the claims of secured and unsecured creditors.

The other reason for dissatisfaction was related to the main advantage of reorganization over liquidation – an ability to preserve the going concern value. The strict application of absolute priority rule demanded first the determination of "reorganization value" of the debtor's property.[119] After that, priority order had to be established by grouping the claimants into classes. The reorganization value was actually a threshold - if a particular class of claimants

[116] 308 U.S. 106 (1939).
[117] Id.
[118] Supra note 58, at 1142.
[119] Id.

was placed below, it would not participate in the assets' distribution. Furthermore, the entire process was very expensive and time-consuming and hence took its toll on the main advantage of reorganization.[120] Thus, shareholders were very often completely omitted from the plan. Moreover, the delay caused by the long proceedings was fatal for the businesses under reorganization.

The strict and exhaustive application of the absolute priority rule was question by the Congress in 1978. The question was whether the rule was really worth such a great effort its inexorable application demanded. The answer was: no. The absolute priority rule lost its status of the principle rule of bargain under reorganization. Instead, creditors were allowed to negotiate positions and consequently to have a say on the distribution. The rules on priority and other mandatory norms governing reorganization continued to exist and thus the creditor's leeway on negotiation was not absolute.[121]

However, the absolute priority rule did not cease to exist; it merely lost the position of a principle rule in reorganization. It became an exception that will be invoked only if there is an impaired class that votes against the plan, and the proponent of the plan insists on the plan confirmation. Moreover, the rule will not be applied to all classes, but only "from the dissenting class down"[122]; whereas the senior classes will receive the same value they negotiated for. The change was explained in the legislative history in following words:

The bill does not impose a rigid financial rule for the plan. The parties are left to their own to negotiate a fair settlement. The question of whether creditors are entitled to the going-concern or liquidation value of the business is impossible to answer. It is unrealistic to assume that the bill could or even should attempt to answer that question. Instead, negotiation among the

[120] Id.
[121] Id.
[122] Supra note 58, at 1143.

parties after full disclosure will govern how the value of the reorganizing company will be distributed among creditors and stockholders.[123]

"Only when the parties are unable to agree on a proper distribution of the value of the company does the bill establish a financial standard… Simply put, the bill requires that the plan pay any dissenting class in full before any class junior to the dissenter may be paid at all. The rule is a partial application of the absolute priority rule."[124]

Hence, the absolute priority rule remains to exist but only as the limitation of the cramdown, as a tool of protection of creditors who failed to achieve a favorable position in settlement.

The Bankruptcy Code sets out the meaning of the absolute priority rule with respect to secured creditors, unsecured creditors, and equity holders.

3.2.1.2. Secured creditors

Secured creditors enjoy a priority position with respect to the collateral. The absolute priority rule requires that a plan must acknowledge their position, which means that they must be paid in full of their secured claims and they must retain their liens. There are three avenues a plan might pursue[125]:

a) Secured creditors will retain the liens securing their claims to the extent of the allowed amount and will receive deferred cash payments totaling at least the allowed amount of such claim, of a value, as of the effective date of the plan, of at least the value of the collateral.

Professor Tabb made some considerations on the application of the first avenue. First, the liens which will be retained by secured creditors will secure only "allowed amount" of the claims. It means that the total debt will not always be secured, because it exceeds the allowed amount. Thereby, the remaining amount of the debt will be treated as an unsecured claim.

[123] H.R.Rep. No. 595, 95th Cong., 2nd Sess. 224 (1978), in Supra note 58, at 1144.
[124] Id.
[125] Section 1129(b)(2)(A) of BC.

Second, deferred cash payment will be subject to two tests: the "principal amount" test and the "present value" test.[126] The "principal amount" test requires that the total amounts of payments under the plan must equal the value of the collateral. The "present value" test requires that "the stream of payments when discounted to present value as of the effective date of the plan must equal the value of collateral".[127]

b) The collateral will be sold and the liens will attach to the proceeds of such sale.

The secured creditor enjoys protection over the proceeds in a form of the lien that will be attached to proceeds of sale of the collateral. BC is silent on what happens when the sale brings the price lower than the fair price. The Supreme Court of the United States filled the gap in RadLAX Gateway Hotel, LLC v. Amalgamated Bank[128]. In a unanimous decision, the Supreme Court upheld the right of a secured creditor to credit bid at the sale of collateral[129], and to offset her claim against the purchase price. The Supreme Court said that a plan which does not allow secured creditors to credit-bid cannot be confirmed by the court.

Tabb recognized the obsolescence of this avenue.[130] According to him, the power of secured creditors has changed from 1978 when BC was enacted. The nature of corporate financing has changed and affected the position of secured creditors. In 1978, corporations were funded through bond financing and equity financing. Corporations usually did not have all their assets encumbered. Hence, the management of bankruptcy debtor did not use interests of secured creditors into account in reorganizations. Nowadays, corporations in the US usually have all their assets encumbered. Secured creditors not only have lien on all of their assets,

[126] Charles J. Tabb, Credit Bidding, Security, and the Obsolescence of Chapter 11, 2013 U. Ill. L. Rev. 103, 121 (2013).
[127] Supra note 58, at 1146.
[128] 132 S. Ct. 2065 (2012).
[129] The right to credit bid is set forth in Section 363(k) (of Chapter III which applies to all bankruptcy cases): "At a sale … of property that is subject to a lien that secures an allowed claim, …the holder of such claim may bid at such sale, and, if the holder of such claim purchases such property, such holder may offset such claim against the purchase price of such property." See Alan Resnick, Denying Secured Creditors the Right to Credit Bid in Chapter 11 Cases and the Risk of Undervaluation, Hastings Law J. 323, 331 (2012).
[130] Supra note 58, at 1144-1153.

but also very often a contractual right to decisively influence corporate decisions. Even in bankruptcy, the debtor very often does not have any source of financing but pre-bankruptcy secured lenders. Secured creditors accordingly exploit their position through management of debtor corporations in bankruptcy. Some authors named this phenomenon as "secured party in possession"[131] and "creditors' ball."[132]

The free sale and right to credit bid of secured creditors in bankruptcy can even yield more favorable results for them than non-bankruptcy foreclosure. By using his influence, the secured creditor can initiate the sale in which he „gets a clean title, possibly a higher price (or at least zero risk of a lower price, because of credit bidding), and a safe port in the storm from any other creditor actions against the debtor's assets because of the automatic stay".[133]

This avenue can serve purposes other than the ones it was created for and thereby the authors advocate its reconsideration.

c) The secured creditors will realize the indubitable equivalent of such claims.

The "indubitable equivalent" is a standard used in BC that was interpreted several times by the court. The term was first mentioned in the In re Murel Holding Corporation[134] decision and incorporated in the BC. The "indubitable equivalent" is a test whereby the parties of negotiations are given the leeway for reaching the most suitable agreement for a given debtor under the reorganization. Thereby, BC does not set out an exhaustive list of possible methods that can be used to repay the secured creditors' claims. The parties are permitted to arrange the most suitable method, as long as it realizes "indubitable equivalent" of secured claims.

[131] Elizabeth Warren and Jay L. Westbrook, Secured Party in Possession, 22 AM. BANKR. INST. J., Sept., 12 (2003).
[132] David A. Skeel, Jr., Creditors' Ball: The "New" New Corporate Governance in Chapter 11, 152 U. PA. L. REV. 917, 925 (2003).
[133] Supra note 61, 143.
[134] 75 F.2d 941, 942 (2d Cir. 1935).

For example, In re River East Plaza LLC[135] the court held that the "indubitable equivalent" standard was not satisfied when the plan provided for the substitution of the collateral for a different kind of collateral. The reason was that such substitution would have conveyed the risk to the secured creditor.

Professor Tabb suggests that the "indubitable equivalent" standard should abandoned completely. Due to the change in corporate finance, he argues that the standard nowadays yields different and perverted effects – it enhances the position of already exorbitantly influential secured lenders. He advocates the return to the basic principle of bankruptcy law whereby a secured creditor is ought to be paid from the value his collateral, which in today's circumstances would be depriving him from the "indubitable equivalent" safeguard that enhances his capability to pursue interests other than the ones bankruptcy law was created for.[136]

As demonstrated, Chapter 11 allows parties to negotiate for the most suitable arrangement in a concrete situation, provided that secured creditors primacy in reorganization has not been usurped.

3.2.1.3. Unsecured creditors and equity holders

Compliance of the plan with the absolute priority rule vis-à-vis unsecured creditors and equity holders means acknowledgement of the non-bankruptcy priority ranking in bankruptcy reorganization. The principle established by the Supreme Court in Louisville Trust Co. v. Louisville, New Albany & Chicago Railway Co. remained applicable to unsecured creditors and equity holders.

The meaning of the words "fair and equitable" in a case of unsecured creditors and equity holders is explicated in two different scenarios. They are set out alternatively and thus the

[135] 669 F.3d 826 (7th Cir. 2012).
[136] Supra note 58, at 150.

plan will satisfy the requirement if any of the two is followed with respect to dissenting class of unsecured creditors: 1. the dissenting class in paid in full; and 2. no class junior to the dissenting class gets anything under the plan on account of its claim or interest.[137]

The fair and equitable standard establishes a priority between various types of unsecured creditors and equity holders. The most basic rule is that "a junior interest may not be retained unless the claims of senior interests are fully satisfied."[138] Thereby, priority ranking between usecured creditors and equity holders is arranged to guarantee to the unsecured creditors "full payment or no equity participation."[139] Also, priority between equity holders depends on the rights borne by equity security vis-à-vis liquidation. Thus, preferred stocks enjoy priority over common stocks if they bear liquidation priority entitlement.[140]

Very important limitation of the absolute priority rule is that BC sets forth that it applies only from dissenting class down – as it was explained in 3.2.1.1. This is important because it provides other creditors with a possibility to waive their priority rights. In other words, creditors are entitled to bestow the value they ought to receive upon other creditors. The aforementioned possibility established leeway for creditors which evolved into "a practice of senior creditors bypassing intermediate creditors in favor of lower ranked ones by 'gifting' part of their distribution under the plan. Some view this practice as legitimate as a gifting exception to the absolute priority rule."[141]

The status of the gifting is contestable in Chapter 11 BC. Prior to enactment of 1978 BC, the gifting was a common practice in bankruptcy reorganizations. Congress and the Supreme

[137]Functional meaning of Section 1129(b)(2)(B) of BC and Section 1129(b)(2)(C) of BC stipulating fair and equitable standard for unsecured creditors and equity holders is explained in Charles Jordan Tabb, The law of bankruptcy 1154 (2014).
[138] H.R. Rep. No. 95-595, 95th Cong. 251 (1977).
[139]Stephen J. Lubben, The Overstated Absolute Priority Rule 19 (2015), https://papers.ssrn.com/abstract=2581639 (last visited Feb 23, 2017).
[140] Supra note 58, at 1155.
[141]Amy Timm, The Gift That Gives Too Much: Invalidating a Gifting Exception to the Absolute Priority Rule, 2013 U. Ill. L. Rev. 1649, 1680 (2013).

Court attempted to prohibit it.[142] They championed the absolute priority rule by advocating its mandatory application in all bankruptcy reorganizations and allowing no exceptions. However, their efforts were unsuccessful. As Professor Brubaker remarked: "[f]or a time, not too long ago, it seemed to be a widely held view in the Chapter 11 bar that 'give ups' . . . were perfectly appropriate, entirely unproblematic, and essentially an exception to the absolute priority rule and other distribution strictures such as the prohibition against "unfair discrimination."[143]

After 1978, the gifting was revived by the decision in Manufacturing Corp. v. Stern (SPM)[144]. The court dealt with Chapter 7 liquidation case and ruled that :"While the debtor and the trustee are not allowed to pay non-priority creditors ahead of priority creditors [from the property of the estate], creditors are generally free to do whatever they wish with the bankruptcy dividends they receive, including to share them with other creditors."[145] The decision influenced courts dealing with Chapter 11 gifting and thus the gifting doctrine had been reestablished in bankruptcy reorganizations as well.[146]

However, in In re Armstrong World Industries, Inc.,[147] a Chapter 11 case, the court ruled that the gifting of unsecured creditor class to equity holders, bypassing the general unsecured creditors was prohibited by the absolute priority rule. What is probably even more important is that the court stressed that unsecured creditors in general were barred from gifting by the absolute priority rule in Chapter 11.[148] What remained unclear was whether the prohibition of

[142] Id. at 1654.
[143] Ralph Brubaker, Taking Chapter ll's Distribution Rules Seriously: "Inter-Class Gifting is Dead! Long Live Inter-Class Gifting!," BANKR. L. LETTER 1-2, 1 (2011).
[144] 984 F.2d 1305 (1st Cir. 1993).
[145] Id. at 1313.
[146] For example, in In re WorldCom, Inc., 2003 WL 23861928 (S.D.N.Y. 2003), the court confirmed Chapter 11 gifting by invoking SPM decision.
[147] 432 F.3d 507 (3d Cir. 2005).
[148] Id. at 517.

gifting exception applied only to unsecured creditors or to all secured creditors as well,[149] until the decision in In re DBSD N. Am., Inc.[150], where the court closed the door for the gifting exception for secured creditors.

Despite the contestations over the legitimacy and effects of gifting in the US law, lessons for all emerging market with developing bankruptcy law could be drawn. As the most successful bankruptcy law in the world, the US law does not explicitly and easily discard the right of creditors in bankruptcy to bargain over conveying their distribution under the plan to other creditors in return for a consideration. Even if the gifting has been explicitly prohibited, alternative strategies having the same effect as the gifting are not prohibited. Parties can reach voluntary agreements, "where two parties agree to transfer property outside the context of the plan"[151]. Also, creditors can reach a settlement before the acceptance and confirmation of the reorganization plan.[152]

BiH and all other emerging markets can learn that the gifting has been used as a powerful tool used by creditors to champion various interests in bankruptcy proceedings. The US experience demonstrates that a non-consensual confirmation of the plan (cramdown) can be very expensive, unpredictable and time consuming.[153] To prevent such risks, **s**enior creditors may want to share their distribution in exchange for cooperativeness from the recipient creditors in the form of support during the plan confirmation or in the aftermath of the confirmation. Furthermore, they may use it as a gesture of goodwill in order to avoid litigation

[149] See more in Debra A. Dandeneau, Wrapping Up Gifting: Some Additional Thoughts (and Even More Questions) on DBSD, 128 BANKING L.J. 521, 524 (2011).
[150] In re DBSD N. Am., Inc., 634 F.3d 79 (2d Cir. 2011).
[151] Amy Timm, The Gift That Gives Too Much: Invalidating a Gifting Exception to the Absolute Priority Rule, 2013 U. Ill. L. Rev. 1649, 1662 (2013).
[152] The court assessed this issue in In re Iridium Operating LLC 478 F.3d 452. It held that a pre-plan settlement has to comply with the absolute priority rule, but it concluded that "where the remaining factors weigh heavily in favor of approving a settlement, the bankruptcy court, in its discretion, could endorse a settlement that does not comply in some minor respects with the priority rule. See more in Reuben E. Dizengoff, Beyond Gifting: Harmonizing the Devolution of Reorganization Plan Gifts and the Evolution of Sale Gifts (2017), https://papers.ssrn.com/abstract=2939750 (last visited Mar 27, 2017).
[153] *Id.*

by junior creditors attacking its security interest in estate property, or they may gift equity holders to encourage them to dully control management of the reorganizing debtor.[154] The very possibility of gifting thus is apt not only for creditors involved in bargain, but it also enhances the chance of a plan being accepted and confirmed.

3.1.3. The plan does not discriminate unfairly

What precisely means that a plan must not discriminate unfairly is not clearly stated within the standard. The case law shows that there are confusions in understanding the meaning of the term. Some patterns in the courts' interpretation emerge, however. Denise R. Polivy noticed:

First, some decisions confuse the requirement that a plan not discriminate unfairly with other requirements of plan confirmation, including the requirement that a class contain substantially similar claims or interests and the requirement that, in cramdown, the plan must be fair and equitable. Second, the cases seem to approach unfair discrimination from three different perspectives, which this Article terms "restrictive, "mechanical," and "broad." Third, the plan proponents and courts proffer a variety of rationales for allowing discrimination between creditor classes. Fourth, discrimination can take many different forms. And fifth, since each secured claim is generally considered unique, unfair discrimination rarely arises in the context of secured claims.[155]

The reason for this confusion is portrayed in the history of the unfair discrimination standard. The history is mostly the same as the history of "fair and equitable standard", thus only relevant information about the unfair discrimination standard will be mentioned.

[154] Amy Timm, The Gift That Gives Too Much: Invalidating a Gifting Exception to the Absolute Priority Rule, 2013 U. Ill. L. Rev. 1649, 1654 (2013). See more in Leah M. Eisenberg, Gifting and Asset Reallocation in Chapter 11 Proceedings: A Synthesized Approach, AM. BANKR. INST. J. (2010).
[155] Denise R. Polivy, Unfair Discrimination in Chapter 11: A Comprehensive Compilation of Current Case Law, 72 Am. Bankr. L.J. 191, 226 (1998).

As mentioned in 3.2.1.1., the first statute governing corporate reorganizations from 1934 included the unfair discrimination standard, stipulating that the plan could be confirmed only if "the plan could not unfairly discriminate and had to be fair."[156] In the Chandler Act of 1938, Congress omitted to mention the unfair discrimination standard in all Chapters[157] except thes ones related to reorganizations of railroads (Chapter VIII) and municipal arrangements (Chapter IX). The explanation of Congress for the omission of the standard was that the terms "fair and equitable" and "feasible", used in the Act implicitly encompassed the unfair discrimination standard.[158]

The unfair discrimination standard was resurrected in Bankruptcy Code of 1978. However, the vagueness of the meaning of words "unfair discrimination" remained to exist. The majority sponsors of the law argued that the adoption of the unfair discrimination standard was necessary for clarity, even though they did not define what it clarifies[159]. The House Report[160] explained that the standard was necessary to tackle with the subordination issues[161] which could not be solved only by the application of "the fair and equitable" standard.

[156] Act of March 3, 1933, ch. 204, § 77(g), 47 Stat. 1467, 1479, in Bruce A. Markell, A New Perspective on Unfair Discrimination in Chapter 11, 72 Am. Bankr. L.J. 227, 231 (1998).

[157] The Chandler Act replaced single reorganization section from the previous Act with three chapters: Chapter X – reorganization of public companies, Chapter XI - continued and formalized the composition provisions of the previous Act, and Chapter XII - real estate partnerships.

[158] S. REP. No. 75-1916, at 35-36 (1938) (Senate Report No. 1916 accompanied H.R. 8046, which was the bill ultimately enacted), in Bruce A. Markell, A New Perspective on Unfair Discrimination in Chapter 11, 72 Am. Bankr. L.J. 227, 231 (1998): "Subsection (2) of Section 221, derived from Section 77B(f)(1), provides, as a condition to confirmation of a plan, that the judge be satisfied that it is "fair and equitable," and "feasible." Implicit in the former phrase is a prohibition against any unfair discrimination in the plan in favor of any creditors or stockholders and the express statement to that effect in Section 77B is therefore unnecessary."

[159] "The requirement of the House bill that a plan not 'discriminate unfairly' with respect to a class is included for clarity; the language in the House report interpreting that requirement, in context of subordinated debentures, applies equally under the requirements of section 1129(b)(1) of the House amendment" 124 CONG. REc. 32,407 (1978) (statement of Rep. Edwards); id. at 34,006 (statement of Sen. DeConcini), in Bruce A. Markell, A New Perspective on Unfair Discrimination in Chapter 11, 72 Am. Bankr. L.J. 227, 236 (1998).

[160] 4H.R. REP. No. 95-595, at 417 (1977), reprinted in 1978 U.S.C.C.A.N. 5963, 6373.

[161] Bruce A. Markell, A New Perspective on Unfair Discrimination in Chapter 11, 72 Am. Bankr. L.J. 227, 238 (1998), explains the issue: "Subordination is a concept most often used in adjusting priorities among creditors, whether it be subordination adjusting liquidation priorities between secured creditors, or be it subordination of priority imposed upon creditors as a consequence of their prepetition actions. In either case, these typical uses of subordination involve moving the creditor up or down-vertically, as it were-in priority."

The courts have been puzzled by the vagueness of the standard. The House Report did not clarify the purpose of the unfair discrimination standard or how the courts should interpret it. It seems that the fallacy in the Report is that it treats the standard as the tool which tackles with the issue of vertical limitation on the plan confirmation, whereas "fair and equitable" standard deals exactly with that. As a proof of the courts' confusion, Denise R. Polivy recognized that the courts use three different approaches to the standard: (1) the restrictive approach, whereby the courts acknowledge the unfair discrimination only in cases involving subordination; (2) the mechanical approach, whereby the courts acknowledge the unfair discrimination all unsecured creditors if they are not paid the same percent of their claims, regardless of whether they are placed in separate class; (3) the broad approach, whereby the courts flexibly analyze the plan and do not limit themselves to strict rules like in cases of the strict and mechanical approaches.[162]

What is undisputed by the courts, however, is that the contestations over the interpretation and application of the unfair discrimination is reserved for unsecured creditors, since the different treatment of various secured creditors is like "comparing the treatments of two or more secured claims ... might well be like comparing apples and oranges"[163] and thus does not fall within the scope of the standard. Even though the issue has remained unsettled, it is noteworthy to mention Professor Markell's proposal of a solution on how to interpret the standard:

Unfair discrimination is best viewed as a horizontal limit on nonconsensual confirmation, in contrast to the vertical limit imposed by the requirement that a nonconsensual plan be "fair and equitable." Just as the fair and equitable requirement regulates priority among classes of creditors having higher and lower priorities, creating inter-priority fairness, so the unfair

[162] Supra note 155, 199.
[163] In re Calvanese, 169 B.R. 104 (Bankr. E.D. Pa. 1994).

discrimination provision promotes intra-priority fairness, assuring equitable treatment among creditors who have the same level of priority.[164]

3.1.4. New value exception

The absolute priority rule bars equity holders from participating in distribution under the plan before all creditors have been paid in full. However, a rigid application of the rule may negatively affect the policy of promoting reorganizations as the core policy of Chapter 11.[165] The new value exception presupposes the new contribution by the equity holders into a debtor which would allow them to retain ownership interest. The new value exception it not explicitly permitted or prohibited, as the BC omits to mention it.[166]

The court addressed this issue in Kansas City Terminal Railway Company v. Central Union Trust[167] and acknowledged the importance of the new contribution of the equity holders for the success of reorganization:

Generally, additional funds will be essential to the success of the undertaking, and it may be impossible to obtain them, unless stockholders are permitted to contribute and retain an interest sufficiently valuable to move them. In such or similar cases the chancellor may exercise an informed discretion concerning the practical adjustment of the several rights.[168]

The court revisited this issue in Case v. Los Angeles Lumber Products Co.[169] and concluded that the absolute application of the rule is not desirable in situations where the equity holders sought to make a new capital contribution to the debtor. The court thus allowed the departure from the absolute priority rule and allowed the equity holders to retain an ownership interest

[164] Bruce A. Markell, A New Perspective on Unfair Discrimination in Chapter 11, 72 Am. Bankr. L.J. 227, 228 (1998).
[165] Supra note 1 at 2302.
[166] Judith Greenstone Miller; John C. Murray, The New Value Exception: Myth or Reality after Bank of America National Trust & (and) Savings Association v. 203 N. LaSalle Street Partnership, 104 Com. L.J. 147, 149 (1999).
[167] 271 U.S. 445 (1926).
[168] Id. at 455.
[169] 308 U.S. 106 (1939).

ahead of the creditor to the extent of the new capital contribution. Three requirements had been set forth by the court to allow the exception: 1. the contribution must be necessary; (2) the equity holder's participation must be reasonably equivalent to the new contribution into the debtor; and 3. the investment must be in money or money's worth.[170] In Norwest Bank Worthington v. Ahlers, The Supreme Court has concluded that "money and money's worth" requirement is satisfied only by the contributions in tangible property.[171]

The basis for a departure had been found in the wording of BC whereby the holders of interest cannot receive any property "on account of" their interests until holders of claims are paid in full.[172] "The argument goes, if an old equity holder gives new value in order to receive a new equity interest under the reorganization plan, then that old equity holder "will not receive" the new interest "on account of" the old claim, but on account of new value added."[173]

The United States Supreme Court's decision in Bank of America National Trust & Savings Association v. 203 N. LaSalle Street Partnership[174] remains the last word on the new value exception until today. [175] In this case, the court avoided to decide on whether the new value exception rule had been included into the BC. However, the court made clear that exclusive investment opportunities provided by the plan only to old equity holders, free from either competition or exposure to market valuation, are prohibited under the absolute priority rule.[176]

What will be the destiny of the new value exception is unsettled. This, however, does not mean that any final resolution should be unchangeable and transplanted into any other legal systems free of polemics. The case of the new value exception demonstrates that a rigid

[170] Id. at 121.
[171] 485 U.S. 197, 204,05 (1988).
[172] Section 1129(b)(2)(B)(ii) of BC.
[173] Brandon Michael Poirier, May We Skip?: A Call for Finality on the "New Value Exception" 6 (2014), https://papers.ssrn.com/abstract=2539456 (last visited Apr 2, 2017).
[174] 119 S.Ct. 1411 (1999).
[175] Supra note 58, at 1173-1176.
[176] Judith Greenstone Miller; John C. Murray, The New Value Exception: Myth or Reality after Bank of America National Trust & (and) Savings Association v. 203 N. LaSalle Street Partnership, 104 Com. L.J. 147, 167 (1999).

application of even one of the building blocks of the Chapter 11, which the absolute priority rule is, can undermine the core policy underlying Chapter 11.

3.2. Prohibition to obstruct under Bankruptcy laws of FBiH and RS

Bankruptcy laws of BiH are highly influenced by the German Insolvency Law of 1999. Some provisions are virtually identical. Accordingly, provisions governing the prohibition to obstruct are the same. As the author, I find this occasion fortunate, since it provides an opportunity to use scholarship concerned the prohibition to obstruct under the German law.

Both Bankruptcy Law of FBiH and Bankruptcy Law of RS set out not only the same building blocks, but also the identical wording of provisions[177] of the prohibition to obstruct:

If the necessary majority in a class has not been achieved during the voting, the voting class is deemed to have accepted the bankruptcy plan if: 1. the creditors in this class are in no worse a position than without the plan; 2. the creditors participate to a reasonable extent in the economic value afforded to the parties under the plan; and 3. the majority of classes have voted for the plan by the required majorities.[178]

There is no surprise they resemble some of the cramdown requirements, since they had been transplanted into the law of BiH through the German law influenced by Chapter 11. Manfred Balz wrote the following remark about the prohibition to obstruct: "This rule is derived, in essence, from section 1129 of the U.S. Bankruptcy Code, but is greatly simplified for the use in a civil law system."[179]

Different nomotechnical solutions opted for by legislators of cramdown in Chapter 11 BC and prohibition to obstruct of bankruptcy laws of BiH witness about different understanding of the cramdown itself. Cramdown under Chapter 11 BC entitles the court to confirm the plan in

[177] Section 170 of Bankruptcy Law of FBiH and Section 230 of Bankruptcy Law of RS.
[178] Bankruptcy Law of FBiH in English is available at: http://www.advokatura.ba/pdf/Bilingual%20Bankruptcy%20Law%20_final_.pdf
[179] Supra note 58, at, 178.

spite of dissenting creditors, if thorough list of requirements discussed in previous sections have been met. On the other hand, bankruptcy laws of BiH stipulate that if the requirements of prohibition to obstruct have been met, the court shall deem dissenting classes to have accepted the plan. It seems that legislators of BiH considered the requirements of the prohibition to obstruct stimulating for all creditors, since if they are met there is no valid reason for dissent.[180]

Bankruptcy laws of BiH set out the "protection of creditors" provisions.[181] The creditors may file a motion seeking for the court to deny the plan confirmation if the plan places the creditor in a less favorable position than he would have been in if there were no plan. Thus, the court will not examine the position of creditors under the plan *ex officio,* but the motion from the adversely affected creditors has to be submitted. Moreover, the burden of proof is on the creditor to persuade the court that her position is likely to be disadvantaged on account of the plan.[182] This legal device provides the creditors with suitable safeguards[183] against what the law deems as inappropriate treatment.

The following subsections will address separately the requirements of prohibition to obstruct.

3.2.1. The creditors of dissenting class are in no worse position than without the plan

This requirement is the equivalent of the best interest test of Chapter 11. The dissenting class must not be in worse position under the plan compared to liquidation.[184] As mentioned before, the creditor whose position has been worsen to the extent he ought to receive less than in

[180] Mihajlo Dika, Insolvencijsko pravo 79 (1998), in Marija Vidić et al., Stečajni plan, Zbornik radova Aktualnosti građanskog i trgovačkog zakonodavstva i pravne prakse, 429,448 (2012).
[181] Section 176 of Bankruptcy Law of FBiH and Section 236 of Bankruptcy Law of RS.
[182] Nedeljko Milijević, Procedura usvajanja i potvrde stečajnog plana, 5-6 Pravni Život 147, 155 (2009).
[183] Ewa Balcerowicz et al., The Development of Insolvency Procedures in Transition Economies: A Comparative Analysis 25 (2003), https://papers.ssrn.com/abstract=1440168 (last visited Apr 4, 2017).
[184] De Weijs & Roelf Jakob, Harmonisation of European Insolvency Law and the Need to Tackle Two Common Problems: Common Pool & Anticommons 10 (2011), https://papers.ssrn.com/abstract=1950100 (last visited Apr 3, 2017).

liquidation has right to file a motion requiring for court to reject the plan. Unfortunately, the case law appears to be very hard to find.[185]

The best interest test has been accepted by the law since it starts from the premise that voting does not serve any other purpose but satisfying very often divergent needs of creditors and debtors. The only purpose of the laws is to satisfy the claims of creditors and, if possible, to enable the debtor to continue to operate.[186] As Manfred Balz explained it:

Voting procedures in insolvency serve the exclusive purpose of overcoming the common pool problem that stems from the plurality of unrelated actors. Voting procedures do not serve a political purpose, as in the political majority rule. In the world of economics, there is no reason to believe that a majority is better able to determine what is good for dissenting individuals. Freedom of investment, essential to a market system, requires that no individual be forced to invest or reinvest the liquidation value of its entitlement (i.e., the liquidation value) into a reorganization or other solution which a majority may desire. Therefore, under the new law, a plan may be confirmed by the court only when each dissenting individual claimant receives the full cash equivalent of its claim as that claim would be realized in a best-case liquidation.[187]

3.2.2. The creditors participate to a reasonable extent in the economic value afforded to the parties under the plan

The laws set forth the conditions[188] under which the creditor is deemed to participate to a reasonable extent in the economic value. Balz summarized the conditions in the following

[185] The only court case which appears to be available is the case St-14/04 (2005) ruled by the Municipal Court of Mostar. Secured creditor filed a motion seeking for the court to deny the plan confirmation if the plan places the creditor in a less favorable position than he would have been in if there were no plan. The secured creditor failed to file a proof of claim and thus opted to exercise the right of separate settlement. The court held that secured creditor cannot be adversely affected by the plan due to the right of separate settlement, regardless of the outcome of bankruptcy proceeding.
[186] Section 2 of Bankruptcy Law of FBiH and Section 2 of Bankruptcy Law of RS.
[187] Supra note 29, at 177.
[188] Section 170(2) of Bankruptcy Law of FBiH and Section 230(2) of Bankruptcy Law of RS.

words: "(1) no other claimant or class receives more than the full amount of its claims; (2) neither the debtor nor any junior claimant or class receives any value; and (3) no claimant or class with equal liquidation rank receives better treatment than the dissenting class."[189] This requirement can be traced back to principle of equal treatment[190] set forth by the bankruptcy laws[191].

This rule is obviously an equivalent of the absolute priority rule of Chapter 11 BC as it establishes a priority ranking of actors in bankruptcy. Effects of this requirement in bankruptcy laws with the unitary bankruptcy proceeding such as bankruptcy laws of BiH[192] are contentious because the outcome of the proceeding is not foreseeable at the commencement. The grounds for commencement of bankruptcy proceeding under bankruptcy laws of BiH are debtor's insolvency and imminent insolvency. A petition can be filed only by the debtor in the case of imminent insolvency. The absolute priority rule for equity holders means that in most cases they will receive nothing in bankruptcy proceeding. Both discourages equity holders from filing a petition, since he law in reality does not guarantee them any participation in the proceedings and in the proceeds from a liquidation sale.[193] Moreover, due to the lack of possibility to file a petition prior to the imminent insolvency, their chances of receiving anything in bankruptcy are very low.

Professor Stephan Madaus said that the absolute priority rule "was not made for reorganization scenarios and does not work well in reorganization scenarios… it is a rule in a

[189] Supra note 29, at 178.
[190] Bianca Schwehr, Corporate Rehabilitation Proceedings in the United States and Germany, 12 Int. Insolv. Rev. 12, 27 (2003).
[191] Section 151 of Bankruptcy Law of FBiH and Section 8 of Bankruptcy Law of RS.
[192] Even though Bankruptcy Law of RS introduced restructuring, the bankruptcy proceeding with the two possible outcomes (liquidation or reorganization) and the same grounds for commencement remained a part of the law.
[193] Albeit their assent to the plan is required, the plan can be imposed upon them in spite of their dissent if they are not placed in a less favorable position than his position without this plan, and if none of the creditors receives a benefit or any other accommodation that exceeds the full amount of its claim.

liquidation scenario."[194] In laws with a unitary bankruptcy proceeding where the outcome of the case is not foreseeable, the application of the rule can blur the vision of the proceeding of all actors.

The lesson from the US law could be drawn. New value exception deals with the very issue. Instead of the strict application the absolute priority rule which can be counterproductive, a less rigid solution should be adopted. If offered the possibility to receive benefits from reorganization, they may be stimulated to contribute to reorganization. Not only contribution of new funds might be of the essence for a distressed debtor, but also their endeavor to attempt to rescue debtor and not to choose to surrender the company.[195]

3.2.3. The majority of classes have voted for the plan by the required majorities

As a simplified version of cramdown, the requirements of prohibition to obstruct do not match all requirements prescribed by cramdown under Chapter 11 BC. This requirement is, in fact, in contrast to the requirements of the cramdown. Whereas cramdown requires that at least one impaired class accepted the plan, there is no such requirement in the prohibition to obstruct.

In contrast, prohibition to obstruct sets out the requirement whereby the plan can be confirmed only if the majority of classes accepted it.

This difference yields the need for different strategy from the ones used by actors of reorganization under Chapter 11 BC. Gerrymandering of classes and artificial impairment do not have the same impact if the aforementioned requirement is non-existent. Chapter 11 plan proponent seeks to form as many classes as possible in order to provide that at least one of the impaired classes accepts the plan. He might tend to form classes consisting of small number of creditors or even classes of sole creditors in order to achieve this. In contrast, BiH

[194] Stephan Madaus, Rescuing Companies Involved in Insolvency Proceedings with Rescue Plans 11 (2013), https://papers.ssrn.com/abstract=2271979 (last visited Apr 5, 2017).
[195] Id. at 12.

bankruptcy laws plan proponent might tend to form a small number of classes because he might not need any particular class to vote for the plan, but rather that any majority of classes does so.[196]

[196] Rainer Riggert, Das Insolvenzplanverfahren - Strategische Probleme aus der Sicht absonderungsberechtigter Banken, 1521, 1524 (1998), in Supra note 64, at 28 (2015).

CONCLUSION

This thesis demonstrates that the two compared jurisdictions have different understandings of bankruptcy reorganizations, despite the same formal declaration of the purposes of bankruptcy laws in both. The building blocks of bankruptcy proceedings juxtaposed in this thesis reveal the differences of that understanding. Bankruptcy laws of BiH seem to place to no reliance on bankruptcy debtor in the proceedings. Compared to Chapter 11 BC, Bankruptcy laws of BiH do not confer many entitlements on debtor, thus rendering the proceedings to be only creditor driven. Consequently, debtors do not have incentive to participate in the proceedings.

Chapter 11 BC, on the other hand, endeavor to establish a balance between interests of all actors of the proceedings encouraging active participation of all of them in reaching the ultimate goals of reorganization – enabling the debtor to survive and guaranteeing creditors more than liquidation value. It sees reorganization proceedings as negotiations between many actors with different interests. In such constellation, cramdown fosters negotiations allowing actors to reach an agreement by favoring interests of majority over the interests of individual creditors.

BiH and all emerging systems can learn many lessons on cram from the experiences of Chapter 11 BC. This thesis provides a brief overview of the history of cramdown in order to comprehend its meaning and purpose. Even though the prohibition to obstruct differs from the cramdown to some extent, the rationale of the legal solution is the same. Despite the differences of the compared jurisdictions and degree of development of bankruptcy law, many corollary issues of the cramdown are not impossible to emerge in BiH. This thesis sought to present some of them.

The findings of this thesis reveal the need of reforms of Bankruptcy Laws of BiH and the understanding of bankruptcy proceedings in general. As many other parts of the law, provisions of prohibition to obstruct show that the legislator does not see reorganization as playground of negotiations. Instead, lack of the exceptions to prohibition to obstruct in combination with inexperience of all actors will likely to preserve the initial positions of the actors in negotiations.

Mere reforms of legislation are not likely to change substantially the success of bankruptcy reorganizations. In Bosnia and Herzegovina, bankruptcy debtors are considered to be losers. Because of that, bankruptcy stigma will take its toll despite the adequacy of bankruptcy law.

To reach progress, reforms of bankruptcy law have to be backed up by simultaneous change of perception of bankruptcy.

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