Germany’s Embrace of a Rescue Culture – a Comparison Between the Approaches Taken in Germany, Canada and the United States

by

Sebastian Frederik Ruenz

A thesis submitted in conformity with the requirements for the degree of Master of Laws

Faculty of Law
University of Toronto

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2013

Abstract

An increasing number of restructuring proceedings in both the United States and Canada end in the liquidation of the debtor company. This might prejudice the rescue culture approach which is deeply rooted in both countries bankruptcy laws. At the very least, it is the expression of different economic circumstances and of a different creditors’ structure which has excited for a little over a decade.

This thesis gives an overview of the different approaches available in Germany, Canada and the United States to rescue a debtor and explains what exactly is meant by a rescue culture policy. Furthermore, it examines the extent to which each legislator has embraced the rescue culture approach. Finally, it looks at the reasons and consequences of the above mentioned current North-American trend and examines the extent to which these developments may influence the outcome of restructuring proceedings in Germany.
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Chapter 1
Introduction

There are two main objectives in bankruptcy and insolvency law, which are in tension with one another. The first objective is to ensure that debtors compensate their creditors. If debtors could easily write off existing debt, creditors would face higher risks in obtaining repayment and they would have to secure against this risk with, for example, higher interest rates. The second objective of bankruptcy and insolvency law is to give debtors a fresh start by writing off part of their debts. If debtors did not have the opportunity to obtain a discharge for unpaid debts businesses would be less willing to take on risk. This would have undesirable consequences, particularly for start-up businesses, as taking on risk is a necessary component in achieving entrepreneurial success.

The legislator has to balance these two policies in a country’s bankruptcy laws and decide whether to put more weight on the first or the second consideration. Bankruptcy regimes which favor the first approach usually aim for a liquidation of the debtor’s assets and are considered “creditor-friendly”. Countries which favor the second consideration usually focus on restructuring the debtor’s business and are considered “debtor-friendly”. The expressions “creditor-friendly” and “debtor-friendly” should not be misunderstood. They do not mean that under the former, creditors are generally better off and under the latter the debtor is better off. The expressions serve simply to describe the degree of protection of debtors and creditors.

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One form of debtor-friendliness can be illustrated by a policy that attempts to keep an insolvent corporation afloat instead of liquidating it, the so called rescue culture policy. In a country that appreciates the advantages of a rescue culture policy the legislator provides a legal framework which makes a restructuring easily accessible and achievable and provides more concessions and liberties to the debtor during the process. Besides providing for adequate law which facilitates restructuring, in order to speak of a functioning rescue culture the concept has to be accepted and supported by the parties involved in the process, especially creditors. As explained further below, a sale of a debtor company as a going-concern can also, in principle, be considered as a rescue.

This thesis takes a closer look at the bankruptcy and insolvency laws of Canada, Germany and the United States (hereinafter: US). It seeks to identify the extent to which these countries have adopted the rescue culture approach in their laws and how this approach has been adopted in practice. Canada and the US have traditionally been considered to provide debtor-friendly bankruptcy regimes. Germany on the other hand has traditionally been considered more “conservative” adopting more creditor-friendly insolvency laws. However, recent legal changes have been adopted in Germany that encourage restructuring, casting a different light on Germany’s provisions. At the same time more and more reorganization processes in Canada and the US end in a liquidation of the company therefore challenging the efficiency of their proceedings. The scope of this thesis is limited to commercial proceedings in the corporate sector and does not focus on either individual or private insolvencies, or on insolvencies of governmental or financial institutions.

First, I am going to introduce the different restructuring proceedings in Canada, Germany and the US (see Chapter 2), in order to provide the reader with a better understanding of the options
existing in each country.\textsuperscript{2} As a lead-in to this overview of the different in- and out-of-court restructuring proceedings of each country, I identify a common core regarding the objectives and the restructuring processes of all three jurisdictions. In the following paragraph, I describe the meaning, development and effectiveness of a rescue culture (see Chapter 3). Subsequently, I analyze how Canadian, German and US provisions embraced the rescue culture doctrine by considering how much each legislator did to establish provisions which encourage all parties involved in the financial distress of a company to pursue the firm’s rescue (see Chapter 4). Since in recent times many restructuring proceedings in Canada and the US end in a sale of the debtor, I am going to describe the ongoing practical difficulties with the rescue culture policy, the reasons for and the consequences of these difficulties. Moreover, I will consider whether the same events occur or may occur in Germany (see Chapter 5). Finally, I am going to summarize my results (see Chapter 6).

\textsuperscript{2} The description of the different restructuring proceedings is not exhaustive and intends to give an overview of the most important features, especially against the background of the thesis’ topic.
Chapter 2
Overview of the different restructuring proceedings in Canada, Germany and the United States

1 Common core
1.1 Objectives

Despite numerous profound differences between Canadian, German and US restructuring laws, all three jurisdictions share a common core in their objectives in offering a legal framework for restructuring proceedings. Restructuring proceedings serve as an appropriate alternative to traditional liquidation proceedings when the going-concern value of the debtor company is higher than the value of its assets in liquidation proceedings. Restructuring proceedings can balance the interests of debtors, creditors and the public in the best possible way. The debtor is interested in continuing his business to avoid a collapse by losing its assets. During restructuring proceedings business operations are kept afloat so that the debtor is safe for the moment and does not lose his assets. Creditors are interested in the highest possible recovery rate. Restructuring proceedings can help to fulfill this interest since the value of a going-concern is generally higher than the value of its single assets. The public is interested that a financially distressed company does not become a burden for other constituencies. Restructurings avoid social costs, e.g. created by the dismissal of the workforce or a domino effect of financial difficulties among connected

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3 Such going-concern value exists if a company’s assets are worth more remaining with the company as opposed to being returned to the market.
4 See Wood, “Bankruptcy and Insolvency”, supra note 1 at 311-315, who outlines the different interests of the constituencies as described in this paragraph.
5 Ibid at 312.
suppliers.$^6$ From a theoretical point of view all three jurisdictions know about and appreciate these advantages of restructuring proceedings.

### 1.2 Restructuring process

In practice, there are large differences in the availability and in the realization of restructuring proceedings in Canada, Germany and the US. Nonetheless, at the current point in time all three jurisdictions have a mutual basic understanding of how a restructuring process can take place. Although, especially in Germany, restructuring proceedings can look very different in practice, nonetheless, the possibility exists that the following steps take place in all jurisdictions during a restructuring process.

All of the different restructuring laws give the insolvent debtor a certain time frame during which a stay of proceedings is imposed so that he can develop a plan or proposal. In this plan or proposal the debtor mainly outlines how many cents on the dollar he is going to pay back in which period of time and how he is going to reorganize the company to achieve this goal. That way, the business is kept afloat for the moment and the debtor can restructure its company. This plan or proposal has to comprise certain features and has to be accepted by a certain percentage of creditors which are divided into groups and vote on the plan. Courts, after the creditors’ voting, have to examine and approve the plan. If the Court approves the plan it is usually binding on all creditors, including the dissenting ones.

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$^6$ The role of non-creditor interest groups should not be overrated since in the end the creditors are the ones who vote on a plan, *ibid* at 314.
2 Canada

2.1 In-court restructuring: BIA and CCAA proceedings

Canada offers two different commercial restructuring regimes: a Bankruptcy and Insolvency Act proposal (BIA proposal) under the *Bankruptcy and Insolvency Act*\(^7\) (BIA) and a restructuring proceeding which implements a restructuring plan under the *Companies’ Creditors Arrangement Act*\(^8\) (CCAA). Although earlier reforms attempted to converge BIA and CCAA proceedings, insolvency reforms in 2005/2007 made it clear that both proceedings should be kept separate.\(^9\) Nonetheless, it is possible for eligible companies to continue under the CCAA proceedings initiated under the BIA provided that the BIA proposal did not fail.\(^10\) Since CCAA proceedings are less based on statutory provisions and more on court orders, and are thereby more flexible, and because they are more expensive, they serve as a regime for larger businesses, while the more statute driven and cheaper BIA proceedings are better suited to small and medium-sized firms. The court driven CCAA proceedings facilitate a more individual restructuring process, addressing the specific problems of the particular business. BIA proceedings on the other hand are more cost efficient because of less court involvement; legal consequences derive directly from the statute.

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\(^7\) *Bankruptcy and Insolvency Act*, RSC 1985, c B-3 [BIA].

\(^8\) *Companies’ Creditors Arrangement Act*, RSC 1985, c C-36 [CCAA].

\(^9\) Wood, “*Bankruptcy and Insolvency*”, *supra* note 1 at 311.

\(^10\) CCAA, *supra* note 8, s 11.6. A reverse continuation is not permitted: *BIA, supra* note 7, s 66(2); proceedings under the BIA have to be commenced anew.
Although this conventional view has to be modified to some extent due to legal changes which grant powers to courts in BIA restructuring proceedings formerly only available under the CCAA, CCAA proceedings continue to be more flexible.

In order to open CCAA proceedings, a CCAA Initial Application has to be submitted to the court, usually by the debtor. If the prerequisites of this application are fulfilled the court grants an initial order which activates CCAA proceedings. In order to open BIA proposal proceedings a proposal or a notice of intention to file a proposal has to be filed. If the prerequisites for the filing of the proposal are fulfilled the process starts by virtue of the statute. In BIA and CCAA proceedings an interim receiver may be appointed to protect the assets of the estate. The two proceedings show numerous similarities and differences.

The main similarities between the two regimes are:

- Both regimes require that the debtor is insolvent or bankrupt.

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11 See Wood, “Bankruptcy and Insolvency”, supra note 1 at 322, who mentions, for example, the power to authorize priority of the interim financier over secured creditors: BIA, supra note 7, s 50.6; the power to authorize priority of charges for administrative expenses over secured creditors: (ibid, s 64.2); the power to authorize a sale of substantially all the business assets before putting a plan before the creditors for their approval: (ibid, s 65.13), etc.

12 For example, the stay of proceedings in a CCAA process potentially has a wider scope: see Wood, “Bankruptcy and Insolvency”, supra note 1 at 323 who mentions, inter alia, that the CCAA contains a provision regarding critical suppliers (CCAA, supra note 8, s 11.4), which the BIA does not provide.

13 CCAA, supra note 8, s 10(1)(2).

14 Ibid, s 11.

15 BIA, supra note 7, s 50(1).

16 Ibid, s 50.4(1).

17 Ibid, s 50(2).

18 CCAA, supra note 8, s 2(1), „debtor company”; BIA, supra note 7, s 50(1).
• Under both regimes there is a neutral third party supervising the debtor. Under the CCAA this is the monitor, under the BIA the proposal trustee.\(^\text{19}\) Despite slight differences their powers are very similar. Both are officers of the court who provide courts and creditors with an assessment of the debtor’s business and financial affairs and who support the debtor in navigating through the restructuring process.

• Under both regimes, in order for the court to approve the plan/proposal, the majority of creditors who hold at least two-thirds of the value of the claims, have to vote in favor of the plan/proposal in every class of creditors.\(^\text{20}\) Creditors who voted against the plan/proposal are also bound by it when the majority requirements are fulfilled.\(^\text{21}\) Shareholders’ approval is not needed to implement a plan/proposal.\(^\text{22}\) Both regimes have the same message regarding court approval, namely the plan/proposal has to be reasonable and fair.\(^\text{23}\)

• The stay of proceedings under both regimes binds both unsecured and secured creditors while during bankruptcy proceedings only unsecured creditors are affected by the stay.\(^\text{24}\)

• Neither regime offers a provision that permits a court to bind a class of creditors that have rejected the plan/proposal.\(^\text{25}\)

The main differences between the two regimes are:

\(^{19}\) CCAA, supra note 8, s 11.7(1); Ibid, s 50(10).
\(^{20}\) Wood, “Bankruptcy and Insolvency”, supra note 1 at 421.
\(^{21}\) Ibid.
\(^{22}\) Ibid at 443-444.
\(^{23}\) Ibid at 447.
\(^{24}\) There are certain exceptions to this rule: see Ibid at 335-342.
\(^{25}\) Ibid at 426-427.
• Less technical requirements exist to initiate BIA proceedings compared to CCAA proceedings. For example, no court orders are required to commence proceedings under the BIA.\textsuperscript{26}

• The CCAA has stricter prerequisites for eligibility. The claims against the debtor company and its affiliates must exceed $5m.\textsuperscript{27} In the BIA there is no such threshold. Furthermore, only income trusts and corporations are eligible under the CCAA.\textsuperscript{28} Under the BIA individuals and non-corporate businesses can also initiate proceedings.

• The stay of proceedings under the CCAA derives from a court order while under the BIA the stay of proceedings is an automatic consequence of the commencement of the proceedings.\textsuperscript{29} Furthermore the stay under the CCAA is less extensive than the stay under the BIA\textsuperscript{30} and it is shorter.\textsuperscript{31}

• A CCAA plan can be made to secured and/or unsecured creditors. A BIA proposal must be made to unsecured creditors and in addition may be made to secured creditors.

• A failure of BIA proposal proceedings automatically leads to bankruptcy of the debtor\textsuperscript{32}, while termination of CCAA proceedings only creates the situation that creditors are able to exercise their ordinary remedies again.\textsuperscript{33} This in practice will also lead to the opening

\textsuperscript{26} \textit{Ibid} at 331.

\textsuperscript{27} \textit{CCAA, supra} note 8, s 3(1).

\textsuperscript{28} \textit{Ibid}, s 2(1), „company“ and „income trust“.

\textsuperscript{29} \textit{Ibid}, s 11.02(1)(2); \textit{BIA, supra} note 7, ss 69(1), 69.1(1).

\textsuperscript{30} \textit{CCAA, supra} note 8, s 11.02(2)(3); \textit{Ibid}, s 50.4(9).

\textsuperscript{31} \textit{CCAA, supra} note 8, s 11.02(1)(2); \textit{Ibid}, ss 69(1), 69.1(1)(a).

\textsuperscript{32} \textit{Ibid}, s 57.

\textsuperscript{33} Wood, “\textit{Bankruptcy and Insolvency}”, \textit{supra} note 1 at 346.
of bankruptcy or receivership proceedings but nonetheless it does not take place automatically.

- Proving claims is different. Under BIA proposal proceedings the process is the same as in bankruptcy proceedings which means that creditors have to deliver a proof of claim form to the trustee.\(^\text{34}\) The CCAA says little about the proof of claims. The courts usually set out a claims procedure order and identify a date by which all claims must be proved.\(^\text{35}\)

- Under the CCAA the persons who are allowed to propose a plan are not restricted, which means that a creditor could also propose a plan/or rival plan, if not otherwise provided in the initial order.\(^\text{36}\) Under the BIA only the debtor, receiver, liquidator or trustee in bankruptcy of the debtor are allowed to make a proposal.\(^\text{37}\)

Compared to US bankruptcy law there are more similarities between CCAA restructuring proceedings and Chapter 11 proceedings than between BIA proposal proceedings and Chapter 11. Even if Chapter 11 and the BIA are both more statute driven, CCAA and Chapter 11 proceedings are similar in that they are both flexible and cause high costs.

### 2.2 Other statutory provisions

There are other Canadian laws which contain provisions regarding restructurings. Since these are specialized insolvency regimes they are only mentioned at this point and are not further described. One of these regimes is the Farm Debt Mediation Act\(^\text{38}\) (FDMA) which aims at

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\(^{34}\) *BIA, supra* note 7, s 66(1).

\(^{35}\) Wood, “*Bankruptcy and Insolvency*,” *supra* note 1 at 404.

\(^{36}\) *Ibid* at 424.

\(^{37}\) *BIA, supra* note 7, s 50(1).

\(^{38}\) *Farm Debt Mediation Act, SC 1997, c 21.*
avoiding bankruptcies of farm debtors by providing rules for a mediation process between an insolvent farmer and its creditors. The Winding-Up and Restructuring Act\(^39\) (WURA), primarily concerns insolvencies of banks, insurance companies, loan companies and trust companies and it is occasionally also used to wind-up federal corporations. The Canada Transportation Act\(^40\) (CTA) deals with the restructuring of railway companies.

### 2.3 Out-of-court restructuring

Beyond the above mentioned statutory provisions a restructuring process in Canada can take place out-of-court by way of private agreements between the debtor and creditors. Such an approach has the advantage of saving court costs, of avoiding the stigma of a court supervised restructuring process and of preventing a loss of control. On the other hand such a process brings along a number of disadvantages for the debtor and creditors.\(^41\) The debtor is not able to prevent creditors from enforcing their claims since no stay of proceedings is in place. Furthermore, the agreement only binds the consenting creditors. The overall success therefore can easily be jeopardized by dissenting parties. Creditors often lack sufficient information about the debtor’s business to know if the agreed conditions are feasible. Finally, due to the lack of supervision such arrangements may be detrimental for creditors.

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\(^39\) Winding-up and Restructuring Act, RSC 1985, c W-11.

\(^40\) Canada Transportation Act, SC 1996, c 10.

\(^41\) For the following disadvantages see Wood, “Bankruptcy and Insolvency”, supra note 1 at 308.
3 Germany

3.1 In-court restructuring: Insolvency plan proceedings

The provisions regarding insolvency proceedings in Germany can be found in the German Insolvency Statute\(^{42}\) \textit{(Insolvenzordnung)}. This statute contains provisions for three different proceedings, namely commercial insolvency proceedings \textit{(Regelinsolvenzverfahren)} for natural or juridical persons, consumer insolvency proceedings \textit{(Verbraucherinsolvenzverfahren)} for private persons, and insolvency proceedings of a deceased’s estate \textit{(Nachlassinsolvenzverfahren)}. This thesis concentrates on commercial insolvency proceedings. Commercial insolvency proceedings apply whether the debtor company is going to be liquidated or restructured. If during commercial insolvency proceedings an insolvency plan is developed to restructure the debtor company, insolvency plan proceedings \textit{(Insolvenzplanverfahren)} take place within the frame of commercial insolvency proceedings. An insolvency plan may make deviating arrangements for some of the general provisions regarding commercial insolvency proceedings.\(^{43}\)

Commercial insolvency proceedings begin with a petition of the debtor or a creditor\(^{44}\) to open insolvency proceedings whether liquidation or restructuring of the debtor company is desired.\(^{45}\) Subsequently, preliminary insolvency proceedings \textit{(vorläufiges Insolvenzverfahren)} start during


\(^{43}\) Insolvency plan proceedings are regulated by \textit{ibid}, ss 217-269. The plan may deviate from the general provisions regarding “the satisfaction of creditors entitled to separate satisfaction and of the insolvency creditors, the disposition of the insolvency estate and its distribution to the parties concerned, as well as the insolvency procedure and the debtor's liability subsequent to the termination of the insolvency proceedings” (see \textit{ibid}, s 217).

\(^{44}\) \textit{Ibid}, ss 13, 14.

\(^{45}\) \textit{Ibid}, s 13.
which the court examines if a reason to open (main) insolvency proceedings exists.\textsuperscript{46} Insolvency, imminent insolvency or over-indebtedness is required to open the process.\textsuperscript{47} Furthermore, during preliminary insolvency proceedings the court can order preliminary measures that help to secure the assets of the debtor, for example a stay of proceedings.\textsuperscript{48} During (main) insolvency proceedings an automatic stay of proceedings applies.\textsuperscript{49} In order to open (main) insolvency proceedings creditors are required to file their claims with the insolvency administrator (\textit{Insolvenzverwalter}) or in case of self-administration proceedings (\textit{Eigenverwaltung})\textsuperscript{50} with the insolvency monitor\textsuperscript{51} (\textit{Sachwalter}) within a definite period of time.\textsuperscript{52} The insolvency plan does not necessarily have to be made to secured creditors.\textsuperscript{53} In order to be accepted the majority of the creditors with voting rights has to back the plan and “the sum of claims held by creditors backing the plan” has to exceed “half of the sum of claims held by the creditors with voting rights”.\textsuperscript{54} German insolvency courts under certain circumstances may deem a voting group to have consented to a plan (\textit{Obstruktionsverbot}).\textsuperscript{55} The plan is binding on creditors who did not proof

\begin{itemize}
\item \textsuperscript{46} “Main” is in parentheses since preliminary insolvency proceedings are not actual insolvency proceedings. Insolvency proceedings only begin in case a reason to open exists. The addition “main” should only illustrate that preliminary insolvency proceedings and insolvency proceedings have to be distinguished.
\item \textsuperscript{47} \textit{Insolvency Statute, supra} note 42, s 17, “Insolvency”; (\textit{Ibid}, s 18, “Imminent insolvency”); (\textit{Ibid}, s 19 “Overindebtedness”).
\item \textsuperscript{48} \textit{Ibid}, s 21.
\item \textsuperscript{49} \textit{Ibid}, s 89.
\item \textsuperscript{50} Hereinafter self-administration proceedings are called debtor in possession.
\item \textsuperscript{51} Insolvency monitor and insolvency administrator have similar duties whereby the powers of the insolvency monitor are not as far reaching as the ones of the insolvency administrator. The debtor’s assets do not vest in the insolvency monitor. Provisions regarding the insolvency monitor can be found in \textit{Insolvency Statute, supra} note 42, ss 270(1), 270c.
\item \textsuperscript{52} \textit{Ibid}, s 174 (insolvency administrator); (\textit{Ibid}, s 174 in conjuction with s 270(1) (insolvency monitor)).
\item \textsuperscript{53} \textit{Ibid}, s 222(1) no 1.
\item \textsuperscript{54} \textit{Ibid}, s 244.
\item \textsuperscript{55} \textit{Ibid}, s 245.
\end{itemize}
their claim or dissented.\textsuperscript{56} A plan is refused if “provisions governing the right to submit a plan and its contents” are not complied with and cannot be corrected, if a plan has no chance of being accepted or “if the claims provided for the parties under the constructive part of a plan submitted by the debtor obviously cannot be satisfied”.\textsuperscript{57} If the insolvency court refuses the plan, usually liquidation takes place within commercial insolvency proceedings.

German insolvency plan proceedings are more similar to BIA proposal proceedings than to CCAA proceedings. Just like BIA proposal proceedings insolvency plan proceedings do not require a minimum debt. Furthermore, both regimes can be considered more statute driven.

Before the recent reform of German insolvency law\textsuperscript{58} (hereinafter: the 2012 reform, reform or latest/recent reform), there were two ways in which in-court restructuring proceedings, which means restructuring under the development of an insolvency plan and the maintenance of the debtor as a legal entity, took place in practice:

- A preliminary insolvency administrator\textsuperscript{59} (\textit{vorläufiger Insolvenzverwalter}) was appointed during preliminary insolvency proceedings.\textsuperscript{60} This preliminary insolvency administrator usually stayed in his position during (main) insolvency proceedings. During these (main)

\textsuperscript{56} After the latest reform now explicitly mentioned in \textit{ibid}, s 254b.

\textsuperscript{57} \textit{Ibid}, s 231.


\textsuperscript{59} The powers of the preliminary insolvency administrator vary depending on whether the court additionally orders a limitation of the debtor’s right of disposal. If such an order takes place the preliminary insolvency administrator is considered a “strong preliminary insolvency administrator”, if not, a “weak preliminary insolvency administrator”. Nonetheless, both alternatives show more similarities with the trustee in bankruptcy in Canadian and US law than with a monitor or a proposal trustee.

\textsuperscript{60} \textit{Insolvency Statute, supra} note 42, s 22.
insolvency proceedings the administrator had the option to restructure the debtor company by introducing an insolvency plan.

- A preliminary insolvency administrator was appointed during preliminary insolvency proceedings. During (main) insolvency proceedings the court ordered debtor in possession under the supervision of an insolvency monitor. During these (main) insolvency proceedings the debtor was allowed to present a restructuring plan for its company.

The problem was that these two options were used very rarely and although the insolvency code offered the instruments of debtor in possession and insolvency plan proceedings, liquidation remained the most likely outcome in commercial insolvency proceedings.\(^{61}\) German insolvency law was considered to be restructuring-unfriendly.\(^{62}\) This was mainly based on three reasons:

- Courts were reluctant to order debtor in possession. This was due to strict prerequisites to order this instrument\(^{63}\) and a general understanding of judges that the management responsible for the status of insolvency cannot be trusted to continue with the operation of the business.\(^{64}\) Courts often also relied on reports of preliminary insolvency administrators which did not support debtor in possession due to the same opinion. As a result many debtors filed late for the opening of insolvency proceedings because of their

\(^{61}\) See Bruno M Kübler, *Handbuch Restrukturierung in der Insolvenz*, 1st ed (Köln: RWS Verlag, 2012) at 8 [Kübler], who says that only in 0.5% of insolvency proceedings in the last five years debtor in possession was ordered.


\(^{63}\) Compare *Insolvency Statute* (5 October 1994) Federal Law Gazette I, 2866, as last amended by Article 3 of the Act of 9 December 2010 (Federal Law Gazette I, 1885), s 270(2), [*Insolvency Statute (old version)*] and *Insolvency Statute, supra* note 42, s 270(2); the statutory prerequisites for debtor in possession were stricter in the old version than in the current version.

\(^{64}\) Kübler, *supra* note 61 at 8.
fear of losing control over their company and because of the stigmatization of the process. Due to this late filing a successful restructuring was often no longer feasible.\textsuperscript{65}

- Debtor in possession was only initiated with the court order opening insolvency proceedings, which meant at the beginning of the (main) proceedings. Accordingly, the debtor usually was facing a loss of control and ownership during preliminary insolvency proceedings due to the appointment of a preliminary insolvency administrator.\textsuperscript{66}

Moreover, because of the above mentioned preliminary administrator, debtor in possession often became less likely during (main) proceedings.\textsuperscript{67} Again this made debtors afraid of entering the process and a successful restructuring less likely.

- Insolvency plan proceedings in practice were very unattractive due to a very time consuming process and uncertainty regarding the consequences of the insolvency plan etc.\textsuperscript{68} Since shareholders were not included in the insolvency plan their consent for debt-equity-swaps was required. The process in many regards was unpredictable for debtors and creditors.\textsuperscript{69}

Thus, the 2012 reform took care of the above mentioned problems in the following way:


\textsuperscript{66} Römermann, supra note 62 at 422.

\textsuperscript{67} Ibid at 423.

\textsuperscript{68} Ibid at 421.

\textsuperscript{69} German Federal Government, supra note 65 at 1.
• The requirements for ordering debtor in possession were lowered.\textsuperscript{70} The reform aims at increasing the usage of debtor in possession and thereby the number of successful restructuring proceedings.

• Pre-insolvency restructuring proceedings (\textit{Schutzschirmverfahren}) were introduced.\textsuperscript{71} If possible, between the petition to order debtor in possession and the order to initiate debtor in possession, courts order these proceedings which mean that during this time an insolvency monitor is only appointed to permit the debtor to develop his own restructuring concept by introducing an insolvency plan. Again the usage of debtor in possession should be encouraged by this step with the intended result of improving the chances of a successful restructuring.

• A debt-equity-swap also became possible without the consent of the shareholders.\textsuperscript{72} The course of procedure was accelerated\textsuperscript{73}, etc. (for details see Chapter 4, 1). Thereby insolvency plan proceedings should become more predictable for all parties involved and consequently used more often as a restructuring tool.

Other considerations of the reform were, for example, the strengthening of creditors’ rights.\textsuperscript{74} Creditors gained more influence especially regarding the choice of the insolvency administrator\textsuperscript{75} and during preliminary insolvency proceedings by establishing a preliminary creditors’

\textsuperscript{70} For details see Chapter 4, 1 of this thesis.

\textsuperscript{71} \textit{Insolvency Statute}, supra note 42, s 270b.

\textsuperscript{72} \textit{Ibid}, s 225a(2).

\textsuperscript{73} Christian Fuhst, “Das neue Insolvenzrecht – Ein Überblick” (2012) 8 Deutsches Steuerrecht 418 at 423.

\textsuperscript{74} German Federal Government, \textit{supra} note 65 at 2.

\textsuperscript{75} \textit{Insolvency Statute}, supra note 42, s 56.
committee (Gläubigerausschuss) more frequently\textsuperscript{76}. Finally, the reform intends to de-stigmatize insolvency proceedings and reduce negative associations with it. The strengthening of insolvency plan proceedings and debtor in possession should be a sign to debtors that the process can be a chance to get rescued.\textsuperscript{77} Not least, German restructuring law should become more competitive with the restructuring laws of other countries.\textsuperscript{78}

### 3.2 Other statutory provisions

Beside the Insolvency Statute there is only one other law which contains provisions regarding restructuring proceedings, the Bank Restructuring Act\textsuperscript{79} (Restrukturierungsgesetz) which came into force on 1 January 2011. It allows systematically important financial institutions (SIFI’s) to be restructured at an early stage. Such a proceeding became urgent after the financial failure of several SIFI’s during the recent financial crisis. SIFI’s are considered to be “too important to fail”.\textsuperscript{80} This thesis does not focus on this law in more detail.

### 3.3 Out-of-court restructuring

Out-of-court restructuring is also available in Germany and is frequently used. This process usually takes place at a stage when the debtor is not yet insolvent. Thus, the likelihood of a

\textsuperscript{76} Ibid, s 21 II no 1a in conjunction with s 22.

\textsuperscript{77} Nonetheless, there is a stigmatization by entering insolvency proceedings. For more details see Chapter 4, 2 of this thesis.

\textsuperscript{78} German Federal Government, supra note 65 at 1.

Most prominent example was the insolvency of Schefenacker corporation which changed their COMI (center of main interest) to the UK in order to be restructured in the course of a more debtor-friendly company voluntary arrangement.


successful restructuring can be higher than during in-court restructurings.\textsuperscript{81} For further advantages and disadvantages see above (Chapter 2, 2.3).

4 USA

4.1 In-court restructuring: Chapter 11 proceedings

In the US, restructuring proceedings are mainly regulated by Chapter 11 of the US Bankruptcy Code.\textsuperscript{82} Chapter 11 applies to both individuals and corporations however it is the main mechanism for corporate reorganizations due to its high costs and other burdensome requirements.\textsuperscript{83} US restructuring proceedings under Chapter 11 are more statute driven and less based on common law, like the US bankruptcy code in general.\textsuperscript{84} Nonetheless, Chapter 11 proceedings remain flexible.\textsuperscript{85}

Chapter 11 cases are opened by the voluntary or involuntary filing of a petition with the bankruptcy court in the appropriate venue without further judicial scrutiny.\textsuperscript{86} The central effect of the opening of Chapter 11 proceedings is the automatic stay of proceedings.\textsuperscript{87} In contrast to Canadian and German restructuring proceedings, the debtor need not be insolvent to file a Chapter 11 case. Before filing the debtor may develop a plan, a so called pre-packaged plan, to

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\textsuperscript{81} Kübler, supra note 61 at 23.

\textsuperscript{82} 11 USC ch 11 §§ 1101-1174 (1978) [11 USC ch 11].


\textsuperscript{84} Ibid at 698-699.

\textsuperscript{85} Ibid at 707.

\textsuperscript{86} 11 USC ch 3 §§ 301, 303 (1978) [11 USC ch 3].

avoid costs and save some time during Chapter 11 proceedings. In regular Chapter 11 cases however the plan is developed after the petition date. Under certain conditions the debtor is granted an exclusivity period during which other parties are precluded from filing a plan. A Chapter 11 plan can be made to secured and/or unsecured creditors. In Chapter 11 a proof of claim is not necessary if the debtor has properly listed the creditors’ claim and not contested its validity. If a proof of claim becomes necessary this has to be done prior to a date set out by the court, by which date all claims must be proved. Usually, the debtor in a Chapter 11 case is by default a debtor in possession. There can be cases in which a trustee is appointed who takes over the operations of the company; most frequently this is caused by mismanagement of the debtor, failure to comply with bankruptcy statutes, conflicts of interest, breach of duty or fraud. In all of these cases an examiner, who does not have decision making powers but whose typical duty is to conduct investigations and to issue a report, can also be appointed. Before the plan can be voted on by the creditors and potentially confirmed by the court the debtor has to file a disclosure statement that is confirmed by the court. The disclosure statement provides the creditors with enough information to vote on the plan, such as information about the debtor, the effects of the plan, how to vote on the plan, etc. If the court approves the disclosure statement the creditors can vote on the plan. A plan is accepted by a class of creditors if it is backed by creditors with at least two-thirds of the amount of claims in the class and who constitute more

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88 For example, a pre-packaged plan may avoid the disclosure statement process or the possibilities of adversaries to delay or abort the process.

89 11 USC ch 11, supra note 82, § 1121(c)-(d) (1978).

90 Then the debtor is a debtor out of possession but can still participate during restructuring proceedings.

91 Lobo, supra note 83 at 707.

92 11 USC ch 11, supra note 82, § 1104(c) (1978).

93 Lobo, supra note 83 at 764.
than one-half the number of creditors in the class.\textsuperscript{94} With respect to voting, the US bankruptcy code offers the “cram down” rule. Under this tool, the court is able to confirm a plan although one or more classes of creditors voted against the plan “if the plan does not discriminate unfairly, and is fair and equitable, with respect to each class of claims or interests that is impaired under, and has not accepted, the plan.”\textsuperscript{95} Shareholders usually vote on the plan but since a dissenting vote typically could be “crammed down” their approval is generally not required to accept a plan. In order to be confirmed by the court a plan has to meet certain requirements such as feasibility, good faith, best interest of creditors, fairness and equitableness.\textsuperscript{96} A confirmed plan binds all creditors whether they voted on the plan or not and whether they rejected the plan or not.\textsuperscript{97} The failure of a Chapter 11 plan usually leads to the liquidation of the debtor company under Chapter 7.

Compared to German restructuring proceedings Chapter 11 is more flexible but is also more cost intensive.

### 4.2 Chapters 9, 12, 13

Besides restructuring proceedings under Chapter 11 there are some other chapters in the US Bankruptcy Code that provide restructuring rules. Since this thesis only focuses on commercial restructurings they will only be mentioned at this point without further consideration. Chapter 13 offers restructuring provisions for individuals and sole proprietorships. Chapter 12 is similar to Chapter 13 but is limited to “family farmers” and fishermen. Finally, Chapter 9 contains rules

\textsuperscript{94} 11 USC ch 11, supra note 82, § 1126(c) (1978).

\textsuperscript{95} Ibid, § 1129(b)(1) (1978).

\textsuperscript{96} Ibid, § 1129 (1978).

\textsuperscript{97} Ibid, § 1141(a) (1978).
about the restructuring of municipalities and local governments, including governmental corporations.

4.3 Out-of-court restructuring

The option of out-of-court restructuring exists also in US bankruptcy law. With respect to benefits and detriments see above (Chapter 2, 2.3).
Chapter 3
The rescue culture

1 Meaning

The core statement of the rescue culture policy is that a company in financial distress should primarily be rescued instead of being liquidated.

It is important to clarify whether a rescue of the company means a rescue of the debtor as a legal entity or of the debtor’s business. The legislator originally developed these regimes to rescue not only the debtor company’s business but also the debtor as a legal entity. However, the notion of rescuing the debtor has somehow evolved within the insolvency community, no longer requiring a rescue of the legal entity but simply the rescue of the operating business. It can be argued that most of the effects of either a restructuring process or of a going-concern sale are the same. In both cases the business survives, jobs are saved, other stakeholders interested in the survival of the business are protected and social costs are avoided. The only difference is that the debtor does not continue to exist as a legal entity during liquidation proceedings. This shows that a process in which the business is rescued but the debtor as a legal entity is liquidated from a policy perspective can also be regarded as a rescuing process. Such a process may not be feasible in some situations but if a buyer can be found and the company is sold as a going-concern or if it is not necessary to use the expertise of the debtor for a continuation of the business such process may lead to the same results as a restructuring process.

98 Regarding the purposes of BIA proposal and CCAA proceedings, see the interpretation of the Supreme Court of Canada in Century Services Inc. v Canada, 2010 SCC 60, [2010] 3 SCR 379 at para 15, 72 CBR (5th) 170.
It has to be highlighted that the rescue of the debtor company is not supported by the parties involved in the process because of altruism. Creditors only favor such an approach if they can reach a higher recovery rate. The legislator is only interested in this option if it is economically necessary and helps to avoid social costs otherwise created by a piecemeal liquidation of the debtor. Rescuing a debtor or the debtor’s business has no end in itself but merely is a means to an end.

Furthermore, it has to be made clear again at this point that a rescue culture does not already exist simply because the legislator provides a rescuing-friendly insolvency and bankruptcy law. Such law also needs to be supported by the parties involved in the process as an instrument to rescue the debtor company. Admittedly, a well drafted restructuring law probably leads to a wider support of restructuring proceedings. Nonetheless, this correlation does not exist necessarily. Moreover, economical aspects may also reduce or enlarge the possibility of a successful implementation of the rescue culture policy. Accordingly, we have to distinguish between the rescue culture policy, as the “law in the books”\(^{101}\), and the rescue culture in practice. This means that despite a fundamental orientation of the legislator the practical implementation and success of a rescue culture policy is subject to constant change.

As stated in the introduction of this thesis the rescue culture policy is closely connected to the concept of debtor-friendliness. This does not mean that rescue culture equals debtor-friendliness. Put in different words, the rescue culture policy cannot only be found in typically debtor-friendly countries. Also, countries whose core is more creditor-friendly may provide provisions that aim

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\(^{100}\) Christoph G Paulus, “Deutschlands langer Weg in die insolvenzrechtliche Moderne – Auf der Suche nach einer Sanierungskultur (Rescue Culture) –“ (2011) 47 Wertpapier-Mitteilungen 2205 at 2205.

\(^{101}\) Ibid.
at a restructuring of the debtor company. This can be seen in German insolvency law for example. § 1 of the German insolvency statute states that the main objective of insolvency proceedings is the “collective satisfaction of a debtor’s creditors”. Although subsequently the maintenance of the debtor’s enterprise is mentioned it only describes a way, besides liquidation, to satisfy the debtor’s creditors. This formulation shows a considerably stronger tendency to meet creditors’ needs than for example US Chapter 11 which is headlined “reorganization”. Nonetheless, recent reforms in Germany have attempted to promote restructuring proceedings that aim at the survival of the debtor company. This illustrates that the rescue culture policy is not cut and dried. It is a matter of degree in how far different legislators have embraced the policy.

The endorsement or refusal of an extensive rescue culture policy is a value decision. The legislator has to decide whether to put more weight on the compensation of the creditors or the reorganization of the debtor.

2 Development

In the US the rescue culture policy is deeply rooted in the Nation’s history. The first reorganization procedure was introduced as early as 1898. In times when the different states formed a British colony their inhabitants were dependent on British money and goods. This meant that more lenders were situated in Great Britain and more debtors/lessees in America. This made it obvious that American laws would in general favor their compatriots. Another basis

\footnote{102 Bianca Schwehr, “Corporate Rehabilitation Proceedings in the United States and Germany” (2003) 12:1 International Insolvency Review 11 at 11 [Schwehr].}

\footnote{103 \textit{Ibid} at 12.
for the American rescue culture policy was the pioneering position of American entrepreneurs.  

America, at least for a long time, was considered an Eldorado for people with new ideas who wanted to found a company. Added to this, America’s health and welfare system is less supportive. This combination made the idea of a fresh start after an economic failure especially necessary and let the idea of a rescue become widely accepted among the constituents involved in such a process.

Canada shares the same heritage with the US. Although the first provisions regarding a reorganization procedure were introduced slightly later than in the US, namely in the Bankruptcy Act of 1919, the idea of a fresh start is also deeply rooted in Canadian policy.

The rescue culture policy is clearly less entrenched in German insolvency law. The first reorganization procedure in Germany was implemented in 1999. Before this time, liquidation and a transfer of assets to a new legal entity (Übertragende Sanierung) were the only possible outcomes within commercial insolvency proceedings. Since the debtor did not continue to exist as a legal entity after the transfer, this instrument led only to a rescue of the debtor’s business and not to a rescue of the debtor as a legal entity. The reluctance to introduce a restructuring regime can be explained by the legislator’s reliance on economic liberalism. Free

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104 Ibid.
105 Ibid.
107 The term is not mentioned in the Insolvency Statute but constructed and named by Karsten Schmidt in 1980 (Karsten Schmidt, “Organverantwortlichkeit und Sanierung im Insolvenzrecht der Unternehmen” (1980) 5 Zeitschrift für Wirtschaftsrecht 329 at 336). Since then it is a generally accepted instrument.
108 In the course of a transfer of assets to a new legal entity assets and liabilities are separated. While the assets are transferred to a new entity, liabilities remain in the old company which is liquidated subsequently.
market competition should select winners and losers.\textsuperscript{109} Furthermore, as described above (Chapter 2, 3.1), the legislator, insolvency courts and insolvency professionals were of the opinion that the debtor’s insolvency status shows that he is not able to manage the company. An often quoted saying was that one should not “put the fox in charge of the henhouse”.\textsuperscript{110} Also due to this approach, after the introduction of restructuring proceedings in Germany in 1999 the desired effect of a significantly increased number of successful restructuring proceedings was not achieved.

Despite the rootedness of a rescue culture policy in America’s early history recent developments in the US and Canada show a trend that more and more restructuring proceedings are aimed at a liquidation or sale of the debtor’s business. The picture in Germany looks different. Neither before nor after the 2012 reform was the number of successful restructuring proceedings declining. After the legislator’s recent reform preliminary statistics show that considerably more insolvency plan proceedings are initiated and debtor in possession is used more frequently.\textsuperscript{111}

\textsuperscript{109} Schwehr, supra note 102 at 15.

\textsuperscript{110} Kübler, supra note 61 at 8.

\textsuperscript{111} Reliable statistics about the exact increase in the number of restructuring proceedings and debtor in possession are still missing. The Federal Office of Statistics has not released tables for the period after the coming into force of the ESUG. Nonetheless, first numbers show that in three times as many proceedings debtor in possession was ordered after the introduction of the law than before, see Dirk Weischede & Christian Schulze, “ESUG – Sanierungsbegleitung durch den Steuerberater” (2012), online: vbsprockhoevel <http://www.vbsprockhoevel.de/content/dam/g4547-0/downloads/ESUG%20-%20Voba%20Sprockh%C3%B6vel%2020121205.pdf>. Furthermore first surveys illustrate that a large number of bankruptcy professionals are of the opinion that less liquidation proceedings are necessary after the introduction of the ESUG, see Roland Berger Strategy Consultants & Noerr, “ESUG-Studie 2012 – Erste Praxiserfahrungen mit der neuen Insolvenzordnung” (2012), online: rolandberger <http://www.rolandberger.de/media/pdf/Roland_Berger_ESUG-Studie_20121106.pdf>.
For more details regarding the actual situation in Germany, Canada and the US and the question of whether the same development that took place in the US and Canada could take place in Germany see below at Chapter 5 of the thesis.

3 Effectiveness

With respect to effectiveness we have to distinguish between the different groups affected by an insolvency process and consider how effective a rescue culture is for them as compared to a liquidating approach under which the debtor’s business is not rescued. A debtor considers a rescue culture effective only if he is able to continue with its business and is given a second chance to avoid previous mistakes otherwise not provided.

Creditors consider a rescue culture effective if their recovery rate through a rescue of the debtor company is higher than through liquidation. Where a company has a going-concern value, a reorganization or a going-concern sale usually produce higher returns for creditors than a piecemeal liquidation. As explained in more detail further below, especially secured creditors are indifferent as to whether there should be a restructuring or a going-concern sale, as long as they recover an amount that equals the value of their collateral. Unsecured creditors on the other hand favor restructuring proceedings in situations where the returns in these proceedings are high enough to lead to a surplus which is distributed to them after the secured creditors have been paid out.

The public considers a rescue culture policy effective if the rescue of the debtor company avoids insolvencies of suppliers or connected companies, saves jobs, etc. In contrast to a piecemeal

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112 This is not the case for secured creditors if they can receive their full collateral through a piecemeal liquidation.
liquidation, restructuring has the advantage that the debtor’s business is kept afloat. This effect can also be reached through a sale of the company on a going-concern basis.

Accordingly, as mentioned above (see Chapter 3, 1) aside from the advantages for the debtor the benefits of a rescue culture for creditors and the public can also be achieved by rescuing only the debtor’s operational business and not the debtor as a legal entity. From a policy perspective rescue culture can be achieved in both ways.
Chapter 4
Adoption of the rescue culture policy in Canada’s, Germany’s and the United States’ provisions

In this section I am going to examine to what extent Canada, Germany and the US have embraced the rescue culture policy in their provisions. In other words, I will examine how much the legislator did to establish provisions that encourage all parties involved in the financial distress of a company to work towards the firm’s rescue. Therefore, I try to establish what the important factors for successful restructurings are that the legislator should consider when constructing the law.

In particular, the legislator’s duty in order to embrace the rescue culture policy includes encouraging the debtor to apply for the process by letting him understand what to expect after initiating restructuring proceedings, eliminating third parties’ reservations against reorganizations, not letting the debtor be severely stigmatized by the process, allowing an early restructuring process in order to preserve as much value of the debtor company as possible, giving the debtor an active and liberal role in the process instead of letting him lose substantial control, restricting third parties’ rights to destroy an ongoing restructuring process and ensuring as far as possible that the debtor may receive sufficient funding during the proceedings.

1 Making the debtor aware of what to expect in restructuring proceedings and eliminating third parties’ reservations

The more uncertainties that exist about the consequences of a reorganization process, the more hesitant a debtor will be in approaching this goal and the more reluctant creditors will be in supporting such a process. The fewer debtors enter restructuring proceedings and continue working in financial distress the more debtors will end up being liquidated piecemeal. After
insolvency law reforms in 1999 the German legislator had already provided the options of an insolvency plan and debtor in possession. However, debtor in possession was considered to be an exception to the typical implementation of an insolvency administrator.\textsuperscript{113} This exceptional nature was equally carried out by courts, creditors and administrators. Although insolvency plan proceedings were not considered exceptional but called the “centerpiece of that reform”\textsuperscript{114}, they were not equipped well enough to eliminate prejudices of courts, creditors and administrators. Therefore, until the 2012 reform it was highly uncertain for the debtor whether the above mentioned parties would support insolvency plan proceedings and debtor in possession. There was always the threat of ending up being liquidated and/or losing control to the insolvency administrator. These uncertainties regarding the debtor’s control rights in the process and regarding the course of insolvency plan proceedings were intended to be reduced by the latest reform.

Debtor in possession should be offered as the preferred approach to reorganization.\textsuperscript{115} Most importantly requirements for debtor in possession were lowered. While under the old regime debtor in possession was only ordered in cases where it did not “lead to a delay in the proceedings or other disadvantages to the creditors”\textsuperscript{116}, under the new law it is sufficient for the court that “no circumstances are known which lead to the expectation that the order will place the creditors at a disadvantage”\textsuperscript{117}. Furthermore, under the new law the insolvency courts in cases of imminent insolvency shall inform the debtor if they plan to refuse his application.

\textsuperscript{113} Kübler, \textit{supra} note 61 at 8.


\textsuperscript{115} Kübler, \textit{supra} note 61 at 8.

\textsuperscript{116} Insolvency Statute (old version), \textit{supra} note 63, s 270(2).

\textsuperscript{117} Insolvency Statute, \textit{supra} note 42, s 270(2).
explaining why this is the case, thereby giving him an opportunity to withdraw his application for the opening of insolvency proceedings. In addition, insolvency courts shall order debtor in possession if it is supported by the majority of the creditors in the creditors’ committee. Finally, the rights of individual creditors to appeal a court’s decision regarding debtor in possession were restricted. All of these steps intend to assure the debtor that an order of debtor in possession becomes more certain under the new regime. By introducing the new pre-insolvency restructuring proceeding the debtor should obtain the possibility to be the one who drafts and presents an insolvency plan rather than the insolvency administrator as was usually the case before. This again intends to provide the debtor with more certainty about his control rights in the process.

Insolvency plan proceedings were enriched with further reaching possibilities for an ultimately successful restructuring of the company. Furthermore, procedural barriers which endangered an implementation of the plan were eliminated.

So far only creditors were included in an insolvency plan. If shareholder rights had to be changed their consent was required. After the reform share- and membership rights may be included in the insolvency plan. Persons with participating interests in the debtor constitute a group which

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118 Newly introduced *ibid*, s 270a(2); withdrawal is possible since there is no obligation for the debtor to file for the opening of insolvency proceedings in cases of imminent insolvency (*ibid*, s 18).


120 Compare *Insolvency Statute*, supra note 42, s 272(1) with *Insolvency Statute* (old version), *supra* note 63, s 272(1).

121 *Insolvency Statute*, supra note 42, s 270b.

122 Kübler, *supra* note 61 at 11.

123 *Insolvency Statute*, supra note 42, s 217.
can now vote on the plan.\textsuperscript{124} Nonetheless, this class very often can be “crammed down”, especially if they are not in a worse position than they would be without the plan. In particular, a conversion of creditors’ claims into share- or membership rights (debt-equity-swap) is now possible also against the will of persons with participating interests.\textsuperscript{125} Another amendment relates to the implementation of an insolvency plan in cases where there are insufficient assets to satisfy preferential creditors.\textsuperscript{126} Since this led to a failure of many restructuring plans, after the latest reform and under certain circumstances, an insolvency plan may also be implemented even where preferential claims are not satisfied.\textsuperscript{127} Furthermore, the course of procedure was accelerated.\textsuperscript{128} A creditor’s request to refuse the judicial approval of an insolvency plan can now be rejected if the plan provides funds for parties placed at a disadvantage.\textsuperscript{129} Also the right to appeal against a court approval of a plan and the consequences of such appeal were restricted.\textsuperscript{130} Through all of these steps, the risk of prejudice by creditors against insolvency plan proceedings should also be eliminated. By establishing more clarity in the process and providing more favorable terms to achieve a successful plan a higher support by the different parties involved should be reached. In the end more support also allows the debtor to rely on a more stable and successful process.

\textsuperscript{124} Ibid, s 222(1) no 4.

\textsuperscript{125} Ibid, s 225a(2), which says also that such debt-equity-swap is not possible against the will of the affected creditors.

\textsuperscript{126} With respect to the definition of preferential creditors see ibid, ss 53-55.

\textsuperscript{127} Ibid, s 210a.

\textsuperscript{128} Ibid, ss 231(1), 232(3), 235(1) sent 3.

\textsuperscript{129} Ibid, s 251(3).

\textsuperscript{130} Compare Insolvency Statute, supra note 42, s 253 with Insolvency Statute (old version), supra note 63, s 253.
The legal measures of the recent reform intend to provide more certainty for the debtor and eliminate prejudices by courts, creditors and administrators. Accordingly, the German legislator embraced the rescue culture policy in this regard.

These modernizations are not necessary in US Chapter 11 or Canadian BIA proposal or CCAA proceedings. Debtor in possession has always been the typical situation in North-American restructuring cases. Also the German innovations regarding insolvency plan proceedings were implemented in North-America at an earlier date. In addition to the cram down rule, Chapter 11 provides further provisions that allow for the disregarding of single dissenting creditors.\(^{131}\) The cram down rule always applied to shareholders, since they were always participating in the voting on the plan. Moreover, there are further restrictions with respect to shareholder rights.\(^{132}\) Chapter 11 also allows for a debt-equity-swap.\(^{133}\) Canadian law also offers the possibility of a debt-equity-swap. Canada does not however provide an equivalent to the US-American or German “cram down rules”. To restrict the influence of dissenting creditors in Canada less fragmentary creditor groups that vote on the plan are formed.\(^{134}\) Thereby, dissenting creditors are given less power than if they were put into a small group in which they dominated. Accordingly, the US and Canada have also embraced the rescue culture policy in this regard.

\(^{131}\) 11 USC ch 11, supra note 82, § 1126(e)-(g) (1978).


\(^{134}\) Wood, “Bankruptcy and Insolvency”, supra note 1 at 436-437.
2 Preventing a stigmatization by entering the restructuring process

The more stigmatization it causes for the debtor to enter reorganization proceedings, the less he will be willing to take this step and the more likely it will be that he ends up being liquidated piecemeal.

To enter German insolvency plan proceedings the debtor has to file a petition to open insolvency proceedings. Also the recent reform leaves untouched the unity of the restructuring and insolvency process. In other words, this means that no in-court reorganization is possible without the stigmatizing and burdening step of applying for the opening of insolvency proceedings. The applications to initiate a BIA-proposal, CCAA or Chapter 11 proceeding are different to the initiation requirements for bankruptcy proceedings. Accordingly, restructuring proceedings in Germany take place within insolvency proceedings, in Canada and the USA restructuring proceedings are separated from bankruptcy proceedings.

The German way seems to have more disadvantages for the debtor since it could happen that outsiders see the reputation of the debtor company destroyed and consider the corporation past remedy since it finds itself in insolvency proceedings. This seems superficial since in Canada and the US the debtor is usually also insolvent when initiating in-court restructuring proceedings. Nonetheless, the public image of a company in financial distress is less negative than that of a company that is actually in insolvency proceedings. On the other hand the adoption of two different proceedings makes a use of the restructuring process as a tool for liquidations and as a consequence thereof procedural concerns more likely (see Chapter 5, 3). Accordingly, although Germany has embraced the rescue culture to a lesser degree with respect to the stigmatization of the restructuring process, the unity of the process also provides advantages.
3 Supporting an early restructuring

The earlier a debtor enters the restructuring process the more likely a rescue of the company is since it is more likely that valuable assets still exist.\textsuperscript{135}

In order to find out at what point in time a debtor is able to enter reorganization in the respective countries we have to examine their requirements regarding the status of the debtor for the initiation of the process. In Canada there is a different insolvency test for restructuring proceedings than for liquidations.\textsuperscript{136} In \textit{Re Stelco} the Ontario Superior Court of Justice held that during restructuring proceedings a company is already insolvent “if it is reasonably expected to run out of liquidity within a reasonable proximity of time as compared with the time reasonably required to implement a restructuring.”\textsuperscript{137} Thereby the court intended to encourage debtors to initiate restructuring proceedings earlier. In the US the debtor does not have to be insolvent at all to apply for the opening of Chapter 11. In Germany this is not the case. In Germany the grounds for opening insolvency proceedings are the same whether liquidation or reorganization of the debtor company is sought. This means that in Canada and in the US it is possible to begin a restructuring process earlier than in Germany.\textsuperscript{138} This has advantageous effects since time is

\textsuperscript{135} Kübler, \textit{supra} note 61 at 8.

\textsuperscript{136} The definition of an “insolvent person” is regulated by the \textit{BIA, supra} note 7, s 2. Usually the provision distinguishes between a backward-looking and a forward-looking cash-flow test and a balance sheet test to determine if a person is insolvent. In \textit{Re Stelco} the court extends the forward-looking cash flow test.

\textsuperscript{137} \textit{Re Stelco Inc.} (2004), 48 CBR (4th) 299 at para 26, (available on CanLII), (Ont SCJ).

\textsuperscript{138} For criticism of the \textit{Re Stelco} decision see Wood, “\textit{Bankruptcy and Insolvency},” \textit{supra} note 1 at 23. He mentions the problem of interpreting the statute in two different ways, the uncertainties in predicting events in the future and constitutional problems. For criticism regarding the US approach, see Roman Trips-Hebert, “Restrukturierungsmaßnahmen im US-amerikanischen Insolvenzrecht: ein summarischer Vergleich mit der deutschen Insolvenzordnung” (17 April 2009) (Auszarbeitung WD 7 - 3000 - 061/09, Wissenschaftliche Dienste des Deutschen Bundestages (2009)) at 14, online: German Federal Parliament (Bundestag) <http://www.bundestag.de/dokumente/analysen/2009/US-Insolvenzrecht.pdf>,

essential for a company in financial distress. The feasibility of a plan can decline over a short period of time. Canada and the US accordingly embraced the rescue culture policy in this regard to a broader extent than the German legislator.\textsuperscript{139}

Another factor that may lead to earlier restructuring proceedings is to provide the debtor with control rights during restructuring proceedings.\textsuperscript{140} A debtor who is able to stay in possession of the company’s assets will be willing to apply for restructuring proceedings earlier since he is less afraid of a loss of control over his company. As mentioned above, in Germany for many years it was uncertain for the debtor whether he would be able to stay in control of the company after applying for the opening of insolvency proceedings. This is intended to be changed by the recent reform which declared debtor in possession to become the preferred way in restructuring proceedings. In the US and Canada debtor in possession is used in almost all cases. Accordingly, Germany has now taken a step in a more rescue-friendly direction in this respect, which took place in the US and Canada long before.

who claims that without the prerequisite of a determined reason to open insolvency proceedings the debtor is able to use the process even if a restructuring does not make sense. In my opinion this argument forgets the strong influence of creditors prior to the opening of the process.

\textsuperscript{139} Admittedly, in Germany out-of-court restructurings serve as a frequently used alternative to the in-court process. But out-of-court restructurings cannot be used as an excuse for the lacking option of starting in-court restructurings at an earlier point in time. They are of no importance for answering the question in how far the legislator embraced the rescue culture in this regard. Furthermore, out-of-court restructurings are also not completely comparable to in-court restructuring proceedings since they provide less protective measures for the debtor.

\textsuperscript{140} Kübler, supra note 61 at 7.
4 Giving the debtor an active and liberal role in the restructuring process

By allowing the debtor to make major decisions about his business during the restructuring process it is possible to save costs and time and use existing expertise.\textsuperscript{141} By internalizing knowledge of the debtor more qualified decisions can be made. Simultaneously, costs and time to inform a less experienced insolvency administrator can be saved. All of these factors increase the probability of a successful outcome. Nonetheless, in Germany until recently this approach was considered to be dangerous since it was the debtor’s management which was blamed for the situation that led to the company’s bankruptcy and accordingly the existing management was not regarded capable of continuing with the running of the business. This led to the above mentioned loss of control and the implementation of an insolvency administrator who usually was responsible for developing the restructuring plan. The extension of debtor in possession and the introduction of pre-insolvency restructuring proceedings should change this situation (for details see Chapter 4, 1.). In the US and Canada the advantages of an active debtor during restructuring proceedings were known and appreciated much earlier. Under the statutes in these countries the debtor generally stays in possession and it is usually him who develops the restructuring plan. Accordingly, all three jurisdictions at this point embrace this element of the rescue culture policy.

\textsuperscript{141} \textit{Ibid.}
5 Restricting third parties’ rights to destroy an ongoing restructuring process

Before the recent insolvency reform, creditors in Germany could easily delay the realization of a plan until it eventually became inefficient to pursue that goal.\(^{142}\) Even if a majority of creditors voted in favor of the plan, minority rights were strong enough to threaten the whole process.\(^{143}\) Although something similar to the US-American cram down rule already existed in German insolvency law before the reform\(^ {144}\), creditors nonetheless were offered remedies that could prolong the process and thereby put a successful outcome at risk. Furthermore, in the past shareholders consent was required for a debt-to-equity swap and they often denied such a swap.\(^ {145}\) These potential vulnerabilities of the restructuring process were restricted by the recent reform (for details see Chapter 4, 1). Also US and Canadian law provide several measures against third party disturbances and delays (for details see Chapter 4, 1).

6 Ensuring as far as possible that the debtor receives sufficient funding during restructuring proceedings

Kübler describes financing to continue the debtor’s business as a matter of life and death of each restructuring proceeding.\(^ {146}\) It is vital to keep the debtor’s business afloat. The capability of the legislator is limited in this context since financing depends on the presence of a financier. The legislator is only able to create incentives for potential investors. The more incentives that exist, the higher the likelihood of a reorganization process.

\(^{142}\) *Ibid* at 10.

\(^{143}\) *Ibid*.

\(^{144}\) *Insolvency Statute, supra* note 42, s 245 („Obstruktionsverbot“).

\(^{145}\) Kübler, *supra* note 61 at 11.

\(^{146}\) *Ibid* at 21.
In the US and Canada financing is considered central in restructuring proceedings.\textsuperscript{147} The legislator provides measures which help to ensure enough financing in many restructuring processes.\textsuperscript{148} In the US financing is achieved in particular by the release of cash collateral\textsuperscript{149} or debtor in possession financing (hereinafter: DIP financing)\textsuperscript{150}, in Canada primarily by DIP financing\textsuperscript{151}. The release of cash collateral means that cash, negotiable instruments, documents of title, securities, deposit accounts, or other cash equivalents can be released in accordance with the security right owner or otherwise due to a cash collateral order of the court if the debtor needs these funds to continue its business and avoid irreparable harm. In case of a release of cash collateral the affected creditor is granted an “adequate protection”.\textsuperscript{152} DIP financing means that new credit is provided for the debtor to continue its operations either by an already related creditor or a completely new creditor. A market for DIP financing can only develop if strong incentives are offered to DIP financiers. Usually, beside priority rights a priming lien is ordered that gives preference even over existing security interests.\textsuperscript{153} For accruing damages due to this interference with security interests the creditors of the existing security interests again are compensated.

In German insolvency law a creditor who provides the debtor with financing to continue its business during restructuring proceedings can be granted a priority over existing unsecured and

\textsuperscript{147} Béla Knof, “Erfordert die Fortführungsfinanzierung (doch) einen Umverteilungstatbestand im Insolvenzrecht?” (2010) 44 Zeitschrift für das gesamte Insolvenzrecht 1999 at 2006 [Knof].

\textsuperscript{148} Nonetheless, there are problems in practice with DIP financing and release of cash collateral (see Chapter 5, 2.1.4 of this thesis).

\textsuperscript{149} See 11 USC ch 3, supra note 86, § 363 (1978).

\textsuperscript{150} Ibid, § 364 (1978).

\textsuperscript{151} BIA, supra note 7, s 11.2(1)(2); CCAA, supra note 8, s 50.6(1)(3).

\textsuperscript{152} 11 USC ch 3, supra note 86, § 361 (1978).

\textsuperscript{153} Knof, supra note 147 at 2007.
secured creditors and ranks as a preferred creditor.\textsuperscript{154} The problem is that this incentive often is not enough to find a financier. The costs for the insolvency process as well as obligations that become legally effective after the notification of insufficiency of the assets (\textit{Masseunzulänglichkeit}) still rank before a financier’s claim. Furthermore, he competes with other preferential creditors (\textit{Massegläubiger}).\textsuperscript{155} Moreover, usually there are no free assets that could be encumbered and a financier is not granted a preferred security interest in an asset already used as collateral. Also further privileges which are granted for a subsequent insolvency process are not extensive enough to constitute a sufficient incentive for financiers. They are temporally and materially restricted.\textsuperscript{156} Therefore, in order to keep a business afloat the German legislator offers insolvency aid (\textit{Insolvenzgeld})\textsuperscript{157}. This means that the debtor’s employees have claims against the Federal Employment Agency to get their salaries during or shortly before restructuring proceedings up to a maximum period of three months. Since it takes some time until these claims are determined, especially in cases of a continuation of the debtor’s business, banks often pre-finance the insolvency aid in return for an assignment of the employee’s claims against the Federal Employment Agency. Nonetheless, three months is not a long period, in particular for large and complex reorganizations. Insolvency aid cannot replace funding through possibilities such as the release of cash collateral or DIP financing. But the legislator did not create rules which explicitly aim at improving financing. Some of the new provisions in German

\textsuperscript{154} \textit{Insolvency Statute, supra} note 42, s 55(2) (Echter Massekredit); \textit{Insolvency Statute, supra} note 42, s 264(1) (Kreditrahmenkredit).

\textsuperscript{155} Knof, \textit{supra} note 147 at 2004.

\textsuperscript{156} \textit{Ibid.}

insolvency law indirectly facilitate obtaining sufficient funding during a restructuring process.\textsuperscript{158} The newly introduced debt-equity swap may produce positive effects on the debtor’s balance sheet and it improves the data relevant for credit ratings.\textsuperscript{159} Furthermore, the new limitation period applicable to claims that are unknown during insolvency proceedings and become known at a later point in time improves the business’ chances in securing DIP financing since there are less bad surprises that could later surface for creditors.\textsuperscript{160}

The increase in restructuring proceedings following the 2012 reform, which did not provide direct improvements to the provisions regarding DIP financing, can be explained by the large number of other legal changes. I believe that changes such as the acceleration of proceedings and the restriction of individual creditors’ rights to oppose the plan led to a greater degree of trust of creditors in the process.

Accordingly, this element of the rescue culture policy is better internalized in the US and Canada.

7 Interim result of Chapter 4

A rescue culture policy can be found in all three jurisdictions. Although it is embraced to a larger extend in the US and Canada, especially with respect to a de-stigmatization of the process, a support of an early restructuring and funding during the process, Germany has nevertheless introduced a number of new provisions that have led to a notable approximation of the German law to the American approach. Especially with changes regarding uncertainties in the process

\textsuperscript{158} \textit{Insolvency Statute}, supra note 42, ss 225a, 258(2), 259a, b.

\textsuperscript{159} Knof, supra note 147 at 2008.

\textsuperscript{160} Ibid.
that disadvantaged both debtors and creditors, the role of the debtor and restrictions of disturbers, the legislator has made a successful restructuring much more likely. The German orientation towards the North-American approach does not mean that American laws are the best possible framework with respect to the embracement of the rescue culture. As discussed further below, there are also deficiencies in several American rules, e.g. with respect to financing (see Chapter 5, 2.1.4).
Chapter 5
Practical problems with the rescue culture

In Chapter 5 of the thesis I am going to concentrate on recent developments in the outcome of restructuring proceedings in the US, Canada and Germany. I am going to analyze the development of an increasing number of US and Canadian restructuring proceedings used for a liquidation of the debtor’s assets and ask the question of whether this trend also takes place or is likely to take place in the future in Germany. I come to the conclusion that restructuring proceedings in Germany are not and are unlikely to become used as a tool for liquidations. This is mainly caused by the different structure of the German insolvency process. Nonetheless, if we are observing – besides the use of restructuring proceedings for liquidations – a general trend towards more liquidations in total in the US and Canada, the factors causing this trend might frustrate the German legislator’s objection to increase the number of successful\textsuperscript{161} restructuring proceedings. In other words, the German legislator in its 2012 reform might have failed to consider important economic changes which may make restructuring proceedings less likely going forward.

1 What is happening in the United States and Canada on the one side and Germany on the other side?

For a little more than a decade the US and Canada have faced a decline in successful restructuring proceedings. There is a trend that has developed whereby restructuring proceedings are being used as a liquidation tool. Debtors, instead of being rescued, use the proceedings to sell their assets piecemeal or on a going-concern basis and divide the proceeds among their

\textsuperscript{161} Successful (or classical) means that the debtor company after restructuring proceedings continues with its business (or a part of it) as the same legal entity.
creditors. While in some cases a restructuring plan intending a sale of the debtor company is presented but finally does not work out (e.g. because negotiations among the creditors showed that a rescue will not be viable), in other cases these sales take place in the absence of a rescue plan, which means that liquidation is planned from the outset of entering the process. While in 2002 21% of the verifiable CCAA proceedings ended in liquidation, this number increased steadily to 82% in 2012. From 2002 to 2007 the number of successfully completed BIA proposal proceedings declined from 46% to 10%. At the end of the last and the beginning of the new century the number of Chapter 11 cases in which the debtor company was sold in large ranged between ca. 6 % and 9 %. Since 2003 this number has been increasing and remained constant between ca. 20 % and 30 %.

The question arises whether this trend represents a general development towards more liquidations in total, that is liquidations in cases in which the company formerly would have been rescued, or if it only illustrates a shift from liquidations within classical liquidation proceedings to liquidations within restructuring proceedings. Wood suggests that both factors contribute to the recent developments. Besides a number of

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163 The outcomes of some cases are unknown because they are still ongoing or records are incomplete.

164 Liquidation in this context means liquidation within restructuring proceedings and not liquidation due to conversion to bankruptcy proceedings under the BIA (Canada) or Chapter 7 (US).


166 Lynn M LoPucki, UCLA-LoPucki Bankruptcy Research Database, Tables and Graphs, 363 Sales, online: UCLA School of Law <http://lopucki.law.ucla.edu/tables_and_graphs/363_sale_percentage.pdf>, (exception in 2001 with 21 %).

167 Ibid, (exception in 2001 with 42 %).

168 Roderick J Wood, “Rescue and Liquidation in Restructuring Law” (2013) 53:3 Can Bus LJ 407 at 408 [Wood, “Rescue and Liquidation”]. There are no statistics in this respect. One would have to compare the changes in the relationship between the number of classical restructurings and the number of liquidations within liquidation and restructuring proceedings. The problem is that BIA DIV I records do not show whether a debtor company was liquidated or whether it continued to operate. This hint I got from Professor Roderick J Wood.
liquidations within restructuring proceedings which formerly would have been conducted within regular liquidation proceedings, this means that recently, classical reorganizations pursuing the maintenance of the debtor as a legal entity have lost support. Accordingly, we have two developments. We can observe more liquidations in total which are performed within restructuring proceedings.

As mentioned above, it is not necessarily problematic from a policy perspective that liquidations take place within restructuring proceedings since if the company is sold as a going-concern many effects are the same as within reorganization. Nonetheless, procedural concerns render the trend of liquidating debtor companies within restructuring proceedings problematic (see below under Chapter 5, 3).

The development in Germany is different. In its history, insolvency plan proceedings have never been primarily used as a realization instrument. A liquidation of the debtor’s assets predominantly takes place within classical liquidation proceedings. Insolvency plan proceedings are typically used for the rescue of the company working towards the maintenance of the debtor as a legal entity. Moreover, an increase in the total number of liquidations cannot be seen in Germany. In fact, the average number of insolvency plan proceedings measured against the total number of opened insolvency proceedings doubled from around 0.7% in 1999 to around 1.5% in 2011. First numbers after the reform of the German insolvency law in 2012 show that this number continues to rise. Accordingly, at the moment we have two different developments in

\footnote{Wilhelm Uhlenbruck, Insolvenzordnung – Kommentar, 13th ed (München: Verlag Franz Vahlen, 2010) at 2432.}


\footnote{See footnote 111. Official statistics still have not been released. But first numbers and surveys show that the number of restructuring proceedings is rising.}
Germany. The number of insolvency plan proceedings rises and these proceedings are typically not used for liquidations.

In order to determine whether the North-American trend could nonetheless take place in Germany in the future and what effects it would have, we have to take a look at the reasons and consequences of more liquidations in total (see Chapter 5, 2) and their enforcement within restructuring proceedings (see Chapter 5, 3) in the US and Canada.

2 Favor of liquidations over classical restructurings in the United States and Canada and its implications for Germany

2.1 Reasons for this trend and their occurrence in Germany

As mentioned above the development that in the US and Canada more and more restructuring proceedings do not end in a reorganization of the debtor company but in the liquidation of its assets has not only taken place due to a shift from liquidating assets within regular liquidation proceedings to a liquidation in the restructuring process. In several restructuring proceedings formerly aimed at the rescue of the debtor, a sale of the company is now intended. This development is most likely caused by the following reasons.

2.1.1 Lack of going-concern value

In order for a reorganization to be successful the company in financial distress needs to have a going-concern value. Without going-concern surplus it is not reasonable to keep a business

172 An argument for this assumption is the constant proportion of Chapter 7 and Chapter 11 cases. Since 2007 the relation of Chapter 7 and Chapter 11 cases is more or less the same. If liquidations only shifted from Chapter 7 to Chapter 11 proceedings one might suggest that the number of Chapter 7 proceedings would have dropped. Of course, there are also other circumstances that may influence the proportion between these two proceedings. Nonetheless, the fact that there are more liquidations in Chapter 11 cases but the proportion between Chapter 7 and Chapter 11 processes stays the same speaks for more liquidations in general.
afloat; the assets will fulfill the same use whether in whole or in part in another company. Baird and Rasmussen argue that US companies often do not have substantial going-concern value.\textsuperscript{173} This belief is based on the assumption that in today’s economy many assets are not especially dedicated to one firm.\textsuperscript{174} The economy has become more and more service and information based and relies less on hard assets like heavy machinery which are specialized to the needs of only one company.\textsuperscript{175} A law firm’s assets for example may only be office furniture and personal computers.\textsuperscript{176} These assets can easily be transferred to another legal entity. Moreover, intangible assets, such as know-how are usually present in more successful companies than among companies in financial distress.\textsuperscript{177} Therefore, the question of transferability of these assets does not arise for many debtors. Also assets like human capital today are more industry-specific than firm-specific and will equally fulfill their purpose elsewhere.\textsuperscript{178} Baird and Rasmussen further argue that even in cases where a company owns hard assets a going-concern value does not exist if it is the business plan that fails.\textsuperscript{179} Since a lack of going-concern value is a result of the international change of the economy the same situation can also be found in Germany.

2.1.2 Simplicity of conducting a going-concern sale

Baird and Rasmussen also argue that in cases in which the valuation of a debtor speaks for a going-concern value this does not necessarily lead to a reorganization of the company. Instead, it

\begin{itemize}
  \item \textsuperscript{173} Baird & Rasmussen, “End of Bankruptcy”, \textit{supra} note 162 at 754, 758.
  \item \textsuperscript{174} \textit{Ibid} at 768.
  \item \textsuperscript{175} \textit{Ibid} at 762.
  \item \textsuperscript{176} \textit{Ibid}.
  \item \textsuperscript{177} \textit{Ibid} at 764.
  \item \textsuperscript{178} \textit{Ibid} at 774.
  \item \textsuperscript{179} \textit{Ibid} at 767.
\end{itemize}
could be sold to a third party purchaser with equal or even higher returns. One requirement for such sale is having a purchaser with enough capital for the acquisition. In contrast to previous times, today there are single companies with enormous amounts of capital which are able to perform such deals. This argument may have lost some of its persuasiveness during the world financial crisis between 2007 and 2009. During that time liquidity problems arose. The drying up of liquid investors made the sale of a company as a going-concern more difficult. Furthermore, according to Baird and Rasmussen transaction costs also often put a ceiling on alternative operations within the company. A sale of a company may turn out to be cheaper than the costs for all the arrangements necessary to keep a company’s operations afloat. The economic change towards more financially strong companies which are able to purchase a struggling debtor is a global one. Therefore, also in Germany it may be easier to find a third party purchaser than to arrange for a reorganization of the debtor.

2.1.3 Changes in the creditors’ structure

An important reason for increasing liquidations within restructuring proceedings is mentioned by Baird and Rasmussen in an essay from 2010. While around a decade ago a single bank, as the secured lender in combination with several other unsecured creditors, shaped the typical picture of a creditor composition, today’s typical structure is radically different. While formerly all creditors had the interest of maximizing the value of the estate, creditor’s concerns became much

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180 Ibid at 777.
181 Ibid at 761.
183 Baird & Rasmussen, “End of Bankruptcy”, supra note 162 at 768.
185 Ibid at 651.
more complex. Along with the above mentioned creditors came long- and short-term investors such as private equity firms and hedge funds which in contrast to usual unsecured creditors are better informed about the debtor company and the market. Financial investors often have fundamentally different interests compared to banks. While banks might have a long term relationship with the debtor company, care about their public reputation (especially due to offerings of other services) and generally have no ownership interests, investors’ interests are often completely adversarial. Furthermore, distressed debt investing became more popular in recent years. This means that big investors such as hedge funds and private equity firms buy debts of financially distressed companies from other creditors in order to influence the reorganization process and negotiate higher returns than the former creditors would have been able to achieve or even try to get control of the debtor’s business. Especially smaller, less patient and less prepared creditors are willing to sell their claims to bigger investors to receive an immediate return. In the first place, this development does not speak against restructuring proceedings. Unsecured investors which attempt to gain control over the debtor are interested in reorganizing instead of liquidating the company. That this eventually does not take place is caused by the following facts:

- Well informed investors which adopt a “loan-to-own”-strategy are interested in supporting an insolvency plan only if it fits their needs and will be less willing than less

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186 Ibid at 651, 652, 654.
187 Ibid at 651, 652.
188 Ibid at 670.
189 Ibid at 657, 658.
190 Ibid at 661.
191 Ibid at 660.
192 Ibid at 671.
informed creditors to make concessions. Their perception of the amount of returns may not be compatible with the amounts that could be conceded to them in a feasible restructuring plan. In that case they might use their nuisance value to block the restructuring process which endangers its success. Furthermore, they will be especially unwilling to make concessions if there are other investors in the restructuring process with similar intentions, a situation which has become more common in today’s financial world. Fights among financial investors have already caused trouble in restructuring proceedings, a process that requires a prompt intervention.\textsuperscript{193} Litigation and struggle for power can cause severe risks for the success of the process.

- The various and more complex creditors’ interests detrimentally affect the creditors’ committee\textsuperscript{194} as a principal institution in Chapter 11 proceedings to mediate the interests of the unsecured creditors.\textsuperscript{195} Less consent in the creditors’ committee further delays and endangers the process of implementing a viable restructuring plan. In Canada the same takes place with respect to the monitor who brings in line the different creditors’ interests and whose work may be complicated.\textsuperscript{196}

\textsuperscript{193} See e.g. the US case \textit{re FiberMark, Inc.}, 349 BR 385 (Bankr.D.Vt. 2006), in which three hedge funds were fighting about control rights over the debtor company. This time-consuming behavior put the success of the restructuring plan at risk and was only able to be settled by a court-appointed examiner.

\textsuperscript{194} Creditors' committees can play a major role in Chapter 11 cases. The committee is appointed by the U.S. trustee and ordinarily consists of unsecured creditors who hold the seven largest unsecured claims against the debtor, see 11 USC ch 11, \textit{supra} note 82, § 1102 (1978).

\textsuperscript{195} Baird & Rasmussen, “Antibankruptcy”, \textit{supra} note 182 at 657.

\textsuperscript{196} In Canadian CCAA proceedings there is no provision for creditors’ committees. The process is supervised by the monitor who is supposed to protect creditors’ interests (see \textit{CCAA, supra} note 8, s 23, especially s 23(1)(e), advising creditors).
• Many distressed debt investors trade claims, whereby some have insider information about the debtor company. (Insider) trading\(^{197}\), which may take place when the investor is not pursuing a “loan-to-own” strategy or has lost its interest in controlling the debtor company may be contrary to the debtor’s interest in reorganization. Fast and significant returns on the investment are often the main objectives of hedge funds and private equity firms and not a long reorganization case.\(^{198}\) Such a policy leads to frequently changing creditors within restructuring proceedings which makes negotiations on a plan more difficult and jeopardizes the success of the process.

• An increasing number of financial investors own secured debt of the debtor company.\(^{199}\) Accordingly, they do not necessarily have an interest in a restructuring process (for details regarding the interests of secured creditors see Chapter 5, 3).

This change in creditor structure has also taken place in Germany. Even if the German market for distressed debt investing in its dimensions cannot be compared to the American one nonetheless it is a growing business model of financial investors such as investment banks, hedge funds and private equity firms.\(^{200}\)

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\(^{199}\) Baird & Rasmussen, “Antibankruptcy”, supra note 182 at 671.

2.1.4 Rise of secured creditors

Another reason for less classical restructuring proceedings is the rise in power of secured creditors. This power relates to both the quantity and the degree of control over the debtor company.

The increasing quantity of secured creditors is especially caused by the rising number of syndicated loans and second lien loans.\textsuperscript{201} For a syndicated loan banks and other financial investors consolidate to mitigate risks in their lending practice.\textsuperscript{202} When several lenders in coalition finance multiple debtors the default risk is lower than each lender financing one debtor. Usually senior loans do not exhaust the debtor’s borrowing capacity. Therefore, a company is able to borrow additional money.\textsuperscript{203} While this financing formerly took place on an unsecured basis, today it frequently occurs as a second lien loan, where the same assets from the senior loan serve as security.\textsuperscript{204} Also the power of secured creditors over debtor companies has increased both outside and inside of bankruptcy. More assets are covered by the security interest and the lead lender has more control over the cash of the debtor company.\textsuperscript{205} The terms for providing interim financing have changed allowing the lender to exercise wide-ranging control over the debtor company.\textsuperscript{206}

The increase in number and power of secured creditors has several detrimental effects on restructuring proceedings:

\textsuperscript{201} Baird & Rasmussen, “Antibankruptcy”, supra note 182 at 666-675.
\textsuperscript{202} Ibid at 667.
\textsuperscript{203} Ibid at 671.
\textsuperscript{204} Ibid at 671-675.
\textsuperscript{205} Ibid at 675-676.
\textsuperscript{206} Ibid at 676.
• More secured creditors and more assets covered by security interests lead to more encumbered assets in total. Thus, it gets more difficult for the debtor to acquire financing from parties other than the pre-bankruptcy lenders\textsuperscript{207} even if the DIP lender enjoys priority over (almost) all the other creditors in case of a successful restructuring, since in the case of an unsuccessful restructuring the DIP lender is in the same position as the pre-filing creditors.\textsuperscript{208}

• DIP financing, especially when provided by the pre-insolvency lender, often has to be paid dearly by the debtor. Frequently, oppressive contracts transfer almost all of the powers in the restructuring process to the secured lender.\textsuperscript{209} These contracts may contain conditions so detrimental for the debtor that a successful restructuring process is not viable.\textsuperscript{210} The DIP lender often uses its control to steer the restructuring to a sale process.\textsuperscript{211} In a sale process a secured creditor has an advantage over other bidders. Credit bidding allows a secured creditor during the sale of secured assets of the debtor to bid the amount of its debt as a non-cash bid.\textsuperscript{212} This means that he can compete with cash bidders by offsetting its bid against existing debt. Creditors making a credit bid either pursue a “loan-to-own” strategy, try to sell the acquired asset after some time when market conditions are better or intend to encourage higher bids in an auction.

\textsuperscript{207} Miller, supra note 198 at 9.

\textsuperscript{208} Wood, “Bankruptcy and Insolvency”, supra note 1 at 354.

\textsuperscript{209} See ibid at 359.

\textsuperscript{210} In re Tenney Village Co., Inc., 104 BR 562 (Bankr. D.N.H. 1989) at 568 the court rejected DIP financing since it did not support the reorganization process. I am not sure if this is always clear to the court. Furthermore, there might be no alternative if no other investor provides DIP financing.

\textsuperscript{211} Wood, “Bankruptcy and Insolvency”, supra note 1 at 359.

\textsuperscript{212} In the US credit bidding is based on 11 USC ch 3, supra note 86, § 363(k) (1978). In Canada there is no explicit provision that allows credit bidding but it is widely accepted in practice, see Joe Latham et al, “Credit Bidding in Canada – Recent Developments” (2011) 27:1 BFLR 93 at 93.
Furthermore, secured creditors have no interest in achieving higher proceeds than the amount of their collateral in contrast to unsecured creditors. If this goal can be reached by a sale process there is no need to support a more time consuming and more expensive restructuring process. In this respect the interests of secured creditors and unsecured creditors may not align.

Secured creditors are on the rise in numbers as well as in the control they have over the debtor company in Germany also. Syndicated loans are popular in Germany.  

2.1.5 Financial innovation

Finally, financial innovation also plays a role in the change of restructuring habits. It especially influences and harms restructuring efforts which have been started before filing for or outside Chapter 11, CCAA or BIA proposal proceedings. Very often communications between a debtor and creditor start before actual in-court restructuring proceedings. Filing then is only the trigger to implement the previously developed plan. Financial innovations such as credit default swaps and total return swaps endanger these efforts. Credit default swaps are credit derivatives. Simply speaking a creditor, usually a bank, tries to mitigate the debtor’s default risk by purchasing a credit default swap. The sellers of credit default swaps, usually a financial investor or another bank, pays the buyer the amount he lent to the debtor if a credit event, usually the bankruptcy or restructuring of the debtor, occurs. This leads to a change in the creditor’s

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215 Ibid at 678.
interests. While before this deal under no circumstances would the creditor have wanted the
debtor to fail, the creditor may now, due to the safeguard of the credit default swap, obtain higher
returns if the debtor’s business fails. This leads to a higher incentive to blow up the debtor
company instead of saving it. Therefore, in practice the buyer of a credit default swap will
frequently try to stop efforts to restructure the company outside statutory proceedings and instead
try to force the company to file for insolvency.

Besides credit default swaps, investments of one investor in different competing companies may
lead to situations in which the demise of one of the debtors is more beneficial than its
reorganization.

Although hedge funds and private equity companies, parties usually involved in credit default
swaps, are recovering in Germany, hedging loans with these types of derivatives occurs less
frequently than in the US. Furthermore, in Germany there is no habit of in-court pre-packaged
insolvency plans as is the case in the US. Due to the obligation of the debtor to apply for
insolvency usually there will be no time to develop a prepackaged plan if the debtor is insolvent
or over-indebted. Accordingly, the above mentioned instruments under the point of financial
innovation are less prevalent in Germany.

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216 Ibid at 681.
217 Credit default swaps played an important role in the bankruptcy of the investment bank Lehman Brothers and in
the bailout of the American insurance company AIG.
219 Tobias Bayer, “Massenvernichtungswaffen”: Mehrheit der Kreditderivate dümpelt vor sich hin“ (3 June 2010),
online: Financial Times Deutschland
<http://www.ftd.de/finanzen/maerkte/marktberichte:/massenvernichtungswaffen-mehrheit-der-kreditderivate-
duempelt-vor-sich-hin/50122242.html>.
220 Klaus Priebe, “Chapter 11 und Co.: Eine Einführung in das US-Insolvenzrecht und ein erster Rückblick auf die
2.2 Consequences of this trend in the United States and Canada

The above mentioned reasons are the main cause why many debtor companies are sold piecemeal or on a going-concern basis instead of being reorganized.\(^{221}\) As mentioned above, in terms of the rescue culture there is not much of a difference whether the debtor is liquidated on a going-concern basis or restructured. Consequences for the public very often are the same whether choosing restructuring or liquidation through a going-concern sale. In both cases the business survives, jobs are saved and other stakeholders interested in the survival of the business are protected. Social costs are avoided in either case. The only difference is that the debtor does not continue to exist as a legal entity during liquidation proceedings. Indeed, when the different restructuring proceedings were drafted the legislator considered the rescue of the debtor company as a rescue of the legal entity itself.\(^{222}\) However, the notion of rescuing the debtor has somehow changed in the insolvency community away from a rescue of the legal entity to the rescue of the operating business.\(^{223}\) Only in cases of piecemeal liquidations are rescue objectives not equally well served.

2.3 Implications for Germany

The North-American trend of a rising number of liquidations has not taken place in Germany so far. Although several of the just described reasons that lead to this development take place in Germany also, current numbers show that there are more insolvency plan proceedings and less liquidation proceedings opened. This situation has been reinforced and strengthened since the 2012 reforms. This is most likely because the number of in-court restructuring proceedings was

\(^{221}\) It seems that there is no uniform picture regarding these liquidations. In other words, it depends on the individual case whether the debtor is sold piecemeal or as a going-concern.

\(^{222}\) Bish, *supra* note 99 [forthcoming].

\(^{223}\) *Ibid.*
on such a low level. Therefore, an improvement of the legal framework for restructuring proceedings could easily lead to an increase in the numbers of insolvency plan proceedings. The main reasons for this low level of restructurings were not the reasons that led to more liquidations in North-America, but the German legislator’s failure to provide an attractive restructuring process. From my perspective, uncertainties in the process and the stigmatization caused as a result of participating in the process, a lack of co-operation and consensus by the parties involved, as well as the limited role available to the debtor were the main reasons why liquidations have clearly dominated over restructuring proceedings in Germany. But does this mean that the reasons that led to more liquidations in North-America will not have similar effects in Germany? From my perspective, the highest level of insolvency plan proceedings will be reached in the near future. In my opinion, this number will be lower than expected by many constituencies. It will probably circle around the level of restructuring proceedings in the US and Canada at the moment (accordingly, a lower level than around one or two decades ago). I think that the large increase which seems to be taking place in Germany at the moment will slow down as long as the above mentioned economic changes which have led to fewer and fewer classical restructurings in North-America continue, since many of these changes occur also in Germany. As already mentioned, the only reason why the effects on restructuring proceedings have not been the same in North-America and Germany so far is that insolvency plan proceedings in Germany were on an almost negligible level. The deficient drafting of the law so far led to the situation that most parties involved in an insolvency opposed a plan or at least had doubts about its success. Accordingly, the economic changes that led to a decline of restructuring proceedings in the US and Canada up to the present were not able to take full effect in Germany. I assume that they will start to take effect increasingly after the 2012 reform. Nonetheless, as long as
liquidations take place by way of going-concern sales (“übertragende Sanierung”) such development would not be detrimental with respect to the rescue culture.

3 Procedural concerns regarding liquidations within restructuring proceedings

3.1 Reasons and consequences of this trend

It seems that the main problems regarding liquidations within restructuring proceedings are procedural concerns. Often creditors and not the debtor are the ones who initiate restructuring proceedings as an alternative to other realization proceedings. Small unsecured creditors do not have much of a vote on whether to liquidate or to restructure. If there is a vote it only relates to the distribution of a surplus. Big unsecured creditors and secured creditors are the ones who are able to steer the process. In particular, since many CCAA liquidations are performed without any formal plan, unsecured creditors have less say in the process than secured creditors who can influence the debtor’s management in their favor. 224

Secured creditors are indifferent about the kind of proceedings initiated as long as they recover the amount of their collateral. They are not able to recover more than the value of their securities and therefore intend to choose the cheapest and quickest process to reach this goal. Liquidations compared to reorganizations are quicker and cheaper. Liquidation may however prejudice small unsecured creditors. Small unsecured creditors in some cases are able to achieve higher recoveries in restructuring proceedings. In classical restructuring proceedings, after the distribution of proceeds to secured creditors, unsecured creditors were often able to recover some

224 Nocilla, supra note 165 at 396, 397.
money.\textsuperscript{225} In restructuring proceedings in which the debtor is sold this takes place less often.\textsuperscript{226} Accordingly, in many proceedings the interests of secured and unsecured creditors do not align and it is the small unsecured creditors whose recovery rates are detrimentally affected by the current trend.\textsuperscript{227}

The question arises as to why secured creditors choose restructuring proceedings to liquidate a debtor’s assets and not classical liquidation proceedings.

In some cases a liquidation within restructuring proceedings may be more profitable than a liquidation within bankruptcy proceedings. During bankruptcy proceedings in the US and Canada a trustee carries on the debtor’s business and the trustee needs time and will incur costs until he is able to decide how the company should be liquidated. At the beginning of the process he does not have knowledge of market conditions, former transactions, relationships with customers or suppliers, existing assets, etc.\textsuperscript{228} This consumption of time and money may endanger a more profitable going-concern sale. Moreover, for example, due to existing liabilities many trustees are unwilling to carry on the debtor’s business over a longer timeframe, which, in the case where a buyer is not found quickly, may also lead to a loss of going-concern value and to a usually less profitable piecemeal liquidation of the company.\textsuperscript{229} The BIA provides for the

\begin{flushright}
\textsuperscript{225} Bish, \textit{supra} note 99 [forthcoming].
\textsuperscript{226} Ibid.
\textsuperscript{227} Ibid.
\textsuperscript{229} Ibid.
\end{flushright}
appointment of inspectors by the creditors in bankruptcy proceedings.\textsuperscript{230} Inspectors supervise the trustee and must authorize important decisions regarding the administration of the estate otherwise decided by the trustee himself.\textsuperscript{231} Nonetheless, some of the bigger creditors, especially secured creditors, are able to exercise control over the supervisors of a restructuring process, a power that seems to be not available to the same extent under bankruptcy proceedings and which allows them more control of the process.

In Canada besides bankruptcy proceedings and CCAA proceedings secured creditors can also chose to conduct a liquidation within receivership proceedings.\textsuperscript{232} \textsuperscript{233} Receivership is a certain kind of control right for a secured creditor which, in case of an occurring default\textsuperscript{234}, allows the appointed receiver to carry out the management of the debtor’s business or to enforce the creditor’s security interest by way of selling assets.\textsuperscript{235} Receivership is a court-supervised process specifically suitable for going-concern sales.\textsuperscript{236} It provides many features similar to restructuring proceedings. For example, courts usually authorize super-priorities of interim financing charges or administrative costs.\textsuperscript{237} Furthermore, in cases in which there is a court-appointed receiver,

\textsuperscript{230} \textit{BIA, supra} note 7, ss 116-120. For details regarding inspectors, see Wood, \textit{“Bankruptcy and Insolvency”}, supra note 1 at 223-226.

\textsuperscript{231} I was unable to find any literature on the effectiveness of inspectors protecting creditors’ interests, in particular, in helping to ensure that the trustee sells the assets for the best possible price.

\textsuperscript{232} \textit{BIA, supra} note 7, ss 243-252.

\textsuperscript{233} Receivership proceedings and bankruptcy proceedings can also take place at the same time, see Wood, \textit{“Bankruptcy and Insolvency”}, supra note 1 at 470.

\textsuperscript{234} The debtor does not have to be insolvent, in order for the creditor to appoint or apply for the appointment of a receiver.

\textsuperscript{235} Wood, \textit{“Bankruptcy and Insolvency”}, supra note 1 at 468.

\textsuperscript{236} Wood, \textit{“Rescue and Liquidation”}, supra note 168 at 411.

\textsuperscript{237} Ibid at 412.
typically a stay of proceedings is ordered. Therefore, Wood is of the opinion that it is difficult to see how a going-concern sale process could obtain higher proceeds and be more efficient when controlled by the debtor instead of a receiver. A reason why in many cases creditors nonetheless prefer CCAA proceedings over receivership proceedings could be the decision of the Canadian Supreme Court in *TCT Logistics*. In this case the court decided that a receiver cannot be immunized from his or her liability as successor employer. Since such immunization is possible under CCAA proceedings this ruling could be an incentive for restructuring professionals to favor CCAA proceedings even if they do not seem appropriate for the debtor company. However, this liability problem was addressed in the 2005/2007 amendments of Canadian bankruptcy law. Ever since, no receiver or trustee can be personally liable for any liability such as being liable as a successor employer. Nonetheless, doubts remained after these legislative amendments whether this protection is exhaustive. Finally, a reason for a rising number of liquidating CCAA proceedings could be that CCAA proceedings give more flexibility to secured creditors. The receiver in receivership proceedings and the monitor in CCAA proceedings are supervising the respective proceedings. Probably, they are differently receptive to creditors’ influence. There are two different types of receivership, the privately appointed receiver and the court appointed receiver. While traditionally only the court appointed receiver was subject to court supervision a court is now able to supervise the operations of a privately

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238 Wood, “*Bankruptcy and Insolvency*”, *supra* note 1 at 482.

239 Wood, “*Rescue and Liquidation*”, *supra* note 168 at 412.

240 *GMAC Commercial Credit Corp. – Canada v. TCT Logistics Inc.*, 2006 SCC 35 at paras 52, 66, 73, 84, 129, [2006] 2 SCR 123.

241 Nocilla, *supra* note 165 at 401.

242 *BIA*, *supra* note 7, s 14.06(1.2).
appointed receiver. Accordingly, both kind of receivers act in the interest of all the creditors. The monitor is also an officer of the court. His main duty is to provide the creditors and the court with information about the debtor’s financial status. Furthermore he especially advices and assists the debtor. With increasing frequency secured creditors have influence on the debtor’s management. Therefore, Wood is of the opinion that in the end the monitor may work for the benefit of the secured creditor. Furthermore, he claims that it is easier for a secured creditor to exert influence on the monitor than on the court-appointed receiver whose duties are better defined. Against these arguments it could be said that courts should supervise the work of a monitor. If the monitor for example does not prevent the debtor of obtaining a purchase price which is detrimental for the unsecured creditors the court will probably object to such an action. Nonetheless, Wood’s arguments of larger control possibilities do not seem to be completely unreasonable explanations of the growing support of secured creditors for CCAA proceedings.

Accordingly, it seems that secured creditors probably choose restructuring proceedings instead of classical liquidation proceedings because it is the easiest way to achieve the highest possible return. It is possible that in CCAA proceedings they have the most far-reaching possibilities to influence and steer the process.

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243 Wood, “Bankruptcy and Insolvency”, supra note 1 at 471.
244 Wood, “Rescue and Liquidation”, supra note 168 at 413.
245 Ibid.
246 Ibid.
247 See Wood, “Bankruptcy and Insolvency”, supra note 1 at 391.
3.2 Possibilities to change this trend

The question arises whether the legislator or the courts should do something about the rising imbalance between secured and big unsecured creditors on the one hand and small unsecured creditors on the other hand. An idea would be to make it clear that restructuring proceedings usually can only be used for restructuring proceedings. Liquidation proceedings typically would have to take place within classical liquidation proceedings. Guidelines for court approval of sales of assets under restructuring proceedings could be set out. Liquidating restructuring proceedings would be prohibited if the fundamental purpose of such a process is not complied with by the sale. Therefore, the purpose of the respective restructuring proceeding would have to be clarified by the parliament or the Supreme Court. Furthermore, the debtor’s intention would have to be scrutinized. Only after the examination of the viability of a restructuring plan would a liquidating restructuring process be considered.

Such alterations would only make sense if unsecured creditors were better protected then. This would only be the case if unsecured creditors in classical liquidation proceedings had more say in the decision whether the debtor company should be restructured or liquidated or if their recovery rate was higher through a liquidation in such proceedings compared to the rate in liquidating restructuring proceedings. Also in bankruptcy proceedings unsecured creditors have no say in the decision whether the debtor is restructured or liquidated. Admittedly, the trustee in bankruptcy proceedings acts in the interest of all creditors. This means for example that he has

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248 For CCAA proceedings see Nocilla, supra note 165 at 404.
249 For CCAA proceedings see ibid.
250 For CCAA proceedings see ibid at 405.
251 For CCAA proceedings see ibid.
252 Wood, “Bankruptcy and Insolvency”, supra note 1 at 220.
to conduct a sale which brings the best possible price. But as mentioned above also within CCAA proceedings there are mechanisms to secure that the monitor makes sure that the debtor gets the best possible price. Whether these mechanisms work efficiently, in other words whether courts are always aware of a monitor, who does not make sure that the debtor complies with his duty to act impartially in conducting the sale, is outside the scope of this thesis. In a court appointed or privately appointed receivership unsecured creditors still do not have a say in the question whether restructuring or liquidation should take place. Furthermore, in both kinds of receiverships, the receiver is under the obligation to act in the interest of all the creditors. While the court appointed receiver was always supervised by the court to achieve the best price, by now there are also mechanisms to ensure that the privately appointed receiver gets the best possible price. Both kinds of receivers are subject to the same duties as the secured party itself pursuant to the provincial Personal Property Security Acts (PPSAs). Accordingly, they have to sell the collateral for the best possible price. Nonetheless, also within CCAA proceedings supervisory mechanisms exist.

Accordingly, it seems that stricter prerequisites to conduct liquidating restructuring proceedings would not constitute a significant improvement for small unsecured creditors. Even if we assume with Wood that the monitor is more receptive to creditor influence and consider the supervision of the monitor through the court as not sufficient to observe his actions, a liquidation within classical liquidation proceedings would change the situation of unsecured creditors only to a slight extent. Their say regarding the restructuring or liquidation of the debtor would be the same.

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253 For the Ontario PPSA see Personal Property Security Act, RSO 1990, c P-10, s 1(1), “secured party”, which includes receivers in its definition. Part V of this Act contains provisions requiring the secured party to sell the collateral for the best price reasonably obtainable.
in restructuring proceedings and classical liquidation proceedings. It seems that in some cases their recovery rate might be higher in classical liquidation proceedings.

In order to significantly improve the role of small unsecured creditors within restructuring proceedings, receivership or classical liquidation proceedings more far-reaching reforms of bankruptcy law are necessary, for example restrictions of securities within bankruptcy proceedings or strengthening the role of unsecured creditors. The evaluation of the feasibility of these extensive changes is outside the scope of this thesis.

3.3 Implications for Germany

Also in Germany secured creditors are interested in the cheapest and quickest process to achieve the amount of their collateral. Liquidation instead of reorganization is typically cheaper and quicker. The question arises whether secured creditors would favor a liquidation within restructuring proceedings as it happens in North-America.

Liquidations whether piecemeal or on a going-concern basis, usually take place within classical liquidation proceedings, although literature generally accepts the possibility of liquidations within insolvency plan proceedings.\(^{254}\) This is mainly caused by the different structure of the German insolvency process. There is one united insolvency proceeding whether for liquidation or restructuring of the debtor company. The only difference is that in the case of a restructuring an insolvency plan is presented in which the parties can deviate from some of the provisions of the Insolvency Statute.\(^ {255}\) This means that a restructuring process takes place if an insolvency plan is presented. In case no plan is presented we deal with liquidation proceedings. Put in

\(^{254}\) See Kübler, *supra* note 61 at 19.

\(^{255}\) For details see footnote 43.
different words, except under the development of an insolvency plan no liquidation can take place within restructuring proceedings. But a sale within insolvency plan proceedings is considered more cost-intensive and time-consuming than a liquidation without a plan, namely within liquidation proceedings.\textsuperscript{256} Therefore, creditors have little incentive to opt for a liquidation within restructuring proceedings.

Furthermore, creditors’ possibilities to exercise control are sufficiently protected in liquidation proceedings.\textsuperscript{257} Although controlled by an insolvency administrator, the creditors’ committee and the creditors’ assembly (Gläubigerversammlung) have to confirm a going-concern sale, and the administrator has the duty to inform the creditors and preserve their interests in the sale process.\textsuperscript{258} Moreover, opportunities available to creditors to influence the insolvency monitor in cases of debtor in possession are not really higher than the influence exerted on the insolvency administrator since their duties are similar in many respects.

Not least in Germany a different understanding exists of who is best placed to continue operating the debtor’s business. It was often claimed that the debtor cannot be trusted and continue the business himself anymore since under his responsibility the company became insolvent.\textsuperscript{259} This was the general notion even if insolvency predominantly was not the debtor’s fault. Accordingly, German creditors had less prejudices of an insolvency professional controlled process than

\begin{footnotesize}
\textsuperscript{256} Kübler, supra note 61 at 20.
\textsuperscript{257} Ibid.
\textsuperscript{258} Ibid.
\textsuperscript{259} Ibid at 8.
\end{footnotesize}
North-American creditors might have. This also explains why practically no use is made of the theoretical option to use debtor in possession also within liquidation proceedings.  

All this shows is that, compared to the situation in North-America, it seems rather unlikely that German restructuring proceedings are used for liquidations. Accordingly, procedural concerns regarding the way in which liquidations take place will not be of the same importance in Germany as in the US and Canada.

4 Conclusion of Chapter 5

In Chapter 5 of this thesis we discovered that for a little more than a decade the number of liquidation proceedings has risen in the US and Canada. This development has been to a large extent caused by a change in the global economy. Less debtor companies have a going-concern value. Furthermore, in some cases going-concern sales are easier to conduct than a reorganization of the debtor. The conduct of some classes of creditor has also contributed to the rising number of liquidations, especially the conduct of secured creditors. Fights among creditors with competing or differing interests, or the desire of quick money of many financial investors diminishes the number of successful restructuring proceedings.

We have seen that the effects of all of these developments are not necessarily negative if instead of reorganizations a going-concern sales take place. In both cases the debtor’s business survives, jobs are saved and other stakeholders interested in the survival of the business are protected. The only difference is that the debtor does not continue as a legal entity during liquidation proceedings. It seems that in either case objectives of the rescue culture are equally well served.

260 See *ibid* at 19.
We also discovered that many of these liquidations take place within restructuring proceedings. This development leads to procedural concerns since small unsecured creditors do not get a vote on whether to liquidate or restructure the debtor company. Small unsecured creditors are able to recover some money in restructuring proceedings if the process brings a surplus. Therefore, in some cases they would vote for a reorganization.

We have seen that there is not much the legislator can do about this except by introducing far-reaching changes in insolvency law. Prohibiting liquidations within restructuring proceedings does not seem to provide significant improvements for unsecured creditors.

In Germany liquidations usually do not take place within restructuring proceedings but in classical liquidation proceedings. This is mainly caused by the different structure of German insolvency proceedings. There is only one single process whether the debtor company is liquidated or restructured. Therefore, procedural concerns are less likely to occur in Germany.

We found out that the reasons that led to more liquidations in total in North-America to a large extent can also be found in Germany. Nonetheless, the current trend, especially after the 2012 reform, shows an increasing number of restructuring proceedings and thereby a development that is contrary to what has occurred in the US and Canada. The main reason why the number of in-court restructuring proceedings was on such a low level before the reform was the unattractiveness of the legal framework. Since the 2012 reform improved the framework in various parts I am of the opinion that after the reform the North-American reasons will start to take effect. I do not think that the German legislator has considered these economic changes in North-America. Therefore, from my perspective the rise of the numbers of restructuring proceedings will not be as high as estimated from the legislator. I assume that the number of restructuring proceedings in Germany will reach a similar level as in the US or Canada at the
moment. This shows that it would have been better for the German legislator to improve restructuring proceedings at a time when they were booming in North-America. Now that restructurings seem to become less likely effects of a reform are probably less far-reaching in practice. In order to raise the number of restructuring proceedings a bit further, Germany could think about introducing provisions which explicitly facilitate obtaining DIP financing.\textsuperscript{261}

Nonetheless, I would consider the 2012 reform useful. Insolvency plan proceedings have been on such a low level before the reform that even if the increase of this number is not as high as expected a rise of these proceedings is good news. Especially in cases in which a sale of the debtor company is unlikely, for example due to the lack of a third party purchaser, it makes sense to have a well drafted legal framework for the restructuring of these companies.

Countries which are currently thinking about introducing reforms to their restructuring laws so as to increase the number of such proceedings should keep in mind the North-American economic changes. More research is needed to determine whether restructuring is still a viable option or whether law makers should not concentrate too much on it.

\textsuperscript{261} As mentioned in Chapter 4 of this thesis the 2012 reform touches DIP financing only indirectly.
Chapter 6
Conclusion

The thesis began by considering the restructuring proceedings in the three jurisdictions of Canada, Germany and the US. Besides the numerous differences in the various proceedings, we found out that all jurisdictions share a common core with respect to the objectives of restructuring law and the restructuring process. The thesis took a closer look at the meaning, development and effectiveness of the rescue culture. We found out that a rescue cannot only take place within restructuring proceedings. A going-concern sale of the debtor can also be considered as a rescue of the debtor’s business. The only difference between this and classic restructuring proceedings is the fact that within liquidations the debtor does not continue to exist as a legal entity. Furthermore, we found out that it is a matter of degree in how far a legislator embraces the rescue culture policy. In Chapter 4 of the thesis I come to the conclusion that all three jurisdictions embrace the rescue culture policy to a certain extent. Although restructuring proceedings are embraced to a larger extent in the US and Canada, Germany, in particular through its 2012 reform, has introduced several provisions which make a successful restructuring more likely. In the final part of my thesis I discussed the practical problems with the rescue culture and came to the conclusion that more and more restructuring proceedings end in the liquidation of the debtor company. It is especially procedural concerns that give rise to criticism. Even if these procedural concerns are unlikely to occur in Germany, and although the current development in Germany shows a rising number of classical restructuring proceedings, it seems that the trend towards more liquidations will also affect Germany in the near future.
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