CORPORATE RESCUE
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Preface

The Netherlands Association for Comparative and International Insolvency Law (NACIIL) (in Dutch: Nederlandse Vereniging voor Rechtsvergelijking en Internationaal Insolventierecht, NVRIIL) has been established in 2011. Its goal is to promote the interest for and the knowledge of comparative and international insolvency law. The association will for this purpose hold conferences and organise lectures or courses, initiate student initiatives and the publication and distribution of articles and reports. As many of the initiatives will be in English, the association also reaches out to professionals, scholars and students (with their COMI) outside the Netherlands in an aim to further jointly the development of comparative and international insolvency law. Presently the Association has over 150 members.

Its second Annual Conference was held on November 8, 2012, in Amsterdam. Central topic at this Annual Conference is the theme “Corporate Rescue”. In the draft-reports proposals for a European Rescue Plan have been developed and the recently (March, 2012) implemented changes in Germany for improvement of “company rescue” (Gesetz zur weiteren Erleichterung der Sanierung von Unternehmen) have been analysed. The reports are written by Robert van Galen, Esq. (Nauta Dutilh N.V. & member of the board of NACIIL) and Prof. dr. Stephan Madaus, University of Regensburg, whom was awarded a PhD in 2010 on his comparative study “Der Insolvenzplan”. We are confident that these reports will be of influence (both nationally as well as on a European level) in the debate about how to structure an efficient rescue regime, which also safeguards the rights of all parties involved. The reports have been finalised taking into account the discussions during the conference.

The board of NVRIIL thanks both reporters for their expertise and commitment to deliver their reports.

We would also like to thank the sponsors who have made the Annual Conference possible Houthoff Buruma, SDU Publishers and Kluwer Legal Publishers.

For further information about NACIIL see: [www.naciil.org (eng)](http://www.naciil.org) or [www.nvrii.org (nl)](http://www.nvrii.org)

Board NVRIIL
May 2013
Jaarrede Prof. mr. B. Wessels

Rede van de voorzitter, Prof. mr. B. Wessels

Is de Nederlandse faillissementswetgeving ‘globalisation proof’?

Tweede jaarvergadering, Amsterdam, donderdag 8 november 2012

Dames en heren,

Er steekt een enorme juridische storm op over Europa. Waar de economisch-financiële storm iets lijkt te zijn gaan liggen, is in Europa de wetgevings-wind afgelopen jaar waarlijk opgestoken. Ik loop de belangrijkste ontwikkelingen met u door.

Eind vorig jaar nam het Europese Parlement een motie aan die de Europese Commissie verzoekt met doortimmerde voorstellen te komen “..... relating to an EU corporate insolvency framework”. Het Europese Parlement vraagt de Commissie ook voorstellen voor te bereiden om te komen tot harmonisatie van nationale insolventiewetgevingen. Wat 10 jaar terug voor geheel onmogelijk werd gehouden wordt nu, zij het voorzichtig, als werkbaar alternatief gepresenteerd om stukjes insolventiewetgeving te harmoniseren vooral om grensoverschrijdende zaken efficiënter te laten verlopen.

In het voorjaar van dit jaar startte de lang verwachte evaluatie van de Europese insolventieverordening. De onderzoeks- en discussie-periode is uitzonderlijk kort geweest, zo’n acht maanden. De voorstellen van de Commissie zullen waarschijnlijk in december het licht zien. Het valt te vrezen dat deze voorstellen de vrucht zullen zijn van een voorbereiding die onder een enorme tijdsdruk heeft plaatsgevonden. De ervaring leert dat dergelijke wetgevingsproducten niet altijd de best denkbare zijn.

In juni van dit jaar is in Nederland een systeem van interventie ten aanzien van banken en hun mogelijke insolventie inwerking getreden. Wijzigingen vonden plaats in een groot aantal wetten, onder andere in het BW en de Awb, maar met name in de Wet op het financieel toezicht en de Faillissementswet, in de laatste met ruim 30 wetsbepalingen. Het Staatsblad met de wijzigingen verscheen in juni, maar dankzij een merkwaardig staaltje van wetgeving, zijn deze bepalingen met terugwerkende kracht tot 20 januari 2012 ingevoerd.
In diezelfde maand juni verschijnt van de Europese Commissie een voorstel voor een Europese richtlijn “… establishing a framework for the recovery and resolution of credit institutions and investment firms.” Daarin betekent “resolution” de “… restructuring of an institution in order to ensure the continuity of its essential functions, preserve financial stability and restore the viability of all or part of that institution.” Resolution wordt gepresenteerd als een alternatief voor “normal insolvency procedures”, waarvan de definitie nagenoeg woordelijk aansluit bij de definitie in artikel 1 van de Insolventieverordening. In onze taal zal “resolutie” waarschijnlijk als nieuw juridisch begrip worden geïntroduceerd. Het is te hopen dat mogelijke wijzigingen in de Insolventieverordening worden afgestemd op deze ontwerp-richtlijn, omdat interne consistentie binnen het EU recht wel een eerste vereiste van behoorlijk wetgeven is.

Als klap op de vuurpijl verschijnt op 3 oktober van de hand van EU commissaris Barnier een nieuw visie-document. Het legt de wens neer “…… for a strong, deep and integrated Single Market which creates growth, generates jobs and offers opportunities for its European citizens which were not there 20 years ago.” Ik citeer: “The completion of the Single Market is a continuous exercise and is a central element of the European growth agenda to address the current economic crisis. This is why the European Commission has today adopted Single Market Act II, putting forward twelve key actions for rapid adoption by the EU institutions.” Één van de, wat in marketing-jargon wordt genoemd, “…… main drivers for growth, employment and confidence”, is “b) cross border mobility of citizens and businesses”. Op zich is dat nog weinigzeggend, maar dat wordt anders nu als derde actiepunt in deze categorie wordt genoemd: “…… (iii) modernise insolvency proceedings, starting with cross-border cases, and contribute to an environment that offers second chances to failing entrepreneurs.” Behalve de wijzigingen in de Insolventieverordening, waaraan Barnier refereert, zijn er andere voorstellen te verwachten. In Barnier’s woorden: “…. However, we need to go further. At present, there is in many Member States little tolerance for failure and current rules do not allow honest innovators to fail ‘quickly and cheaply’. We need to set up the route towards measures and incentives for Member States to take away the stigma of failure associated with insolvency and to reduce overly long debt discharge
periods. We also need to consider how the efficiency of national insolvency laws can be further improved with a view to creating a level playing field for companies, entrepreneurs and private persons within the internal market. To this end, the Commission will table a Communication together with the revision of the European Insolvency Regulation.” Ik wijs u erop dat u binnenkort dus kunt meepraten! Sterker nog, de voorstellen omtrent Corporate Rescue die we vanmiddag gaan bespreken kunnen dus eind dit jaar al bij de Europese Commissie op tafel liggen!

Kortom, de Europese ontwikkelingen denderen over ons heen. De ontwikkeling van onze vereniging is daarvan een weerslag: in 14 maanden van 0 naar ruim 150 leden en vier activiteiten dit jaar. Met onze vereniging willen wij aan de spits lopen van ontwikkelingen in het internationale insolventierecht. En daarmee zijn wij goed op weg, want het zijn de internationale ontwikkelingen die ons de komende jaren in de greep zullen houden.

HoeandersisdatinNederland. Daarzijnwetgevingsontwikkelingen begin vorig jaar door de thans weer missionaire minister Opstelten tot stilstand gebracht. Het Voorontwerp is om weinig overtuigende redenen een halt toegeroepen. In mijn vorige jaarrede heb ik aangegeven dit te betreuren, omdat Nederland nog steeds geen behoorlijke reorganisatie-regeling kent zoals in landen om ons heen. Daarnaast is – dat blijkt ook uit de al vijf jaar durende legal thriller met Yukos Oil – ons internationaal insolventierecht, enkel gebaseerd op rechtspraak, obsoleet. Buitenlandse partijen kunnen het amper kennen, want het is niet duidelijk vastgelegd. Er is geen efficiënte erkenningsregeling, er is geen zekerheid over toepasselijk recht en er is geen basis in de wet voor grensoverschrijdende coördinatie van procedures door curatoren en rechters. Mijn oproep van vorig jaar om het in 2007 in het Voorontwerp in afdeling 10 opgenomen stelsel van “Internationaal Insolventierecht” met spoed ter hand te nemen is kennelijk – en helaas! – aan dovemansoren gericht geweest. Nederland kan zich op het terrein van het internationaal insolventierecht beslist niet meten met de wetgeving van de Verenigde Staten en onze buurlanden Engeland, Duitsland en België.
We zijn nu een jaar verder. De ontwikkelingen gaan ongeremd voort. Enkele andere Europese lidstaten hebben de UNCITRAL Model Law ingevoerd, waarbij landen als Slovenië en Griekenland in de wet hebben verankerd dat curatoren in internationale gevallen protocollen kunnen aangaan. Bij ons in Nederland niets van dat alles. Er is slechts één stormpje, overigens niet beperkt tot een glas water: het kabinet heeft in het Belastingplan 2013 flux een herijking van het bodemrecht voorgesteld, waardoor de fiscus naar schatting € 100 miljoen op jaarbasis extra kan gaan binnenharken. Voor het eigen belang van de Staat wordt in de wetgeving goed gewaakt. Is dat alles? Ik vrees het wel. Ik weet niet of u de moeite heeft genomen voorafgaand aan de recente verkiezingen de programma’s van de politieke partijen door te nemen. Ik zal u de speurtocht besparen. Op een enkele partij na, die lippendienst bewijst aan steun voor gemeentelijke schuldhulpverleningsplannen, is “herziening van insolventiewetgeving” of “stimulering van kansrijke ondernemingen die tijdelijk in een liquiditeitsdip zitten” geen punt van aandacht. Ook in het twee weken geleden gepresenteerde regeerakkoord wordt geen enkele brug geslagen naar faillissement, laat staan herziening van de wetgeving daarover.

So the ultimate question is: can Dutch insolvency law withstand the test of time? De genoemde ontwikkelingen zo overziende denk ik dat op langere termijn te vrezen zal zijn dat de Nederlandse insolventiewetgeving niet globalisation proof is. Het bestaande bouwwerk is nu al wankel. Het is, wellicht met uitzondering van de recente Interventiewet, ook onvoldoende ingericht en toegespitst om deze internationale ontwikkelingen te dragen. Dat is slecht voor partijen (zoals schuldeisers) wier positie adequaat beschermd moet worden, dat schept onzekerheid, vooral voor buitenlandse investeerders, dat legt teveel druk op het rechterlijk apparaat en dat is slecht voor de reputatie van Nederland dat economisch wel vaart bij goede internationale commerciële verhoudingen.

Ik wens u een goede jaarvergadering toe.

Prof. mr. B. Wessels, Leiden / Dordrecht
Annual address Prof. dr. B. Wessels (Summary)

Annual address professor Bob Wessels, Chairman of the Netherlands Association for Comparative and International Insolvency Law, Second

Is Dutch Insolvency Legislation ‘globalisation proof’?

Annual meeting, Amsterdam, Thursday November 8, 2012

A legal storm affects Europe. November last year the European Parliament requested the European Commission to submit solid proposals “….. relating to an EU corporate insolvency framework”, including proposals to harmonise parts of national insolvency laws. In Spring this year the evaluation of the EU Insolvency Regulation started. The Commission’s proposals are to be expected in December 2012. The speed of this process does not warrant a well-balanced outcome. In June this year in the Netherlands the Intervention Act was introduced for a system of resolution of banks, leading to many legal changes, including some thirty in the Bankruptcy Act. In that same month the European Commission published a draft-directive “….. establishing a framework for the recovery and resolution of credit institutions and investment firms.” “Resolution” means the “….. restructuring of an institution in order to ensure the continuity of its essential functions, preserve financial stability and restore the viability of all or part of that institution.” Resolution is presented as an alternative to “normal insolvency procedures”, the definition of which is nearly similar as the one in Article 1(1) of the EU Insolvency Regulation. In the Dutch legal language we probably will have “resolutie” as a new legal term. And it goes on.

On 3 October 2012 EU Commissioner Barnier presented a new vision document, expressing a wish “….. for a strong, deep and integrated Single Market which creates growth, generates jobs and offers opportunities for its European citizens which were not there 20 years ago.” I quote: “The completion of the Single Market is a continuous exercise and is a central element of the European growth agenda to address the current economic crisis. This is why the European Commission has today adopted Single Market Act II, putting forward twelve key actions for rapid adoption by the EU institutions.” One of the “….. main drivers for growth, employment and confidence”, is “b) cross border mobility of citizens and businesses”, which includes to “….. (iii) modernise insolvency proceedings, starting with cross-border cases, and contribute to an environment that offers second chances
to failing entrepreneurs.” Barnier refers to the expected amendments to the Regulation, but adds: “... However, we need to go further. At present, there is in many Member States little tolerance for failure and current rules do not allow honest innovators to fail ‘quickly and cheaply’. We need to set up the route towards measures and incentives for Member States to take away the stigma of failure associated with insolvency and to reduce overly long debt discharge periods. We also need to consider how the efficiency of national insolvency laws can be further improved with a view to creating a level playing field for companies, entrepreneurs and private persons within the internal market. To this end, the Commission will table a Communication together with the revision of the European Insolvency Regulation.”

In short, European changes will influence our area of practice. Our Association reflects these developments: in 14 months from 0 to nearly 150 members, with 4 activities this year.

In the Netherlands this is all different. There is hardly any wind. Legislative changes presented by a Royal Committee in 2007 have been halted by the Dutch Minister of Justice, early 2011. We still have to live with an Act of 1896, we do not have a reliable rescue-proceeding and we miss a system of international insolvency law relating to non-EU countries. The result is a legal thriller concerning Yukos Oil. Foreign parties do not understand our system, as it is based on a few court cases. We do not have an efficient system of recognition. There is no certainty re applicable law. Our law does not provide a basis for cross-border coordination of cases between insolvency office holders and courts. In the most recent political elections of two months ago “rescue of companies”, “modernising insolvency law” or similar subjects have not been considered by any of the many political parties.

So the ultimate question is: can Dutch insolvency law withstand the test of time? Seeing these European developments we may fear that our house of insolvency legislation is not globalisation proof. The present old building is already weak. It’s architecture is insufficient to include these international concepts. This legal status is bad for parties, like creditors, whose position should be adequately protected, it creates uncertainty, especially for foreign investors, will result in case-loads of work for courts and is bad for the reputation of the Netherlands, so dependent of good international commercial relationships.

Prof. mr. B. Wessels, Leiden / Dordrecht
INSOLVENT GROUPS OF COMPANIES IN CROSS BORDER CASES AND RESCUE PLANS

Report to the Netherlands Association for Comparative and International Insolvency Law (conference of 8 November 2012)

by Robert van Galen Esq., Partner Nauta Dutilh

1: Groups of companies and their legal relevance

I. Different types of groups
II. Groups under German law
III. Consolidation and the VIIth Directive
IV. Some provisions of Dutch law
V. Conclusion

2: The preferable regime for insolvency of a group of companies

I. Insolvency, synergy margin, Pareto improvement and group compensation rule
II. Existing insolvency law with respect to groups of companies
III. Distinction between European law and other recognition cases
IV. Two ends of the spectrum of solutions
V. Regimes in ascending order of integration

3: A group rescue plan

I. Restructuring scenarios
II. Classification, cram down and confirmation under U.S. and German law
III. Classification, cram down and confirmation with respect to group plans
IV. INSOL Europe’s European Rescue Plan
V. Conclusion
VI. Comments by Professor Madaus

4: Propositions
This report discusses rescue plans with respect to international groups of companies in the European Union and, in particular, the European Rescue Plan included in the proposal made in June 2012 by INSOL Europe for revision of the European Insolvency Regulation. I should say at the outset, however, that the main topic of this report is the principles and policy considerations that play a role in connection with the effective reorganisation of groups and the interests at stake. They are relevant independently of the INSOL Europe proposal itself.

The European Rescue Plan is part of a larger draft which contains a choice on how insolvencies of international groups should be treated in general. As the regulation of international rescue plans cannot, in my view, be seen independently of this context, part of this report (Section 2) will be devoted to a discussion of which regime is preferable for insolvencies of international groups. Furthermore, no matter what regime is chosen for insolvencies of international groups, both the regime and the rescue plan require a way to determine whether or not a company is a group company. Section 1 of this report will therefore consider what constitutes a group of companies and what are its distinguishing features.

Section 1: Groups of companies and their legal relevance

I. Different types of groups

I will not attempt here to devise a definition of a group of companies. In fact, many legal systems do not provide a definition, which seems to confirm my doubts as to whether it is indeed possible to catch the concept of a group in a simple definition. The reason for this is that when we think of groups several elements spring to mind, but not all of them need to be present and probably no single element constitutes a distinguishing feature.

1 Although my views on the INSOL Europe proposal can hardly be impartial as chaired the drafting committee, I can at least discuss some of the considerations leading to the proposal. For the text of the proposal see http://www.insol-europe.org/technical-content/revision-of-the-european-insolvency-regulation-proposals-by-insol-europe/.

4. In general, a mere joining of forces such as in the formation of a cartel does not create a group of companies: an element of unified control is lacking. On the other hand, the existence of unified control does not always mean that there is a group. A small supplier may be completely dependent on a large company and may therefore be controlled *de facto* by it, but this is not usually considered to be a group. Obviously, shareholdership is an important feature and majority shareholdings (‘subsidiaries’) are usually considered to be included in the group of the majority shareholder. However, such shareholdership is not always decisive. Under § 17(2) in conjunction with § 18(1) of the German Aktiengesetz a majority shareholding only creates a presumption of a conglomerate (Konzern).

5. On the other hand, enterprises are often structured as groups of companies with business units or functions in separate legal entities. Sometimes a division is along geographical lines with separate companies for each country or region, sometimes the division depends on the type of activity (separate manufacturing, financing, trading companies) and sometimes there is a matrix-like structure. In many instances the reason for the group structure is to limit risk. Each company has its own debtors and creditors, and the insolvency of one company should not necessarily drag down the other companies. Sometimes the reasons are more of an organisational nature. Responsibilities are limited to separate companies which each have their own management structure. And sometimes the reasons have to do with the financial structure of the group. In cases where the group structure has been the result not of a blueprint but rather of a process of takeovers and joint ventures, the structure may be historically determined in the sense that assets or activities just happen to be in separate companies and were never transferred.

6. The creation of a group may generate synergy between the individual group companies. Such synergy may occur in several ways:\(^3\):

- There may be a common policy determined by the parent company.
- The companies of the group may have integrated

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\(^3\) As regards levels of integration, see I. Mevorach, *Insolvency within multinational enterprise groups*, 2009, p. 130 et seq.
businesses. Sometimes, economies of scale can be achieved if several units in different countries have similar activities. Sometimes, each of the units is responsible for a separate link in the process (vertical integration). A company that fulfils a function subservient to the group may therefore be unable to survive independently. An example would be a company that produces parts for a machine that is assembled elsewhere in the group if such parts have no other use. Businesses can also be said to be integrated where they share some kinds of support services (‘overhead’).

A group of companies may have a stronger position in the market than a single company would have. The group can negotiate more favourable contracts with other market participants because of its size or because it monopolises a certain type of assets such as mineral resources or intellectual property rights.

There may be an integration of assets. Several companies in the group may use the same intellectual property rights held by one of their number or they may share equipment. There may be financial integration.

7. There are cases in which a subsidiary is allowed to act fairly independently or where there is no real synergy between the parent and the subsidiary, and there are even cases where the parent does not have control over the subsidiary, although “subsidiary” may not be the right term here. This may be because other shareholders have certain priority shareholdings or even because a corporate governance system is in place which does not give control to the shareholders or owners or beneficial owners. Such separation of control and ownership may be achieved under Dutch law, for example by interposing a foundation as sole shareholder and giving the owners depositary receipts issued by the foundation which do not confer any voting rights and give no control over the foundation or the company. Recently, moreover, the possibility of having shares without voting rights was introduced in Dutch law.
II. Groups under German law

8. German law has a fairly sophisticated set of rules on conglomerates, which merit brief discussion because they focus on conflict-of-interest issues between the companies concerned. §§ 15-18 Aktiengesetz (law on public companies) determine when companies constitute a conglomerate. §§ 300 et seq. Aktiengesetz regulate certain consequences of the formation of a conglomerate. The starting point of the rules is a control agreement (Beherrschungsvertrag) between a controlling company and a controlled company. The distinguishing feature is that under such an agreement the controlling company has the right to give instructions to the controlled company (§ 308 Aktiengesetz). The controlled company is then bound to obey these instructions even if they are contrary to its own interests. This may be the case, for example, if the instructions are prejudicial to the business of the controlled company or to the interests of its creditors or minority shareholders.

9. § 18-I AktG provides that a controlling company and one or more dependent controlled companies constitute a conglomerate (Konzern). Where there is a control agreement there is always a conglomerate. § 76-I AktG provides that the management of an AG has some discretionary power to decide whether to follow instructions. This discretionary power also exists if there is a majority shareholder, but not if there is a control agreement. In the latter case, however, the controlling company has to provide compensation for the controlled company’s losses (§ 302-I AktG). The controlling company also has to make up for the deficit of the controlled company in any year. The rationale for these rules is that as a consequence of the right of the controlling company to instruct the controlled company, the latter company may be prevented from pursuing its own interest, i.e. the interest of its stakeholders such as employees and creditors, and must follow instructions from the controlling company. As the interests of the two companies may conflict, the controlling company has to be liable for losses sustained during the period of control.

10. The starting point for these provisions is the control agreement. It is dealt with in §§ 308-310 AktG. However, control agreements are rare, and control is usually exercised through a majority holding. §§ 311-318 AktG therefore concern the situation
in which there is control but no control agreement. § 317-I AktG provides that if there is no control agreement but the company with de facto control instructs the controlled company to enter into a transaction that is to its detriment, the controlling company should provide compensation for such loss.

11. §§ 308 et seq. AktG do not apply to private limited liability companies (GmbHs) and cannot be applied by analogy to them⁴.

12. The management of a GmbH do not have the discretionary powers available to the management of an AG. § 46-6 GmbHG provides that the shareholders may give detailed instructions to the management and only in exceptional cases may the management refuse to comply. In conglomerates the German subsidiaries are almost always GmbHs and control agreements are very rare. It follows that the provisions of §§ 308 et seq. AktG on obligations in conglomerates (with or without control agreement) do not seem very relevant. The law on GmbH conglomerates is unwritten and is based on the Treuepflicht⁵, i.e. the obligation to act in good faith. This good faith obligation means that the controlling company should not exercise its control in a way that is prejudicial to the interests of the GmbH subsidiary. However, the manner in which the good faith obligation is interpreted is connected with §§ 311 et seq. AktG, which, as mentioned above, deal with conglomerates of AG’s without control agreement.

13. Because of the focus on conflicts of interests in the German doctrine on group relations, ‘control’ is the central issue. Under § 18-I AktG, which also applies to GmbHs, the requirement is that there should be a controlling and a controlled company⁶ under the common management of the controlling company. A group of companies always exists if there is a control agreement, even if the controlling company is not a shareholder of the controlled company. If the company is a majority shareholder of another company, it is assumed that a subsidiary is controlled by the parent, but this assumption is rebuttable.

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⁵ Idem no. 239 et seq.
⁶ The statutory criterion is ‘Unternehmen’, which is rather more complex than the term company, but I will leave this aside for the purpose of this report.
III. Consolidation and the VIIth Directive

14. The EC Seventh Council Directive of 13 June 1983 (83/349/EC, L193/1) concerns the consolidation of the accounts of group companies. This directive provides that parent companies should draw up consolidated accounts for themselves and their subsidiaries, regardless of where the registered offices of the subsidiaries are situated (Article 3). A parent company is defined as a company that:

(a) has a majority of the shareholders’ or members’ voting rights in another undertaking (a subsidiary undertaking); or

(b) has the right to appoint or remove a majority of the members of the administrative, management or supervisory body of another undertaking (a subsidiary undertaking) and is at the same time a shareholder in or member of that undertaking; or

(c) has the right to exercise a dominant influence over an undertaking (a subsidiary undertaking) of which it is a shareholder or member, pursuant to a contract entered into with that undertaking or to a provision in its memorandum or articles of association, where the law governing that subsidiary undertaking permits its being subject to such contracts or provisions. A Member State need not prescribe that a parent undertaking must be a shareholder in or member of its subsidiary undertaking. Those Member States the laws of which do not provide for such contracts or clauses shall not be required to apply this provision; or

(d) is a shareholder in or member of an undertaking, and:

(aa) a majority of the members of the administrative, management or supervisory bodies of that undertaking (a subsidiary undertaking) who have held office during the financial year, during the preceding financial year and up to the time when the consolidated accounts are drawn up, have been appointed solely as a result of the exercise of its voting rights; or

(bb) controls alone, pursuant to an agreement with other shareholders in or members of that undertaking (a
subsidiary undertaking), a majority of shareholders’ or members’ voting rights in that undertaking. The Member States may introduce more detailed provisions concerning the form and contents of such agreements.’

15. Obviously the provisions of this directive aim to provide relevant information to third parties dealing with a group of companies. The definition of parent company includes both companies which have a majority financial interest and companies which have control. The directive differs from the rules of German conglomerate law in that its purpose is very different. German conglomerate law is concerned with conflict-of-interest issues and control is paramount. By contrast, the directive is concerned with the provision of financial information about the groups of companies which may in some way be contingent. Here, both control and financial interest (equity) may be relevant.

IV. Some provisions of Dutch law

16. Article 2:403 of the Dutch Civil Code (‘DCC’) provides that if consolidated accounts have been published, subsidiaries do not have to publish extensive accounts of their own, provided the parent company files a statement accepting joint and several liability with the relevant subsidiaries for their contractual obligations. Here no separate definition of parent company is used, although a subsidiary is defined as ‘a legal entity belonging to a group’ and Article 2:24b DCC defines a group as ‘an economic unit in which legal entities and/or partnerships are linked together in organisational terms’. The reason why the liability does not extend to non-contractual creditors is probably that they do not rely on a subsidiary’s accounts when entering into a legal relationship with it. As a result of the provisions of Article 2:403 DCC, the financial interests of group companies are closely interwoven. Although each company is, in principle, a separate unit and has its own assets and liabilities, the statement filed under Article 2:403 DCC creates financial interdependency. Other instruments causing such interdependency are:

- joint and several liability of group companies for a loan facility;
- tax grouping (e.g. for corporate income tax or VAT);
- intercompany claims.
17. Article 33 of the Dutch Works Council Act refers to ‘enterprises linked together in a group’. This Act concerns employee participation through works councils. The expression ‘enterprises linked together in a group’ refers to control (Dutch Supreme Court 14 March 2008, JOR 2008/94).

V. Conclusion

18. The way in which groups are defined differs from one instance to the other and depends on the purpose for which the group-concept is used. Sometimes ‘control’ is the determining factor, sometimes a majority financial interest is of importance.

Section 2: The preferable regime for insolvency of a group of companies

I. Insolvency, synergy margin, Pareto improvement and group compensation rule

19. The basic premise in insolvency laws across the world is that insolvency proceedings concern one legal entity (company) at a time and that each company has its own creditors for whose benefit its assets are available. Thus, in the case of a single company, its assets may be sold individually or as a whole (sale of business), or its creditors may agree to some kind of haircut in order to bring the value of the assets more into line with the liabilities (by decreasing the liabilities).

20. In the case of groups of companies two additional factors may complicate matters. First, there may be synergy between two or more group companies which may be lost if the assets of the companies are sold separately. The KPNQwest insolvency is a clear example of such loss of synergy. KPNQwest owned rings of fibre cable through which data were transported. The rings ran through several countries. For example, one ring ran through Germany, France, Belgium and the Netherlands. However the sections of the rings were owned by local KPNQwest companies. So the German part was owned by a German subsidiary, the French part by a French subsidiary and so on. Clearly, the proceeds of the sale of a ring would be much greater if sold as a whole rather than in sections, but in practice this proved to be impossible to achieve with respect to most of these rings. Another example is a conglomerate in which several products are
manufactured in different companies, but sales and distribution are combined. Preserving synergy may be important in the case of a liquidation. A better price may be obtained if the business or coherent parts of the business which are dispersed over several companies are sold as a whole. However, preserving synergy may also be important in cases where reorganisation is considered. For example, if the group or part of it can be refinanced, thereby allowing the business to be continued, the plan may fail if some assets which contribute to the synergy are owned by another insolvent group company and are sold to a third party. A second feature of groups is that in some cases group companies cannot survive outside the incubator that constitutes the group. Although these individual companies are considered to be separate for the purposes of creditors’ rights, they cannot exist independently of the group. For example, if manufacturing is done in one company and the necessary IP rights are held by another company, the manufacturing company may not be able to survive independently. The same may apply if one group company has all the employment contracts and makes employees available to the manufacturing or trading companies within the group. Here too, dependency may be relevant both in a reorganisation and in a liquidation scenario.

21. Since group companies are not always formed primarily to create separate pools of assets and liabilities for recourse purposes and since creditors do not always rely on this separateness, these legal structures could conceivably be ignored in insolvency proceedings so that all assets and liabilities of the group are pooled. However, it seems to me that this approach would turn things upside down. The essence of a legal entity is still that it constitutes a separate ‘container’ of assets and liabilities and that its assets are only available to its own creditors. The prevailing view is – rightly – that this basic premise should be maintained in insolvency proceedings. The principle is referred to in German as ‘Haftungstrennung’, which I will translate as ‘separateness for recourse purposes’.

22. Outside insolvency proceedings synergy is preserved and interdependency is managed by the chain of command. There may be a unified management or at least instructions from the holding company which looks after the interests of the group as a whole. In some insolvency proceedings the chain of
command is preserved. Often this is the case in preservation or reorganisation proceedings where there is some kind of debtor-in-possession concept. Even in liquidation proceedings this may be the case. However, if liquidators\textsuperscript{7} are appointed or if creditors' committees of individual companies have substantial influence, the chain of command may effectively be broken and in such cases insolvency law might be the only possible means to manage synergy and dependency. Finally, it should be noted that conflicts of interests between individual group companies may be much more pronounced in insolvency proceedings. In fact, these are conflicts of interests between the creditors of these individual group companies. If proceeds are attributed to one company instead of another, creditors of the latter company may receive less. The position is very different in the case of solvent groups because here the creditors may expect to be paid in full. Thus there is no concurrence and no manifest conflict of interests between creditors of solvent groups of companies. In cases where only the ultimate parent company has outside shareholders no manifest conflict of interests will exist between solvent individual group companies.

23. So how should these synergy/dependency/conflict-of-interest issues be resolved in insolvency proceedings? To try to answer this I will take a simple case (the design of which is borrowed from Vormstein\textsuperscript{8}). Let us assume that company A has a subsidiary B. A is a manufacturing company which uses a machine. B manufactures parts for the machine. Both A and B enter into insolvency proceedings. A's liquidator would like to reorganise, but a successful reorganisation can be achieved only if B remains in the group. However, B's liquidator would prefer B's assets to be sold and some of its employees transferred to an outside company that is prepared to pay a good price for the business. Thus, if B's business is kept in the group its creditors are worse off than they would be if the business were sold, and if B's business is sold A's creditors are worse off than if the business were kept. I think that B's liquidator should insist as a minimum condition for cooperation that B's creditors do not suffer a loss as a consequence of the cooperation and that they

\textsuperscript{7} The term ‘liquidator’ is borrowed from the European Insolvency Regulation and will be used in this report to indicate any kind of liquidator, bankruptcy trustee or administrator in insolvency proceedings.

\textsuperscript{8} F. Vormstein, Zuständigkeit bei Konzerninsolvenzen, 2005.
should receive at least the value which they would receive if B’s business were sold to the outside company. It is not necessary for them to receive cash, since if their claims trade at this higher value that may be sufficient. Thus some value will have to be transferred from A to B (in the form of a cash payment, transfer of assets or claims). On the other hand, this value transfer may not be of such a magnitude that A’s creditors are worse off than if the transaction had not taken place. It follows that the amount of the consideration to be given to the liquidator of company B will fall between (i) the value that B’s creditors fail to realise because the stand-alone preferred transaction does not take place (lower boundary) and (ii) the surplus value that A’s creditors realise because the stand-alone transaction does not take place (upper boundary) (this will be referred to as the ‘synergy margin’). The amount of the value transfer should primarily be determined in negotiations between the two liquidators. In general there is likely to be scope for negotiation because if the transaction does not take place the synergy will not be realised. The negotiations are therefore in fact about how the synergy margin is shared. The existence of scope for negotiation demonstrates that there is a conflict of interests between the insolvent companies. The example given here is somewhat theoretical, for example because it may not always be possible to determine at this stage what value B’s creditors could expect to receive if B’s business were sold. Sometimes these values will have to be estimated. Nevertheless, I would propose the following group compensation rule, which is an example of a Pareto improvement:

24. “An insolvent group company may agree to a scenario which is in the interests of other group companies but detrimental to its own creditors only if accompanying measures are taken to ensure that its creditors receive at least what they would have received under the likely stand-alone scenario for this company.”

25. An important application of this rule concerns dependent companies. If B is a dependent company it cannot sell its business to a third party. In that case it may only be able to sell its assets in a fire sale, and the value that can be realised is thus the lower boundary for the compensation (clearly, the upper boundary is the synergy margin that would be realised by the

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9 An action taken in an economy that harms no one and helps at least one person.
companies in the group scenario).

26. The negotiations between the liquidators of different companies to maximise the proceeds for the creditors may be hindered by local legislation. For example, if the legislation of Member State B provides that the assets should be sold within a certain time or in a certain way, this may prevent the liquidator of company B from entering into a transaction that maximises the proceeds for the group and for B’s creditors.

II. Existing insolvency law with respect to groups of companies

27. Under § 1408 (1) of title 28 of the U.S. Code, companies can file bankruptcy proceedings in any district in which they are domiciled or have their residence, principal place of business or principal assets. Furthermore, pursuant to § 1408 (2) of that title a company may file for bankruptcy in a court where a bankruptcy case is pending with respect to an affiliate. The affiliate venue rule enables corporate groups to file all bankruptcy proceedings in the same court. Cases involving groups of companies can be joined\(^\text{10}\) and, if trustees are appointed, the same trustee can be appointed in all or several bankruptcy proceedings\(^\text{11}\), but separateness for recourse purposes is maintained. Joint administration facilitates a group rescue plan, but the plan still needs to meet the requirements in each separate bankruptcy. In some cases, all assets and liabilities of several companies are consolidated if the companies are considered to be a single economic unit or if the assets of the various group companies cannot be disentangled. This is called substantive consolidation.

28. Under the Spanish Bankruptcy Act proceedings involving companies belonging to the same group can be joined. Group proceedings can be requested by the creditors, a liquidator, a debtor, etc.. If the request is granted the same liquidator is appointed in the insolvency proceedings of the group companies and they are supervised by the same court. The joining of the proceedings does not entail consolidation of the assets or liabilities of the group companies. However, this may be allowed if the assets are commingled to such an extent that they cannot be separated without excessive costs.

\(^{10}\) Bankruptcy Rule 1015 (b).
\(^{11}\) Bankruptcy Rule 2009 (a).
29. The Dutch Bankruptcy Act does not contain provisions on the insolvency of groups of companies. In practice, the same person is often appointed as liquidator of all or several group companies. As this does not involve consolidation of assets and liabilities, the principle of separateness for recourse purposes is maintained. In cases where conflicts of interests between estates of the group companies may arise, additional and different liquidators are sometimes appointed to look after the specific interests of the individual companies involved.

30. The prevailing view in the Netherlands is that assets should be consolidated only if they cannot be disentangled. In the Zilfa case\(^{12}\) the Dutch Supreme Court decided that in such a situation the creditors’ meetings of the group companies should be combined.

31. No legislation exists at international level. Although there are some guidelines on court-to-court cooperation, they mainly address cases in which proceedings have been opened in several jurisdictions but with respect to a single entity. However, over the last twenty years there have been a number of very important and large cases involving groups of companies such as BCCI, Montedison, Lehman and Enron and their economic impact has been substantial. There are probably two reasons for the absence of legislation: first, the topic is quite complicated, because there are very different kinds of group structures and levels of integration within groups and because there may be significant conflicts of interests between the group companies, which tend to surface mainly in insolvency situations. Second, sensitive issues of sovereignty play a role here (as the Rastelli\(^{13}\) case may have shown). There is reluctance to let the courts of another country where the parent company is located determine what should happen in the insolvency proceedings of the subsidiary. In the European context it is not surprising that the present Insolvency Regulation does not contain provisions on groups of companies, let alone on rescue plans for such groups. Even with respect to single companies full and automatic recognition of insolvency proceedings opened in another Member State has long been a sensitive issue and it took the European Union almost half a century to adopt the Insolvency Regulation.

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13 EU Court of Justice 15 December 2011, Case No. C-191/10.
32. The courts have dealt with the lack of legislation in two ways. One solution has been to develop protocols between the courts. They play an important role, particularly in transatlantic cases. Another solution that has sometimes been attempted in the European Union is to treat the centres of main interests of the group companies as being situated in the same place. Once a court has allowed concentration of proceedings by opening them with respect to several group companies, the effect of Article 16 of the Insolvency Regulation is that a decision cannot be challenged in other jurisdictions. Some well-known cases on this point are Daisystek\textsuperscript{14}, Rover\textsuperscript{15}, Montedison\textsuperscript{16}, Collins \& Aikman\textsuperscript{17} and Crisscross\textsuperscript{18}, to mention but a few.

**III. Distinction between European law and other recognition cases**

33. As regards desirable legislation on the insolvency of international groups, a distinction has to be made between cases in which groups of companies are all situated in countries that give automatic and full effect to each other’s insolvency proceedings and cases in which there is no such recognition. An obvious example of the former situation is the European Union. Under the European Insolvency Regulation, automatic recognition is given to proceedings in other Member States and the foreign liquidator in the main proceedings can exercise the powers he is charged with under the laws governing the insolvency proceedings in the home State. This system is based on the so-called Community trust which applies between the EU Member States. An example of the latter situation is provided by the UNCITRAL Model Law on cross-border insolvency. Here there is no automatic recognition and the foreign liquidator has to ask the court of the receiving State for ‘relief’ in order to act there. Such relief will usually not be governed by the law of the insolvency proceedings, but by the law of the receiving State. This paper is limited to the type of situation found in the

\textsuperscript{14} Daisystek, High Court of Justice, 16 May 2003,[2003] B.C.C. 562.

\textsuperscript{15} High Court of Justice, Chancery Division, Birmingham 18 April 2005 (MG Rover I), 2005 [EWHC] 874.

\textsuperscript{16} Dutch Supreme Court 28 April 2000, LJN AA5658 (Montedison).

\textsuperscript{17} Collins \& Aikman Europe SA Collins \& Ors, Re Insolvency Act 1986, Court of Appeal-Chancery Division, June 09, 2006, [2006] EWHC 1343 (Ch).

\textsuperscript{18} Crisscross Communications Ltd (in the UK High Court, 20 May 2003, unreported (Crisscross).
European Union.

IV. Two ends of the spectrum of solutions

34. The insolvency of international groups could conceivably be dealt with within the European Union without any legislation. In that case the realisation of the synergy margin will entirely depend on the liquidators or debtors in possession of the individual companies, who will have to negotiate matters such as how the insolvency proceedings should be coordinated, whether and, if so, how assets belonging to several group companies should be sold jointly and how the synergy margin should be shared. Sometimes there will be legal obstacles to realising the synergy margin, and I do not think that there are many examples from the past where mere negotiation between liquidators from different countries has produced an optimal result. At the other end of the spectrum is the option to forget about separate recourse, and to pool all the assets of the group companies and distribute the proceeds of that pool to all the creditors of all companies, as mentioned above at 21. This is what is called substantive consolidation under U.S. law. Substantive consolidation benefits some creditors and deprives others of what they would get if the principle of separateness for recourse purposes were applied. Let me give a simple example:

35. Let us assume that company A has 200 in assets and creditors with claims of 500, all of equal ranking. Company B has 200 in assets and creditors with claims of 1,000, also all of equal ranking. If the bankruptcies are dealt with separately A’s creditors would receive 40% of their claims and B’s creditors 20%. If, however, substantive consolidation is applied and all assets are pooled all creditors would receive 27%. Therefore B’s creditors profit to the
detriment of A’s creditors.

36. Vormstein writes in his thesis *Zuständigkeit bei Konzerninsolvenzen*\(^\text{19}\) that the American tendency to apply substantive consolidation with some regularity can be explained by the fact that American bankruptcies are geared more towards rescue whereas continental European systems perceive insolvency proceedings mostly as a means of liquidation. It may be questioned whether this view gives either system the credit it deserves. However, as mentioned at 21 above I do agree that the principle of separateness for recourse purposes should be the starting point in dealing with groups of companies and in dealing with insolvencies of international groups.

V. Regimes in ascending order of integration

37. Having briefly discussed the extremes, I will now turn to several solutions that have been suggested for the integrated treatment of insolvencies of international groups in relation to the European Union. In more or less ascending order of integration these are:

(a) coordination between the courts supervising the insolvency proceedings or between the liquidators on a non-hierarchical basis;
(b) designation of group main proceedings and coordinating powers for the liquidator of these group main proceedings;
(c) appointment of the same liquidator in all main proceedings;
(d) opening of all main proceedings in the Member State of the group COMI\(^\text{20}\) (joint administration by the court);
(e) substantive consolidation.

The last solution to be considered is the so-called flexible approach, which I will briefly discuss as item (f).


\(^{20}\) Centre of main interests
(a). Coordination on a non-hierarchical basis

38. The lightest form of coordination is coordination on a non-hierarchical basis between the courts and/or between the liquidators.

39. Rules of coordination have been fundamental both in legislation such as the European Insolvency Regulation and in guidelines such as the IBA Cross-Border Insolvency Concordat, the ILA Guidelines and the CoCo Guidelines as well as in protocols drafted for the purpose of individual cases. Most of these guidelines and items of legislation concern multiple insolvency proceedings with respect to a single debtor, for example where there are main and secondary proceedings. Some of the protocols in individual cases concern multiple debtors (groups of companies). Legislation and guidelines with respect to single companies could to a large extent also be used for coordinating proceedings in a group setting, but not without caution. Since situations with multiple debtors involve different sets of creditors, conflicts of interests are much more likely to occur between the estates of group companies than between the creditors in main and secondary proceedings involving the same company.

40. Pursuant to Article 31 of the European Insolvency Regulation the liquidators in the main and secondary proceedings have a duty to communicate to each other information which may be relevant to the other proceedings. They also have a duty to cooperate with each other. The liquidator in the secondary proceedings should give the liquidator in the main proceedings an early opportunity of submitting proposals on the liquidation or use of assets in the secondary proceedings. These rules concern communication between liquidators, not between courts. In the context of the current revision consideration is being given to the inclusion of rules on cooperation and coordination between courts and between courts and liquidators. The INSOL Europe proposal does not contain such rules. When the proposal was being drafted the judicial wing of INSOL Europe was discussing such rules and the INSOL Europe drafting committee wished to avoid intervening in or preempting that process. Since then the judicial wing has drafted proposed rules enabling courts to communicate with each other.
41. Articles 25-27 of the UNCITRAL\textsuperscript{21} Model Law contain provisions on court-to-court communication. Courts should cooperate to the maximum extent possible with foreign courts and foreign liquidators. Communication can take place directly or through the liquidator. Liquidators should also cooperate wherever possible under the supervision of their court and should be entitled to communicate directly with the foreign court. Cooperation may be provided for in an agreement for that purpose adopted by the relevant courts.

42. The IBA\textsuperscript{22} Cross-Border Insolvency Concordat (1996) goes much further than mere coordination because it involves a transfer of powers. For example, it provides that one forum should have primary responsibility for coordinating all insolvency proceedings relating to the same entity (principle 1) and that after payment of secured and privileged creditors in the secondary proceedings the remaining assets should be turned over to the main proceedings for distribution (principle 2). Ordinary creditors can file in the main proceedings (principle 2). The concordat is designed for multiple proceedings with respect to the same debtor\textsuperscript{23}, but it is not easily adaptable to a group situation.

43. The ALI\textsuperscript{24} Guidelines (2001) have been applied in particular in cases between the United States and Canada. They are not explicitly limited to cases involving the same debtor. Guideline 2 provides that a court may communicate with another court for the purposes of coordinating and harmonising proceedings before it with those in the other jurisdiction. Likewise a court may communicate with a liquidator in another jurisdiction. The ALI Guidelines contain rules on how such communication should take place and how transparency and adequate participation by the stakeholders should be ensured. The document also contains other rules, for example that the court may direct that any stay of proceedings affecting parties before it shall not apply to applications or motions before the other court.

\textsuperscript{21} United Nations Commission on International Trade law.
\textsuperscript{22} International Bar Association
\textsuperscript{23} Main proceedings and/or one or more secondary proceedings.
\textsuperscript{24} American Law Institute.
44. The CoCo Guidelines (2007) were drafted by Virgós and Wessels. The guidelines apply to cross-border insolvency proceedings within the context of the European Insolvency Regulation and concern multiple proceedings involving the same debtor. Guideline 6 provides that liquidators should communicate with each other directly. Guidelines 7 and 8 lay down further rules on the obligation of liquidators to communicate with each other. Guideline 12 concerns cooperation: 12.1 provides that liquidators are required to cooperate in all aspects of the case, and 12.2 that they should ensure that cooperation takes place with other liquidators with a view to minimising conflicts between parallel proceedings and maximising the prospects for rehabilitation and reorganisation of the debtor’s business or the value of the debtor’s assets subject to realisation. Guidelines 13 and 14 concern cooperation with a view to cross-border sales and reorganisation. Guideline 16.4 provides that courts should cooperate with each other to the maximum extent possible directly, through liquidators or other persons or bodies appointed to act at the direction of the court. Guideline 12.4 refers to the possibility to attain cooperation between liquidators by way of a protocol. No mention is made of a protocol relating to communication between courts.

45. Examples of protocols with respect to particular cases are the Lehman protocol and the Nortel protocol. The Lehman protocol was agreed between the liquidators of Lehman entities in ten jurisdictions. It did not impose any duties or obligations on any of the liquidators (Section 1.2). The most important provisions concern sharing of information (Section 4), preservation of assets (Section 7) and rules on the establishment of a common set of financial accounting records that form the basis of intercompany claims. These financial accounting records are to be treated as prima facie valid, unless there are elements of proof suggesting otherwise. A committee was established to try to reconcile the intercompany claims.

46. The Nortel protocol was a protocol established by the Canadian and Delaware courts in cases concerning a number of U.S. and Canadian Nortel companies. The protocol provides for rules on communication between the U.S. and Canadian courts
and deals with matters concerning the liability of officials (such as the Canadian monitor) in the other proceedings.

47. Protocols addressing communication and cooperation obligations may be useful. Wessels states\textsuperscript{26} that they may prevent stakeholders from endlessly continuing proceedings at great expense, may reduce costs and maximise value by underlining mutual interests and may allow information sharing. Nevertheless, their possibilities are limited. As appears from the instruments discussed above, rules on communication between courts are mainly concerned with the question how to safeguard transparency and the participation of stakeholders. Ultimately, however, communication between courts can only yield results where they have to take decisions and also have discretionary powers. In the United States, for example, bankruptcy courts can be actively involved and can to a large extent manage the bankruptcy. Sometimes, indeed, it may be wondered who is in possession: the debtor or the court. Since under Anglo-American law insolvency proceedings are a matter of equity, the courts have substantial discretionary powers. A famous example is the Rover case in which the English court decided that the foreign order of ranking could be applied to the proceeds of foreign assets. Other legal systems have a different philosophy. They see insolvency primarily as a fairly rigid system. The positions of the stakeholders are fixed at the commencement of the proceedings and should determine the rights during reorganisation or liquidation. The courts only have a supervisory role or the job of resolving disputes between stakeholders. Where the court lacks discretionary powers, communication between courts will not resolve synergy and conflict-of-interest issues of the kind discussed above.

48. Communication and cooperation between liquidators is good, but saying that they must cooperate to the maximum extent possible and in good faith may be insufficient. Should they not do so anyway? In group situations each liquidator may act in good faith, but he still has to act in the interest of the creditors of his debtor. In practice, such obligations may be insufficient to resolve conflict-of-interest and synergy issues. If

\textsuperscript{26} B. Wessels, Cross-border insolvency agreements: what are they and are they here to stay?, in: D. Faber and N. Vermunt (eds), Overereenkomst en insolventie, Deventer, Kluwer 2012, pp. 359-384.
nobody is in charge, it must be doubted whether an obligation to cooperate is sufficient to bring about the integrated administration and liquidation of the group's assets. What is needed is some kind of centralised control or coordination.  

49. Another important problem is that local law may prevent solutions within the synergy margin. To go back to the earlier example, let us assume that the liquidator of company A would like the business of company B to be preserved because it is necessary for the rescue of the group, whereas the liquidator of company B can get a better price for the assets by selling them to an outsider. As discussed above at 23-24, the solution should be that company B receives sufficient value to compensate for the loss of proceeds. However, even if liquidator B were prepared to accept such a settlement within the synergy margin the laws of country B might prevent the deal, for example because they oblige liquidator B to sell the assets at a public auction within a short time frame. The first core problem here is that rules on coordination and cooperation cannot set aside mandatory rules of national law. This requires binding provisions at an international level which supersede national law. In other words, there should be provisions to that effect in the European Insolvency Regulation. That protocols and guidelines cannot prevail over national law is demonstrated by these instruments themselves, which refer time and again to the supremacy of the applicable law.  

50. In a complicated international group insolvency there is a need for rules that allow a court to take a decision on the sharing of the synergy margin. It is difficult to reach a solution out of court if situations are likely to arise in which liquidators of subsidiaries will try to exploit their holdout position in the interest of their stakeholders or must try to do so in order to further the interests of the creditors of their debtor company in accordance with their national law. Practice has shown that in the absence of such international rules a reorganisation of a European group is

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28 Above at 23.  
29 On the subject of these limitations see also B. Wessels, Cross-border insolvency agreements: What are they and are they here to stay?, in: D. Faber and N. Vermunt (eds), Overeenkomst en insolventie, Deventer, Kluwer 2012.  
not achievable in cases where insolvency proceedings take place in multiple jurisdictions. This is not because the liquidators of the subsidiaries are not acting in good faith, but because there are conflicting interests between the estates. To put it simply, the liquidator of the parent company should be able to ask the court hearing the insolvency proceedings of the subsidiaries to consent to solutions in the interests of the group as a whole which comply with the group compensation rule.

(b). Liquidators with coordinating powers

51. Under the second regime one liquidator is designated to fulfil a role in the interest of the group as a whole and has certain powers to do so. Under the European Insolvency Regulation such rules exist with respect to multiple proceedings involving the same debtor. The liquidator in the main proceedings has some powers with respect to the secondary proceedings. However, most of those powers involve the intervention of the court in the State where secondary proceedings have been opened. For example, the liquidator of the main proceedings may ask the court which opened secondary proceedings to stay the process of liquidation in whole or in part (Article 33(1)). In such a case the court in the secondary proceedings may require the liquidator in the main proceedings to take any suitable measure to guarantee the interests of the creditors in the secondary proceedings and of individual classes of creditors. Apart from that, the request may be rejected only if it is manifestly of no interest to the creditors in the main proceedings. Another example is that the liquidator in the main proceedings may propose a rescue plan, a composition or comparable measure where the law applicable to the secondary proceedings allows for such proceedings to be closed by such a measure (Article 34).

52. If a similar regime were to be applied in the context of groups of companies the following questions arise:

- how should the group be determined?
- how should the ‘group main proceedings’ be determined?

53. The same questions have to be decided under any of the regimes listed above at 37 (b)-(d). Under all these regimes there must be a court or liquidator for the group main proceedings that has
certain powers to further a coherent approach.

54. As is apparent from Section 1 of this report, different ‘definitions’ of the term group are used. How a group should be defined depends in large part on the purpose of the definition. For the purposes of group insolvencies, the definition of the companies belonging to the group could conceivably be based on the degree of ascertainable integration of their businesses into the business of the group. To some extent that would enable a company’s creditors to ascertain in advance whether they will be confronted with a group regime. However, the need for a group regime may depend on quite different factors than whether outsiders can perceive an integrated business. Creditors may not be aware of financial interdependence or the sharing of certain assets. And, as Wautelet writes, creditors may not be aware of the group’s internal structure. It therefore seems preferable not to make the definition of the group contingent on some kind of level of integration, nor, for example, merely on control. My preference would therefore be to apply the broad definition that is used in the Seventh Council Directive for Consolidated Accounts (83/349/EEC) quoted above at 14, in which both financial interest and control play a role.

55. The next, difficult question is how to determine which proceedings should be the group main proceedings. The question of which proceedings should be seen as the group main proceedings or where the group COMI is deemed to be located becomes less important if the answer has less impact on the rights of the creditors of the subsidiary. For example, in model (d), which is discussed below at 73 et seq., the main proceedings of all companies are opened in the State of the group COMI. If Article 4 EIR is applied to all those proceedings, many issues with respect to the insolvency proceedings of the individual group company have to be decided under the laws of the group COMI. Thus, if there is a French parent company with a Belgian subsidiary and the group COMI is deemed to be in France, questions as to the ranking of the creditors of the Belgian subsidiary are determined by French law. The same may apply to many other issues such as rules on set-off, powers of the

liquidator, termination of contracts and so on. Such consequences of a shift from Belgian to French law with respect to the Belgian subsidiary are referred to as the redistributive effect\textsuperscript{32}. I think that in this respect two observations should be made. The first is that the larger the redistributive effect is, the more important becomes the question of where the group COMI is located. The second observation is that it is desirable for the redistributive effect to be as small as reasonably possible. This is because, in our example, the creditors of the Belgian subsidiary have relied on the application of Belgian insolvency law and such reliance should be respected in so far as possible. Moreover, some of the subsidiary’s creditors may be quite unaware of the identity of the group to which the subsidiary belongs. The subsidiary may act quite independently from the rest of the group, but nevertheless coordination of the insolvency proceedings of the group members may be needed, for example because those companies are debtors under one facility. The preferable solution from a legislative point of view is therefore for the group COMI to have minimal effect on creditors’ rights. If that is the case, it does not matter very much if the group COMI is determined on the basis of a single objective criterion, even if that criterion is somewhat arbitrary. If the redistributive effect of the decision on the COMI is small, the question in which State the group COMI should be deemed to be located becomes less important.

\textsuperscript{32} Mevorach, op. cit, pp. 240-249, 254-259, 122, 165, 237 and 327.
56. Several criteria have been proposed for determining the group COMI or, what amounts to the same, the group main proceedings. A criterion which is at first sight fairly simple is to treat the COMI of the top insolvent company (the ultimate parent) as the group COMI. To be rather more precise, in an EIR context the ultimate parent company would be the top company which is both located in the EU and subject to insolvency proceedings itself. I will try to illustrate this in the following diagram.

57. Let us assume that there are four companies: X is located in New York, A in Austria, B in Belgium and C in Cyprus. X is the parent of A, A is the parent of B and B is the parent of C. If both B and C are subject to insolvency proceedings B is the ultimate parent company, but if A, B and C are subject to insolvency proceedings A is the ultimate parent company. If X is also subject to insolvency proceedings, A is still the ultimate parent and therefore the group COMI because X is located outside the EU.

58. This system (which is used in the INSOL Europe proposal) has several disadvantages. (i) It is fairly easy to move a company around within a group or to park it somewhere else, thus redetermining which company qualifies as its ultimate parent company. (ii) If, in the above example, companies B and C open insolvency proceedings first, B is C’s ultimate parent company. But if insolvency proceedings are subsequently opened with

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respect to company A as well, company A becomes C’s ultimate parent. This shift may complicate matters and necessitate the introduction of rules dealing with the transition. However, this problem may not be insurmountable under the regime where the powers of the liquidator of the group main proceedings are mainly limited to the right to make certain requests to the court of State C. (iii) Sometimes the ultimate parent is located in a jurisdiction where the group has no real activity but which serves as a tax haven. INSOL Europe’s solution for this problem is to link the COMI to operational activities.

59. There may also be a problem in designating the ultimate parent company if a structure is in place with two holding companies.

60. The big advantage of this system, however, is its simplicity. If the redistributive effect of the decision on the group COMI is small, that advantage may well outweigh the disadvantages.

61. Another solution is to locate the group COMI at the place where the centre of gravity of the group activities is located. However, this may require knowledge of the group and an assessment of the relevant factors, which may not produce an unequivocal outcome. Moreover, such a centre may be less relevant if there is only minor integration of the activities of the individual companies.

62. Finally, it has been suggested that the main proceedings of the group company opened first should serve as group main proceedings. In my opinion, this is a rather awkward criterion.

63. The regime under which one liquidator – the liquidator of the group main proceedings – has powers of coordination with respect to the other proceedings thus requires a definition of the group and of the group main proceedings. My suggestion is that the INSOL Europe criterion should be adopted and that the main proceedings of the ultimate parent company (the highest European company in respect of which insolvency proceedings have been opened) fulfils this role.

64. The question how the group main proceedings are to be decided is of course also of importance if the adoption of a group rescue plan is a matter for the court of the group main proceedings.
Under regime (b) the basic premise is that the insolvency proceedings of each of the group companies are conducted by a separate liquidator under the supervision of the local court. Intervention by the liquidator of the group main proceedings should, in principle, be subject to consent by the local court of the subsidiary. To enable the liquidator of the group main proceedings to discharge his responsibilities, he should be entitled to receive any information with respect to the subsidiary which is at the disposal of the subsidiary’s liquidator or to which the latter is entitled. Moreover, the subsidiary’s liquidator should, on his own initiative, provide the liquidator of the group main proceedings with all the relevant information. Conversely, the subsidiary’s liquidator should be entitled to receive information from the liquidator of the group main proceedings and from other liquidators of group companies in so far as the information is relevant to the subsidiary’s insolvency proceedings. Furthermore, the liquidator of the group main proceedings should be entitled to take part in any proceedings, hearings and creditors’ meetings with respect to the subsidiary in the same way as a creditor of the subsidiary would be entitled to take part in them, and he should also be allowed to submit any requests to the court in the subsidiary’s insolvency proceedings in the same way as a creditor or quorum of creditors would be allowed to do. The liquidator of the group main proceedings should also be allowed to ask the court in the subsidiary’s proceedings (i) to suspend sales of assets of the subsidiary, or (ii) to prevent secured creditors from exercising their rights. Both measures should be possible regardless of local law. And the liquidator of the group main proceedings should (iii) be allowed to ask the court in the subsidiary’s proceedings to decide that agreements should be continued or terminated, if such order for continuation or termination is possible under the laws of that State and (iv) be allowed to offer a reorganisation plan to the stakeholders in the subsidiary’s proceedings in accordance with the laws of the State of those proceedings.

The test that the court should apply is that the requested measure should be in the interests of both the group and the creditors of the subsidiary. If any action would be prejudicial to the subsidiary’s creditors there should be accompanying measures or compensation in order to at least satisfy the group compensation rule. Furthermore, the court should
investigate whether a reasonable distribution of the synergy margin is provided for. This, by the way, is exactly the kind of issue which could benefit from court-to-court communication.

67. In an Austrian case in which the liquidator of the English main proceedings was also the liquidator in the main proceedings of other group companies, the liquidator applied for a stay in the Austrian secondary proceedings (which actually encompassed all assets of that group company) under Article 33(1) EIR. The order was granted by the Graz Court of Appeal on the grounds that if the liquidator in the main proceedings is also appointed liquidator for several other group companies that are integral part of the organisation and is trying to achieve a uniform sale of all assets as a going concern, a stay of liquidation in the secondary proceedings cannot be deemed to be ‘manifestly of no interest to the creditors in the main proceedings’.

68. In addition to the coordination powers of the liquidator of the group main proceedings, the INSOL Europe proposal provides for a European Rescue Plan. In essence this plan is a composition which includes any number of group companies subject to insolvency proceedings and is confirmed by the court of the group main proceedings. This European Rescue Plan will be discussed in Section 3.

(c). Mutual liquidator regime

69. One step further than the regime in which the liquidator of the group main proceedings has (i) certain powers of coordination, subject to supervision by the courts of the subsidiaries and (ii) the power to propose a plan subject to confirmation by the court of the group main proceedings, is the regime in which the same liquidator is appointed in the main proceedings of all group companies, but the proceedings themselves remain under the supervision of the local courts. This solves many


35 Advocates of this solution are C.G. Paulus, Überlegungen zu einem modernen Konzerninsolvenzrecht, ZAP 44/2005, pp. 1948-1955, I. Mevorach, 2009, p. 159 et seq. and N.W.A. Tollenaar, Dealing with the insolvency of multinational groups under the European Insolvency Regulation, Tvl 2010, p. 94 et seq.
of the problems inherent in the former regime because under
the mutual liquidator regime it is much easier to adopt one
common policy and there is less need for decisions by the courts
of the subsidiaries’ insolvency proceedings. In some instances,
however, such decisions will remain necessary. Similar to what
has been defended above with respect to regime (b), decisions
of the subsidiary’s court are needed not only to resolve
conflicts but also to set aside local law if that is necessary in
the interests of the group, and therefore indirectly in the
interests of the subsidiary’s creditors (see above under 65).
However, one major problem with the main liquidator regime
is that it glosses over the conflicts of interests between the
group companies and between their creditors. In the example
in which a subsidiary should be compensated if it does not
sell off its assets to a third party because the group’s interests
are served by holding on to those assets, the liquidator would
have to negotiate with himself about the form and magnitude
of the compensation. Conflicts of interests may, of course, also
arise over such issues as settlement of intercompany claims
and attribution of assets. As mentioned earlier in this report
(at 22 above), conflicts of interests often become much more
prominent in a situation of insolvency, because if a group is
solvent and only the top company has shareholders there is
no apparent prejudice in trade-offs between group companies.

70. It is remarkable that there are many domestic cases in which the
same liquidator is appointed in the insolvency proceedings of
more than one group company. This of course enhances efficiency,
especially if the same court is supervising all these proceedings,
but it is questionable whether such a joint appointment is always
appropriate. I know of a number of Dutch cases involving very
substantial conflicts of interests where one could have doubts
about how these issues were resolved and about the degree of
detail in which the outside creditors of these companies were
informed of the justification for the settlements. A good example
of an international case where these conflicts of interests are
apparent is the Lehman case. The companies in countries
such as the United States, England, the Netherlands, Curaçao
and Switzerland have different liquidators and different sets of
creditors. How intercompany claims are settled in that case will
be of great importance to these various sets of outside creditors.

71. An additional issue of the mutual liquidator regime is that the liquidators have to deal with different laws and legal cultures with respect to the group companies. Basically, this means that they have to act in an area in which they have no expertise and may be faced with court documents and proceedings in languages they have not mastered. Furthermore, courts that do not speak the language of the liquidator may not be capable of supervising his work adequately.

72. Each case is different and in some cases the efficiency gain may be expected to outweigh the conflict-of-interest issues and communication problems, whereas in other cases the scales would tip the other way. For that reason appointment of the same liquidator or liquidators in all proceedings cannot be the standard solution and cannot serve as the basis for provisions on group rules. However, in the case of some regimes, for example regime (b) (coordinating powers), such an appointment would be possible and could be considered where appropriate. A precondition would be that insolvency practitioners from one jurisdiction can be appointed in the other jurisdiction and that the qualifications of liquidators from one State are recognised in other States.

(d) Joint administration regime

73. The next regime is the joint administration regime. Joint administration is very popular in the United States. There it means that all proceedings of the group companies are conducted in one and the same bankruptcy court, which joins the proceedings for procedural and administrative matters (see also at 27 above). In such proceedings a joint restructuring plan can be proposed for all the companies included in the joint administration, but it has to be accepted and confirmed for each of the companies concerned separately. There are, however, important differences between the American and European situations and some of these make joint administration less attractive in a European setting.

74. First, it should be noted that in a typical U.S. Chapter 11 case the debtor remains in possession of the assets and no trustee is appointed. For a group structure that makes the concept quite different. In a system where a different liquidator is appointed in each of the insolvency proceedings the chain of command
of the group is broken. The liquidator of the parent company cannot dismiss or appoint liquidators of the subsidiaries. In the U.S. situation the management of all the Chapter 11 companies almost always remains in place. This improves the chances of preserving the group structure, although an important change is that the management of each company will have a fiduciary duty to the creditors of that company. In some European jurisdictions debtor in possession regimes have been introduced, but most reorganisation proceedings still involve a liquidator.

75. A second important difference between the U.S. system and the European situation has to do with jurisdiction and applicable law. Joint administration in the United States may mean that a company which is actually located in San Francisco could be subject to Chapter 11 proceedings in New York. However, although this may be a different location, the insolvency proceedings will still be conducted by an American federal court and there will be virtually no change in the applicable law because bankruptcy law is federal law. In Europe, of course, this is quite different. If rules were developed to allow joint administration of group companies with COMIs in different jurisdictions, there would be two possibilities. First, if Article 4 EIR were to be applied, all these proceedings would be subject to the same law. For example, if the group were to consist of a French parent company (i.e. with its COMI in France) and Belgian, Italian and Greek subsidiaries and those companies were to be subject to joint administration by the French court, French law would apply to all these proceedings and therefore also to questions such as the ranking of creditors and the termination of contracts with respect to the Belgian, Italian and Greek companies. This solution is unattractive for a variety of reasons. It would entail a substantial redistributive effect. And it would also be very easy for the group to manipulate the applicable law by moving a subsidiary around inside the group or by moving it outside the group. The second possibility is that the French court would apply Belgian law to the Belgian subsidiaries, Italian law to the Italian subsidiaries and Greek law to the Greek subsidiaries, but this too is very unattractive. Another disadvantage of this kind of joint administration is that it infringes the sovereignty

37 “Virtually” because there are some issues of state law that may affect the bankruptcy, but these concern only a limited number of topics such as the assets that are not included in the bankruptcy estate.
of the States more than is necessary, because it relocates the proceedings of the subsidiary to another jurisdiction.

76. Joint administration has been attempted in several cases of which the Daisytek, Rover and Collins & Aikman cases are the best known. In the Daisytek, Rover and Collins & Aikman cases, the English court decided that the centre of main interests of the subsidiaries was located in England, which justified opening main proceedings in England with respect to the parent and these subsidiaries\(^{38}\). In the Daisytek case the High Court sitting in Leeds opened insolvency proceedings with respect to an English company\(^{39}\) and three German companies and one French company, in the Rover case the High Court sitting in Birmingham opened insolvency proceedings with respect to English, German, French, Dutch, Belgian, Luxembourg, Spanish, Irish, Italian and Portuguese companies\(^{40}\) and in the Collins & Aikman case\(^{41}\) the High Court in London accepted jurisdiction over 24 group companies throughout Europe. In order to achieve this result the London court held that the head office functions were carried out from England. In fact, the court applied here a group COMI criterion in the sense that the determining factor was the location from which control was exercised over the subsidiary. Moreover, both in the Rover and in the Collins & Aikman cases the English court allowed the liquidator to apply local law to the ranking of the creditors with respect to the foreign assets. Virtually all assets of most of these subsidiaries were located in their respective Member States.\(^{42}\) This was in fact the situation described above in which there is joint administration in the court of the group COMI, which then applies local law to the subsidiaries. To reach this result, the English courts deemed the subsidiaries’ COMI to be the COMI of the controlling parent

\(^{38}\) Although the most prominent cases of this kind are English cases, there are also examples from other States, such as Mpotec (France), Energotech (France) and Hettlage (Germany).


\(^{40}\) High Court of Justice, Birmingham 11 May 2005, NZI 2005, 515; B. Wessels *Multinational Groups of Companies under the EC Insolvency Regulation: where do we stand?* Ondernemingsrecht 2009/55.


\(^{42}\) For Austria see for example A. Klauser and G. Mandelbacher, *The European Insolvency Regulation in Recent Austrian Case Law*, which can be found at http://www.iiiglobal.org/component/jdownloads/finish/39/4057.html, p. 8.
Apart from the objections to this solution which I set out above, it is questionable whether this head office criterion can still be applied since the Eurofood judgment and the Stanford judgments of the High Court in London and the Court of Appeal. In the Eurofood judgment the European Court of Justice stressed how important it was that the COMI should be ascertainable by third parties if it is to be somewhere else than the place of the registered office. Moreover, the European Court of Justice held that the mere fact that a company was controlled by a parent company in another Member State was not enough to refute the presumption of Article 3 paragraph 1 EIR that the centre of main interests is located at the registered office. It also seems quite likely that if applications had been made to open main proceedings in the Member States of the subsidiaries’ registered offices before those main proceedings were opened in England, the courts concerned would have accepted jurisdiction. Although the English courts are not the only ones to have attempted joint administration, I think that their judgments are most illustrative of this kind of COMI manipulation.

Joint administration could also involve the appointment of the liquidator in the main proceedings as the liquidator in the proceedings of all the subsidiaries. This is actually a combination of the joint administration and mutual liquidator regimes. In fact, that is what happened in the English cases mentioned here, and the conflict-of-interest difficulties discussed with respect to regime (c) apply here as well. If anything, the problems are actually somewhat more severe here, because not only the liquidator but also the court is the same. In the United States, where joint administration is very common, the same trustee can be appointed in the joint cases, but the creditors have the right to elect separate trustees under Bankruptcy Rule 2009.

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44 ECJ 2 May 2006, C 341-04.
46 Judgment of Tribunal de Commerce Cergy-Pontoise, 1 July 2003, not published (as observed by P.M. Reuss, ‘Forum shopping’ in der Insolvenz, 2011, p. 127).
(e). Substantive consolidation

78. The highest level of integration is obtained under the substantive consolidation regime which was already discussed above (at 34 - 36). Although substantive consolidation must have been applied to cases in many jurisdictions, the doctrine was developed in the United States. The U.S. Bankruptcy Code does not contain provisions on substantive consolidation (except for a provision regarding spouses), so the development of this part of the law is a matter of case law. Although American scholars and courts claim that substantive consolidation is applied only in exceptional cases in the United States, it seems that in practice this may not be entirely true. Under U.S. law, substantive consolidation may be applied in two instances. It may be applied where the financial affairs of the debtor cannot be disentangled and it may be applied where the creditors have dealt with the entities as an economic unit\(^\text{47}\). One of the attractions of substantive consolidation under U.S. law is that it allows the offering of a single Chapter 11 plan to the creditors of the related units.

79. Substantive consolidation is unavoidable where the assets or liabilities of the debtor are entangled to such an extent as to be inseparable. As the Dutch proverb says, ‘Where there is nothing, the emperor loses his right.’ In a European context extending substantive consolidation beyond that category seems unattractive. It would mean that the law to be applied would not be the one expected by the creditors of the disappearing company/proceedings and that there would be a redistributive effect. In cases where there is uncertainty about part of the assets the liquidators in the relevant insolvency proceedings should settle, particularly if the dispute is not worth the cost of litigation.

80. As mentioned above, an incentive for substantive consolidation under U.S. law is that it will open the way to a single plan for the consolidated companies. If the concept of a pan-European plan (as will be discussed below) is adopted there would not be any need for substantive consolidation to create this possibility, because a unified plan is then possible with respect to any combination of companies within the group.

(f). Flexible approach

81. Some authors advocate a flexible approach in which different regimes can be applied to different situations⁴⁸. Some cases would be more suitable for joint administration, others for a protocol or for a liquidator with coordinating powers. My own view is that a flexible approach of this kind creates too much uncertainty and is too complicated. It would be preferable to have a system whose core is formed by rules on liquidators with coordinating powers, as set out in regime (b). This would not prevent solutions involving court-to-court or liquidator-to-liquidator communication, which could in fact play a very useful role in supporting such coordination. Nor does it exclude the possibility of appointing the same liquidator in proceedings with respect to several group companies, but special attention should be given here to issues involving conflicts of interests. Substantive consolidation should be limited to cases where disentanglement is not practicable.

Section 3: A group rescue plan

I. Restructuring scenarios

82. There are essentially two scenarios in which restructurings of insolvent companies take place.

83. The first type of restructuring scenario is a restructuring or rescue plan. The essence of this kind of restructuring is that the creditors agree to relinquish or modify their claims in such a way that the company becomes solvent again. Often such rescue plans entail much more than a mere write-off of debts or postponement of repayment. The activities of the company itself need to be restructured in the sense that less profitable activities have to be sold or ceased, employees may need to be dismissed, management may need to be changed and more profitable activities may need to be developed. Rescue plans launched in the absence of insolvency proceedings usually require the consent of all creditors whose interests would be impaired by the plan (there are exceptions under some legal systems), whereas rescue plans adopted in insolvency proceedings contain mechanisms by which obstructing creditors

⁴⁸ E.g. Mevorach, op. cit, p. 127 et seq.
may be outvoted or crammed down\textsuperscript{49}. In order to safeguard the interests of the disgruntled creditors some kind of court involvement is needed. The rationale for the reduction of the debts is that, as a consequence of the debtor’s insolvency, the claims against the debtor are no longer fully recoverable – or at least not recoverable when they are due – and that in a liquidation scenario the creditors might receive even less then if they ‘allow’ the debtor to continue trading and accept the rescue plan. The basic scenario of such a rescue plan is that the company’s refinancing is used wholly or partially to pay off the old creditors. From the creditors’ point of view, this means that a pot of money which is distributed among them replaces their right of recourse against the debtor’s assets. In this way, their claims are partially repaid and the remainder of the claim is relinquished. Other possibilities are, for example, that the terms of the claims are changed or that claims are exchanged for equity.

84. The second type of restructuring scenario is the going-concern assets sale. Under this scenario the liquidator sells off the assets which comprise the company’s business (or the viable part of the business) to another legal entity. Such an entity may be external, but it may also happen that the entity is financed by creditors or shareholders of the insolvent company. From the perspective of the company’s creditors, such a sale often produces the same result in economic terms as a rescue plan: the rights of recourse against the debtor’s assets are replaced by a pot of money which is distributed among the creditors and reflects the value of the debtor’s viable business.

85. Which of these two basic scenarios is chosen depends on a number of legal factors, which I will now discuss briefly. I will focus on the issues under Dutch law but many of these legal factors play a role under other legal systems as well:

(1) For historical reasons rescue plan proceedings are much more complicated and require much more creditor and court involvement under Dutch law than the going-concern sale of assets. In general, it can be said that the creditors in Dutch proceedings have more rights to influence the liabilities side of the debtor’s balance sheet than the assets side. They are allowed to dispute

\textsuperscript{49} For the meaning of cram down, see 92 below.
each other’s claims, and a write-off of the debt in plan proceedings involves a creditors’ meeting, voting and confirmation proceedings in which creditors can oppose the plan. Under Dutch law a decision in the confirmation proceedings is subject to appeal and a further appeal to the Supreme Court. In the case of a private asset sale the liquidator will need the permission of the supervisory judge, and individual creditors may try to oppose the sale, but no appeal is allowed from the supervisory judge’s decision. Furthermore, secured creditors usually need to be involved because in Dutch insolvency proceedings they retain their rights of enforcement. In many cases it is actually the secured creditors who take the initiative in launching a going-concern asset sale. Thus an asset sale is much less of a hassle than a rescue plan. I think the same applies in most other legal systems. Under Dutch law the difference has to do with the roots of Dutch insolvency proceedings, which lie in proceedings concerning attachments and distribution of proceeds. Moreover, when the Dutch Bankruptcy Act was enacted it included a provision basically preventing a going-concern asset sale until the possibility of establishing a rescue plan had lapsed (Article 101 (1) DBA). However, the Supreme Court killed this provision in the 1930s. As mentioned above, I think that in many other countries too asset sales are easier to accomplish than rescue plans. Sometimes there are obstacles to asset sales, but it seems that such obstacles are now playing a less prominent role. In the United States, where rescue plans have long been quite popular, there now is also a tendency towards sale as a going concern.

(2) The possibilities of accomplishing a Dutch rescue plan are very limited. Only ordinary creditors can be affected by the plan in the sense that a minority can be bound by a majority voting in favour of the plan, but preferred and secured creditors are not affected at all. This means that the interests of preferred creditors and secured creditors cannot be impaired against their will. Employees are very important preferred creditors. Since in most bankruptcies ordinary creditors will not

50 HR 27 August 1937, NJ 1938, 9 (Nieuw Plancius).
receive anything anyway, a rescue plan may not help to resolve the insolvency situation. Furthermore, a party who is prepared to refinance the business may find a rescue plan scenario unattractive because preferred and secured claims, which are not affected by the plan, may come out of the woodwork after the plan has been accepted and executed. Often, therefore, parties in this position prefer to start with a clean company and have an asset sale. Under U.S. and German rescue plans preferred and secured creditors can be bound.

(3) A going-concern asset sale may have negative tax consequences and it may not always be possible to take over all contracts or licences. To the extent that they are needed for the business, this may constitute a problem in the asset sale scenario.

(4) Rescue plans may provide a more flexible approach than the going-concern asset sale liquidation scenario.

For the reasons mentioned at (1) and (2) Dutch rescue plans are very rare. I do not know of any insolvencies involving a substantial number of employees where a plan aimed at continuing the business of the debtor has been accepted.

86. If several group companies are involved it may be attractive to arrange for a coordinated sale of the assets. This involves the cooperation of the liquidators in multiple proceedings. Similarly, if several group companies are involved rescue plans that are offered and adopted for the individual companies could conceivably be coordinated.

87. In a group situation two scenarios can be added to the two scenarios described above. The first additional scenario concerns a consolidated sale of the assets of the viable business of group companies, not by way of coordination between the liquidators of the individual companies, but at the direction of one liquidator (i.e. a unified sale with one seller). The second additional scenario involves the adoption of one consolidated plan for the whole group or a number of group companies. Thus we can distinguish between the following scenarios for a group:
(i) coordinated asset sales by the individual group companies;
(ii) coordinated rescue plans for the individual group companies;
(iii) unified sale of assets;
(iv) unified plan.

In discussing these scenarios I will disregard national groups and move on straightaway to international groups which have group companies in a large number of jurisdictions.

(i) Coordinated asset sales by individual group companies

Under the preferred regime (b) involving a liquidator with coordinating powers, the liquidator of the group main proceedings has the right to ask the court of the subsidiary proceedings to suspend asset sales by the subsidiary’s liquidator. The purpose of this power is to allow a coordinated sale of the assets of several group companies or to include those assets in a reorganisation e.g. through a set of coordinated rescue plans. A coordinated sale of this kind could thus ensue, but would be difficult to achieve in a multi-jurisdictional case because all the courts would need to become aligned. Under the regime involving coordination on a non-hierarchal basis (a), the liquidators of the subsidiaries may need to become aligned as well.

(ii) Coordinated rescue plans

Under the preferred regime involving a liquidator with coordinating powers the liquidator of the group main proceedings can propose rescue plans in all subsidiary proceedings. Although in such a case the role of the liquidator of the subsidiary proceedings may be somewhat reduced, the plan still needs to be accepted in each jurisdiction under local law and each of the courts needs to confirm the plan. Moreover, as the Dutch example shows, the national rules on plans may contain such very serious limitations that coordinated plans are unachievable. To my knowledge, no plan involving continuation of the business of group companies has ever been accepted in three or more jurisdictions.
(iii) Unified asset sale

One way of achieving a concerted sale of the business is by providing that the liquidator of the parent company has the power to sell all or part of the assets of the companies in the group under the sole supervision of that liquidator’s own court. To a large extent this meets with the same difficulties as administration of multiple group companies by the same liquidator, because there may be conflicts of interests with respect to such sales between the group companies and because there is no creditor influence similar to the influence involved in the adoption of a rescue plan. Such a conflict of interests may, for example, concern the question of which assets should be included in the consolidated sale, but also the question of how the purchase price should be attributed to the individual estates. If a patent right is owned by company A and a machine by company B and if the sale of the patent right and the machine together may be expected to yield a substantially better price than the sale of the assets individually, a question of attribution of the synergy margin arises. In fact, where there is no such conflict of interests, solution (i) (coordinated sale) should provide an adequate outcome.

(iv) Consolidated plan

Finally, there is the possibility of having one rescue plan for the whole group. A single plan of this kind is more appropriate for adequately resolving conflict-of-interest issues than a unified asset sale. Under U.S. bankruptcy law especially, rules on reorganisation plans have been developed to deal with conflicts of interests. Although the provisions on rescue plans under Chapter 11 concern single companies, the underlying principles can be applied in a multi-company situation as well. The U.S. system with respect to Chapter 11 rescue plans has been the basis of legislation in other countries such as Germany. As noted at the start, INSOL Europe has developed a European Rescue Plan based on these principles. As will be discussed in some detail below, this plan was framed against the background of the U.S. and German plans.
II. Classification, cram down and confirmation under U.S. and German law

88. The first underlying principle of the U.S. plan is that creditors are placed in classes. U.S. law requires that claims may be placed in a particular class only if they are substantially similar to the other claims of such class (§ 1122 (a) US BC). There may be conflicting interests between creditors of different classes: for example preferred or secured creditors may have an interest in having a fire sale, whereas ordinary creditors may have an interest in an attempt to continue the business of the debtor. However, a very important principle is that the interests of the creditors within a class are mutually aligned.

89. As to the voting procedure the starting point is that all classes of creditors vote on the plan. In fact, this is not entirely correct: creditors that are not affected by the plan are not entitled to vote because they have no legitimate reason to oppose the plan. At the other end of the spectrum there may be creditors who receive no value at all. They do not need to vote either, since they are assumed to reject the plan. After the plan has been voted on, the court will decide whether or not to confirm it. In this respect, it is important to determine whether or not a class has accepted the plan. Under U.S. law, if the plan has been accepted by a class of creditors the basic premise is that each creditor belonging to that class is bound by the majority decision. That is the reason why it is so important for all creditors belonging to that class to have substantially similar claims and to have interests that are mutually aligned. Nevertheless, an individual creditor that has been outvoted may still oppose the plan in subsequent confirmation proceedings. The ground for such opposition is that the creditor receives less under the plan than he would receive in a Chapter 7 liquidation. Although it is usually not phrased in this way, this rule can be explained as meaning that if a creditor would be deprived of any value in his claim, this would amount to an expropriation which he need not accept.

90. German law has similar classification rules. Classes can be created of creditors with the same legal position (if their legal position is different they must be placed in different classes) and similar commercial interests (the latter classification is optional) (§ 222(2) InsO).
91. The basic principle is therefore that an individual creditor should not be forced to accept less value than the value of his claim. Under U.S. law this rule is referred to as the best interests test. It is provided for in § 1129 (a)(7) BC$^{51}$. German law has a similar rule (§ 251(1) InsO). Dutch law too has a similar notion. Pursuant to Articles 153(2)(1), 272(2)(1) and 338(2) Dutch Bankruptcy Act the court has to refuse confirmation if the proceeds of the estate exceed the amounts stipulated in the rescue plan. Under an American or German plan which can include different kinds of creditors such as ordinary, preferred and secured creditors, this means that each creditor should at least receive what he would be entitled to in a liquidation, but a more flexible approach is allowed with respect to the surplus value that can be realised under the plan$^{52}$. Under U.S. law, there are some additional requirements for confirmation of the plan, the most important of which is that the court is of the opinion that the plan is feasible (§ 1129 (a) (11) Bankruptcy Code).

92. The real problem is how to deal with a situation in which some classes accept the rescue plan and some do not. It may well be that all creditors will be better off if the rescue plan is accepted, and the few classes opposing it may be acting unreasonably or trying to negotiate disproportionate advantages. Here the court has to balance the interests of the various groups of creditors. Where the court decides that a group of creditors should have accepted the plan and is therefore deemed to have done so, this is known as ‘cram down’. Under German law the theoretical justification for the court’s cram down powers is that the rejecting groups of creditors are committing an abuse of power$^{53}$. Cram down could therefore be seen as an exceptional measure. Whether the basis for cram down powers is perceived as similarly restricted under U.S. law is questionable. However, it is clear that overruling in this way a group of creditors who have rejected the plan is of a completely different order of magnitude than refusing confirmation because objecting creditors belonging to a class that has accepted the plan by a majority voting in favour of it receive less than liquidation value

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51 With respect to secured creditors the rule has been phrased somewhat differently.


53 S. Madaus, Der Insolvenzplan, pp. 259 and 280.
under the plan. With respect to cramming down a rejecting class, § 1129(b)(1) Bankruptcy Code provides that if a class has rejected the plan the court shall nonetheless confirm the plan ‘if the plan does not discriminate unfairly, and is fair and equitable with respect to each class of claims or interests\textsuperscript{54} that is impaired under, and has not accepted, the plan.’ The most important application of this provision is the absolute priority rule. Under this rule, no one junior to the rejecting impaired class should receive any value under the plan (§ 1129(b)(2)(B) (ii) Bankruptcy Code). Under U.S. law the absolute priority rule applies only from the dissenting class down: ‘classes senior to the dissenting class will not be subject to the rule. In short “senior accepting classes are permitted to give up value to junior classes as long as no dissenting intervening class receives less than the amount of its claims in full.”\textsuperscript{55} For secured claims the test is somewhat different, but that is a topic that is beyond the scope of this report. Under German law, cram down can take place if (i) the creditors belonging to a rejecting class receive an appropriate share of the going-concern value (§ 245 InsO) and (ii) the majority of the classes have accepted the plan. Pursuant to § 245 (2) InsO the requirement of an appropriate share is met if the absolute priority rule is observed and other creditors with the same ranking are not unduly favoured\textsuperscript{56}. The requirement that a majority of the classes should have accepted does not seem very convincing. The relevance of a majority within a class is that a majority of creditors having the same interest decide to accept the plan. The idea is that where the interests are mutually aligned the majority should be able to bind the minority. However, the requirement that a majority of the classes accepts the plan cannot be based on this principle because the different classes may very well have different interests. In fact, that is precisely why creditors are put in different classes in the first place. It may be significant that this requirement did not occur in the government draft of this paragraph, but was inserted on the initiative of parliament\textsuperscript{57}.

\textsuperscript{54} ‘Interests’ primarily refers to shareholders’ interests.
\textsuperscript{55} Tabb, pp. 1151-1152.
\textsuperscript{56} Kreft, \emph{Insolvenzordnung, Heidelberger Kommentar}, 6th ed 2011 p.1724.
\textsuperscript{57} Kreft, Ibid., p.1721.
III. Classification, cram down and confirmation with respect to group plans

93. The system of classification as laid down in the U.S. Bankruptcy Code and the German Insolvenzordnung could very well be used for a single plan involving several group companies. The reason why it can be transplanted fairly easily is that under these plans the treatment of creditors with different interests has already been taken care of by the classification system. In that respect creditors of different companies do not differ substantially from creditors of the same company and the system of classification, cram down and confirmation can just as well be used with respect to creditors from different companies as it is presently used with respect to creditors of the same company who have conflicting interests. In such system creditors of different group companies should not be placed in the same class since their interests are not substantially similar. Furthermore, under the group plan similar tests would be required as in a single company plan, such as the best interests test, and the tests that the plan should not discriminate unfairly and is fair and equitable with respect to each class of claims. On the basis of Community trust it may be expected that the single court dealing with the cram down and confirmation processes will be able to apply such a rule with respect to all creditors regardless of their geographical location or of the identity of the group company which is their debtor (and which is included in the plan). It should be noted, however, that in a group situation the absolute priority rule may be less suitable as a cram down criterion than in a single company case. The group situation is different in the sense that there may not be a ranking order between creditors of different group companies: often it is not possible to say that ordinary creditors of company A are subordinated to preferred creditors of company B. A different cram down criterion should therefore be used in a group plan, bearing in mind that a cram down rule should be applied with restraint because the rejection by the class concerned should be overruled only where upholding the rejection would bring about a manifestly unfair result.
IV. INSOL Europe’s European Rescue Plan

94. Chapter VI of the INSOL Europe proposal provides for a European Rescue Plan, which is essentially a reorganisation plan that includes any number of group companies subject to insolvency proceedings in different jurisdictions. The authority to confirm the plan lies with the court of the group main proceedings. As discussed above\(^{58}\), I think that scenario (ii), providing for a composite plan to be adopted in the main insolvency proceedings of each of the group companies involved, is indeed not achievable in complicated situations. In those situations scenario (iv), providing for a unified plan to be adopted in proceedings before a single court and involving one liquidator, stands a much better chance. The European Rescue Plan is such a plan. The provisions of Chapter VI of the INSOL Europe proposal are attached to this report.

95. Under the INSOL Europe proposal, group companies which are not subject to insolvency proceedings cannot be included in a European Rescue Plan if their creditors are thereby impaired. It is to be assumed that these companies are solvent and that their creditors can therefore receive the full value of their claims. Nevertheless, it is conceivable that companies which are not subject to insolvency proceedings could obtain rights or assume obligations under the plan.

96. With regard to group companies that are subject to insolvency proceedings, there can be several possible variations in the mix of companies included in the plan. The plan need not include the ultimate parent company or all of the other group companies that have opened insolvency proceedings. This is illustrated in the following diagram. The companies that have opened insolvency proceedings have been marked with the Greek letter Θ and those included in the plan have, in addition, been shaded with diagonal lines.

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58 At 87.
97. The following diagram shows another possible variation for the same group.

98. In order to avoid a variety of competing plans involving different sets of insolvent group companies, it is important that only one person should be allowed to propose a plan. Article 47(1) of the INSOL Europe proposal seeks to resolve this issue by granting the right to propose a European Rescue Plan exclusively to the liquidator of the ultimate parent company. The only exception is that the management of the ultimate parent company is entitled to submit a plan together with its request to open insolvency proceedings or while such a request is pending. Under the INSOL Europe proposal, at no time will the management and the liquidator have concurrent powers to propose a plan. In this sense the European Rescue Plan differs from a U.S. Chapter 11 plan and from a plan under German law.
In Chapter 11 proceedings the main rule is that the debtor in possession has an exclusive right to propose a reorganisation plan during the first 18 months of the bankruptcy proceedings. After that so-called exclusivity period has ended, creditors also have the right to propose a plan. Under German law both the liquidator and the debtor are entitled to propose a plan. So in this respect the INSOL Europe proposal is more limited, which is probably necessary: having several proponents in a situation with multiple companies in multiple jurisdictions would be too complicated.

99. Another issue is which court should supervise the group plan. Since the liquidator of the group main proceedings will in most cases be the sole proponent of the plan, it would be most efficient if the court supervising those proceedings also supervises the proceedings relating to the plan and its confirmation. That is the rule adopted in Article 47(1) of the INSOL Europe proposal.

100. With respect to the question of the governing law, it would be impossible to apply the laws of each jurisdiction in which a company subject to the plan is situated because the plan is an integrated one. Moreover, in some jurisdictions – such as the Netherlands – the substantive and procedural rules on reorganisation plans are very old and restrictive. Under Dutch law a plan is not permitted to affect either secured or preferred creditors, although this might be necessary to make the plan viable in a group insolvency situation. In any event, the discrepancies between the plan-related rules in the various jurisdictions would make this approach unworkable.

101. Another possibility would be to apply the law of the Member State in which the group main proceedings have been opened. This would mean, however, that the law governing the permissible contents of the plan and the other substantive and procedural rules applicable to the plan could differ substantially depending on which company is deemed to be the ultimate parent company (as the main proceedings with respect to that company will be deemed to be the group main proceedings). However, the designation of a group’s ultimate parent company and, consequently, the Member State in which the group main proceedings are opened, can be manipulated very easily and is
therefore to some extent arbitrary. If the applicable law were to be the law of that Member State, it would be easy to produce a redistributive effect and this is undesirable from the point of view of legal certainty. It would also mean that each Member State would have to develop its own laws on international group plans. It therefore seems preferable for all such plans to be subject to the same rules and for those rules to be drawn up under Community law. Chapter VI of the INSOL Europe proposal is intended to provide such rules at Community level. Only typically local issues of procedural law should be governed by national law.

102. Article 50 of the INSOL Europe proposal lists a number of issues with which a European Rescue Plan may deal, but this list is not exhaustive. Under the INSOL Europe proposal the proponent of the plan enjoys a large degree of freedom with regard to its contents and structure. Under the U.S. Bankruptcy Code and Dutch bankruptcy law, the possible contents of such a plan are largely unlimited as well. Under German law the rules on the contents of a plan are set out in §217-221 InsO. In view of the complexity of a group’s internal and external legal relations, INSOL Europe elected not to limit the possible content of the plan insofar as the group companies which are subject to insolvency proceedings are concerned. Claims against such insolvent group companies or shares in such companies, may be modified, cancelled or decreased (Art. 50). The plan may affect the rights of secured creditors and provide for the termination of agreements to which insolvent group companies are a party. Solvent group companies may also be included in the plan, but only with their consent. Creditors and shareholders of solvent companies can be impaired under the plan with the consent of each of the affected creditors and shareholders.

103. Under the INSOL Europe proposal there are three key documents: (i) an information memorandum, (ii) a class schedule and (iii) the draft plan itself. Chapter 11 of the U.S. Bankruptcy Code provides for a disclosure statement that must be sent to the creditors and shareholders (§1125). The amount of information to be included in that statement depends on the type of bankruptcy. In small, simple bankruptcies creditors need not be buried under expensive 300-page documents; in

59 See above at 56-58
complicated bankruptcies the disclosure statement will be more elaborate. It is of course important that the creditors receive an information memorandum which is sufficient to enable them to take an informed decision. Under the INSOL Europe proposal the information “must be of a kind and in sufficient detail as far as is reasonably practical” to achieve that purpose. The proposal also requires the information memorandum to be approved by the court (Art. 51). Under U.S. law a disclosure statement is not needed if, prior to the opening of the bankruptcy proceedings, the plan proponent received sufficient powers of attorney to vote in favour of the plan and have it accepted. In that case, there is no need to solicit votes after the opening of bankruptcy proceedings and a disclosure statement is therefore also unnecessary. These proceedings are referred to as pre-pack proceedings. The INSOL Europe proposal does not provide for such proceedings.

104. Under U.S. law, the classification of creditors is part of the plan and is not subject to prior review by the court. Only at the confirmation hearing does the court decide to what extent disputed claims are to be allowed and how disputes on classification should be resolved. This means that under U.S. law these issues are decided after the voting on the plan has taken place. It seems to me that this is an unfortunate sequence of events. For one thing, the classes can be manipulated to influence the voting outcome by, for example, placing dissenting creditors in a larger class of creditors that favours the plan and thereby diluting their influence. Furthermore, It would seem preferable for the court to resolve disputes on the allowance and classification of claims before the actual voting occurs, because the court may otherwise be tempted to resolve them with a view to obtaining the desired voting outcome. Under German law, disputes on the allowance of claims are resolved before voting (§236 InsO). As I understand it, classification issues are part of the German court’s first review under §231 InsO, which takes place before the voting but is not definitive. Under the INSOL Europe proposal, both allowance and classification issues are resolved at the acceptance hearing and precede the voting. Under Article 51 of the proposed rules, the court sets a date for an acceptance hearing after approving the information memorandum. The liquidator then sends the information memorandum, the draft class schedule and the draft plan to the

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creditors and the (outside) shareholders of each of the group companies and invites them to the acceptance hearing. At the acceptance hearing, the court decides whether and to what extent disputed claims will be allowed for the purpose of their participation in the voting process and establishes the class schedule, which sets out the classification of the creditors and shareholders (Article 53).

105. Under U.S. law voting on a plan does not take place in court. The court’s involvement is limited to approving the disclosure statement and confirming the plan. Under German law the voting likewise does not take place in court, but the voting forms have to be sent to the court. In the case of a European Rescue Plan, voting takes place at the acceptance hearing after the court has decided on the disputed claims and established the class schedule (Article 54). The rules on voting are similar to those under a Chapter 11 plan. Classes of creditors who are not impaired under the plan do not vote; the same applies to classes of creditors who receive or retain no value under the plan. In order for a class to accept the plan, the plan must be approved by a majority representing more than two-thirds of the amount of the claims voting in that class and more than half of the number of creditors voting in that class. The same requirement applies under a Chapter 11 plan (§1126(c) U.S. Bankruptcy Code), but under German law simple majorities in both amount and headcount are sufficient (§244 InsO). INSOL Europe prefers the stricter requirement under the U.S. system, because of the international dimensions of the plan. A European Rescue Plan will have far-reaching consequences in the jurisdictions of the subsidiaries and it is therefore necessary that the plan have strong and widespread support. For the same reason the prerequisites for a cram down are rather strict.

106. Under both U.S. and German law, the courts will in principle apply the cram down provisions against a class of creditors that has rejected the plan if the absolute priority rule is met. Under the INSOL Europe proposal an additional test must also be met with respect to such creditors: the rejection must not have

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60 As mentioned above at 92, German law also requires acceptance by a majority of the classes. Under U.S. law the best interests test is not applied in the context of cram down, but always if a creditor opposes confirmation. Therefore, there can be no effective cram down under U.S. law if a creditor opposes confirmation and the best interests test is not met.
been in good faith. In my opinion this addition was warranted because, as mentioned above, the absolute priority rule cannot be applied effectively as between classes of creditors of different group companies. Therefore, if certain classes of creditors of both group Company A and group Company B are impaired but do receive some value and one or more of those classes reject the plan, usually the question of whether the plan is fair and equitable with respect to a rejecting class or whether the plan discriminates unfairly against such a class cannot be resolved through the absolute priority rule. In accordance with Article 54 of the proposal, cram down should be decided upon at the acceptance hearing. Classes of creditors that receive nothing and shareholders are not entitled to vote on the plan. Thus, they do not stand in the way of its acceptance and therefore do not need to be the subject of a cram down decision. They may, however, oppose the subsequent confirmation of the plan essentially on the same grounds as those on which rejecting classes may oppose a cram down. This is mainly a technical matter.

107. Article 55 of the INSOL Europe proposal provides that a plan which has not been rejected will be confirmed unless a creditor, shareholder or liquidator starts opposition proceedings and one of the grounds for refusing to confirm, which are listed in Article 55(3), applies. Article 55(3)(c) and (d) refer to the best interests and feasibility tests, which also constitute grounds for refusing to confirm under U.S. and German law. Under Article 55(3)(b), confirmation will also be refused if the absolute priority rule is not met with respect to objecting creditors that receive no value under the plan or with respect to objecting shareholders. As mentioned above, these creditors and shareholders are not subject to the cram down process. Therefore, the absolute priority rule will have to be applied to them at this stage. Finally, Article 55(3)(a) provides that the court will also not confirm the plan if it unfairly favours one or more creditors or shareholders. INSOL Europe was of the view that this test is needed because of the potential complexity of a European Rescue Plan and because of the limited relevance of the absolute priority rule. A similar test can be found in the Dutch Bankruptcy Act (Arts. 153(2)(3), 272(2)(3) and 338).

108. Although the proceedings are structured somewhat differently, the outcome under the European Rescue Plan is essentially the
same as under U.S. and German plans. An individual creditor should not be forced to accept less value than the value of his claim in a liquidation (best interests test). A more flexible approach is allowed with respect to the value that can be claimed under the plan above liquidation value. This surplus can be the synergy margin or it can be the aggregate of the differences between the going-concern values and liquidation values of the individual group companies. It can also be a combination of the two. The distribution of this margin is a matter for negotiation with or between the different groups of creditors. As to rejecting classes they can be crammed down but under the INSOL Europe proposal the test is somewhat different from the absolute priority rule, because it may not be possible to determine a ranking of creditors of different group companies.

109. It should be noted that the INSOL Europe proposal may not be fully comprehensive and that further rules relating to the European Rescue Plan will have to be added to the European Insolvency Regulation. For example, further rules may be needed to deal with the effects of the submission of the plan on the insolvency proceedings of the group companies included in it, such as rules on (i) a stay of liquidation activities in those proceedings, (ii) a stay of court proceedings with respect to the group companies other than the insolvency proceedings and (iii) expenses and fees incurred in the insolvency proceedings of the group companies that are included in the European Rescue Plan.

110. It has been suggested that the European Rescue Plan in effect amounts to substantive consolidation. I do not think that that is a correct assertion. Substantive consolidation relates to liquidation: all assets and liabilities are pooled and the liabilities are paid from the proceeds of the liquidated assets. A rescue plan in essence means that the creditors forego their mutual right of liquidation and accept value in some form in lieu of the proceeds of the liquidated assets. The value that each of the creditors receives is equal to the liquidation value of his/its claim against the estate of the relevant company or companies, plus a share in the margin as discussed above at 91.

V. Conclusion

111. Section 2 has discussed the possible group insolvency regimes. The
conclusion drawn from that discussion is that the regime in which the liquidator of the group main proceedings has coordinating powers is the preferred standard scenario. This regime may be combined with further rules on coordination between courts, but in many cases such coordination alone is not enough. Appointing one liquidator in all main proceedings of the group companies may sometimes seem an attractive option, but it may often be inadvisable as conflicts of interests between group companies can become particularly apparent in insolvency situations. If the COMIs of the group companies are located in different Member States, joint administration too is not an advisable solution because it produces serious redistributive effects or may require the court to apply laws from all over the European Union. It also seriously infringes the sovereignty of the Member States in which the COMIs of the group companies are located.

112. As discussed in Section 3, under the coordinating powers regime four scenarios are conceivable for the rescue of all or part of the business of an international group. The first scenario involves a coordinated asset sale in which both the liquidators and the courts of all group companies participate, and the second involves bundling rescue plans, one for each of the group companies involved. To my knowledge, no bundling of contingent rescue plans for group companies in three or more jurisdictions has ever led to the rescue of the business. Moreover, it is so complicated that good results can hardly be expected. The third scenario involves a combined sale of assets of group companies by the liquidator of the group main proceedings, under the supervision of the court overseeing those proceedings. This scenario faces the same problems that can occur in the case of a mutual liquidator. The fourth scenario is the unified rescue plan, a variant of which is proposed by INSOL Europe as the European Rescue Plan. It consists of a plan proposed by the liquidator of the group main proceedings (or its management). The plan proceedings are conducted under the supervision of the court of the group main proceedings and governed by Community law. It applies the system developed in U.S. and German rescue plans, which resolve conflict-of-interest issues through a cram down and confirmation process. Where a case is too complicated to achieve a coordinated asset sale or contingent rescue plans (which are, in principle, conceivable under the liquidator with coordinating powers regime, but will
fail in most cases because of their complexity), the unified rescue plan is the only viable solution. I think that it is important for this possibility to be created. U.S. law achieves the same result through joint administration, but as discussed, this is not an attractive solution in the European context for administering the insolvency proceedings of group companies located in different jurisdictions. To some extent the unified rescue plan scenario could be seen – solely for the purpose of adopting the plan – as a partial joint administration governed by Community law. The unified rescue plan scenario would enhance the regenerative possibilities of European groups and put them on a par with their U.S. counterparts. It would also strengthen the internal market and avoid the wasteful and unnecessary destruction of the capital of international groups in financial distress.

VI. Comments by Professor Madaus

113. I was very happy to read in his report to this Association (under VI) that Professor Madaus supports the European Rescue Plan. In that very interesting report, he nevertheless raises a number of objections to the plan in its present form, which will be discussed in this section.

114. As I understand it, Professor Madaus’s main objection relates to the absolute priority rule. As discussed above at 92, this rule provides that if a creditor is impaired a lower-ranking creditor (or a shareholder) may not receive any value. Under U.S. and German law, with respect to single companies, this rule does not apply with respect to classes of creditors that have accepted the plan, but applies only if the court is asked to impose a cram down on classes of creditors that have rejected the plan. The same system is adopted in the INSOL Europe proposal. So if a class has accepted the plan and a minority of creditors within that class opposes confirmation, the court will not apply the absolute priority rule. In other words, the plan can leave something for these lower-ranking creditors or for shareholders provided that the plan is accepted by the higher-ranking class(es). That an outvoted minority has to accept the receipt of value by a lower-ranking class is justified by the fact that a majority of its class – consisting of creditors with parallel interests – has accepted the plan, including this element thereof. Thus the creditors can negotiate on how any surplus above the liquidation value of
the relevant group company should be distributed among the various classes of creditors and the shareholders. If, however, a dissenting minority of a class receives less than the amount it would have received in the event of liquidation, it can successfully oppose confirmation based upon the best interests test. I think this is a fair system. If a class has rejected a plan the court should apply a much stricter test than if that class had accepted the plan. As is the case under Dutch law, a rejection should only be set aside if it is unreasonable (Art. 146 DBA). If the plan does not comply with the absolute priority rule, the rejection is deemed to be reasonable. Professor Madaus, however, is of the opinion that the absolute priority rule should be inapplicable not only if a creditor belonging to a class that has accepted the plan opposes confirmation but also in relation to cram down (II. 4.(2).b-d), VI.6). I respectfully disagree with him on that point.

115. Under the INSOL Europe proposal a European Rescue Plan may only be submitted by the ultimate parent company (when the insolvency proceedings are commenced) or (after such proceedings are commenced) by the liquidator of the group main proceedings. In U.S. bankruptcy proceedings creditors are also entitled to submit a plan after the so-called exclusivity period has ended. Professor Madaus is of the opinion that creditors should likewise be entitled to submit a European Rescue Plan where a company enters insolvency proceedings without preparation (VI.1). In his view this would equalise the relevant parties’ bargaining positions. The main reason why INSOL Europe rejected this possibility is that in group situations a consolidated rescue plan can include different combinations of group companies subject to insolvency proceedings and therefore involve different groups of creditors, as has been illustrated above at 96 and 97. If creditors could submit competing plans, these plans could in part involve different companies and would then need to be voted on by different groups of creditors. In INSOL Europe’s view, this would make the situation too complicated.

116. A third issue raised by Professor Madaus is that, in his view, the European Rescue Plan should not replace reorganisation plans under domestic law; the rules should therefore also deal with a situation in which a European Rescue Plan and a single-company plan under domestic law are proposed at the same time (VI.2).
For example, it may be necessary to stay the proceedings on the domestic plan as soon as a European Rescue Plan is submitted and until the proceedings on the latter plan have been completed. On this issue I agree with Professor Madaus. See also above at 109.

117. Fourthly, Professor Madaus objects to the fact that if the confirmation of a European Rescue Plan is not opposed, the court will confirm the plan without further investigation (VI. 6.a). In his view that would “disregard the honour of the court and (the) purpose of its participation”. It seems to me that if there is no opposition to the confirmation of a plan there is no need for a confirmation hearing on or further investigation of that plan. At least in the Netherlands, the courts never refuse to confirm a plan unless requested to do so. In most cases, the court would lack the knowledge to determine whether there are grounds for such a refusal if there is no dispute. As I see it, confirmation proceedings should function as a limited form of appeal against the acceptance of the plan.

118. A fifth comment by Professor Madaus relates to what he views as an underlying premise of the European Rescue Plan: that shareholders should not receive anything under the plan and should therefore not be entitled to vote on it. He disagrees with this premise, because the participation of shareholders may be necessary for the restructuring of the group whereas they may be willing to participate in the restructuring (VI.3). I am afraid that there is a misunderstanding here. Under the INSOL Europe proposal, shareholders can receive value under a European Rescue Plan provided that all classes of creditors with claims against the relevant group company accept the plan. The absolute priority rule does not play a role in relation to confirmation (except where confirmation is opposed by classes of creditors that receive nothing under the plan or by impaired shareholders (see Art. 55(3)(b))

119. A sixth comment by Professor Madaus concerns the court procedure. In his view an acceptance hearing is unnecessary, particularly to the extent that its purpose is to decide on the allowance of disputed claims and establish the classification schedule (VI.4.b). With respect to the establishment of the classification schedule he recognises that if this were postponed until the confirmation hearing, the court would already know
the outcome of the voting. That knowledge could tempt the court to decide the classification issues in a plan-friendly manner. However, Professor Madaus does not see this as a real problem. In his view the outcome of the vote is almost always known in advance. Moreover, he is confident that when making these decisions judges will not violate their duty to remain independent. I respectfully disagree with Professor Madaus on this point. I think it is important that the parameters with respect to both the allowance and classification of claims be set before the voting. I have seen two cases in the Dutch courts where the court tried to reverse the order so as to influence the outcome.

120. Finally Professor Madaus objects to the use of different cram down rules for, on the one hand, creditors who receive value and, on the other hand, creditors who receive no value and shareholders (VI.6.b). As I see it, there is no substantive difference between the two sets of rules. The difference is merely technical and is caused by the fact that creditors who receive no value and shareholders are not subject to cram down proceedings but can object to confirmation.

121. I would like to thank Professor Madaus for his thorough study of the proposal and his very well-considered comments. I hope that the debate on the European Rescue Plan will continue because in my view a consolidated plan of this nature is necessary in order to enhance the regenerating powers of international groups of companies in the European Union.
Section 4: Propositions

I. The preferred regime in group insolvency proceedings is a regime in which the liquidator of the main proceedings of the ultimate parent company has the power (i) to request the courts of the main proceedings of the subsidiaries to take measures in the interest of the creditors of the group and (ii) to propose local rescue plans. In support of this regime, rules facilitating communication between different courts, between courts and liquidators and between different liquidators should be adopted.

II. It should also be possible to appoint the same liquidator(s) in the insolvency proceedings of two or more companies in an international group, as this is sometimes desirable from an efficiency perspective. However, special attention should be given to conflict-of-interest issues, which tend to become more pronounced in insolvency situations.

III. The possibility of adopting a pan-European rescue plan with respect to two or more group companies should be promoted because it will facilitate international reorganisations where the COMIs of several group companies are located in different jurisdictions. It will also enhance the regenerating powers of European conglomerates, which is necessary in a global environment.
APPENDIX: PROVISIONS OF INSOL EUROPE PROPOSAL

CHAPTER VI: THE EUROPEAN RESCUE PLAN

Article 47
Filing of a European Rescue Plan

1. The liquidator of the group main proceedings may submit a draft European Rescue Plan (a “Plan”) with respect to two or more group companies to the courts of the Member State where proceedings have been opened with respect to the ultimate parent company under Article 3 paragraph 1.

2. The ultimate parent company may also submit a draft Plan jointly with its request to open insolvency proceedings under Article 3 paragraph 1 or pending opening proceedings.

3. The draft Plan shall be accompanied by:

   (i) a draft schedule placing all known claims in classes (the “class schedule”);

   (ii) a draft memorandum to the creditors of the group companies included in the Plan and to the shareholders of these group companies who are not group companies included in the Plan (the “information memorandum”).

Article 48
The Class Schedule
The draft class schedule may place a claim in a particular class only if such claim is similar to the other claims of such class and provided that all claims in one class are claims against the same debtor. If several group companies included in the Plan are liable for the same debt the claim will be placed in one class for each of the group companies.

Article 49
The Information Memorandum
The information memorandum shall contain information of a kind and in sufficient detail as far as is reasonably practicable that would enable each creditor of a group company included in the Plan as well as the shareholders of each group company included in the Plan, to make an informed judgment about the Plan and the class schedule.
Article 50
Contents of the Plan
The Plan may contain provisions which:
(a) modify, cancel or decrease claims against all or any of the group companies included in the Plan;
(b) modify, cancel or decrease shares held in the group companies included in the Plan and modify or cancel rights held in such shares;
(c) modify or cancel security rights with respect to assets of the group companies included in the Plan;
(d) terminate agreements or transfer of enterprises or parts of enterprises belonging to group companies included in the Plan or sell all or part of their assets;
(e) constitute or provide for any other legal act on behalf of the group companies included in the Plan.

Article 51
Approval of the information memorandum and setting of a date for the acceptance hearing
Provided that the court deems the information memorandum adequate it sets a date for a hearing of the shareholders and creditors of the group companies included in the Plan (the “acceptance hearing”). If it finds that the information memorandum is not adequate it will instruct the proponent of the Plan how to improve it or reject the request for proceedings on the Plan. The court sets a time at which the draft Plan, the approved information memorandum and the class schedule must be sent to the creditors and the shareholders of each of the group companies included in the Plan.

Article 52
Convocation and order of acceptance hearing
The law of the member state where the group main proceedings have been opened applies to the convocation of the creditors and shareholders, the filing of claims and the order of the acceptance hearing.
Article 53
Recognition of creditors and determination of class schedule
At the acceptance hearing, each of the group companies included in the Plan, each of the liquidators of such group companies, the ultimate parent, the liquidator of the parent company, each shareholder of a group company included in the Plan who is not itself a group company and each of the creditors of each group company may dispute each claim. The court decides if and to what amount a disputed creditor is allowed to vote on the Plan. The court furthermore establishes the class schedule after hearing the creditors and the shareholders.

Article 54
Acceptance of the Plan
1. At the acceptance hearing the creditors of the group companies included in the Plan vote on the Plan. The proponent of the Plan may adapt the Plan until the voting commences.
2. Classes of creditors who are not impaired under the Plan do not vote on the Plan.
3. Classes of creditors who do not receive or retain any value under the Plan do not vote on the Plan.
4. Classes of creditors who do receive or retain value under the Plan shall vote and shall have accepted the Plan if creditors vote in favour of the Plan who represent more than two thirds of the amount of the claims voting in such class and constitute the majority of the creditors voting in such class.
5. If a class of creditors who do receive or retain value under the Plan does not accept the Plan, the court may determine that such class of creditors is deemed to have accepted the Plan nevertheless provided (i) that the rejection is not in good faith and (ii) that the creditors of such class do not receive less than they would receive if no Plan was adopted and (iii) that no creditor that is junior to such class of creditors with respect to the relevant company and no shareholder of that company receives or retains any value under the Plan.
6. If one class of creditors as defined in paragraph 4 has rejected the Plan and is not deemed to have accepted the Plan under paragraph 5, the court establishes that the Plan has been rejected.
Article 55
Confirmation
1. If the Plan is not rejected the court will confirm the Plan unless (i) a creditor of one of the group companies included in the Plan or (ii) a shareholder who is not a group company included in the Plan or (iii) a liquidator of the ultimate parent or one of the group companies included in the Plan, commences objection proceedings within a period of time determined by the law of the member state of the group main proceedings.

2. If the Plan is not rejected and objection proceedings have been opened the court will hold a hearing at which the creditors, shareholders and liquidators of the group companies included in the Plan and of the ultimate parent company will be heard.

3. The court will confirm the Plan unless objection proceedings have been opened and:
   (a) the Plan unfairly favours one or more creditors or shareholders; or
   (b) a creditor or shareholder who in relation to the relevant company is junior to a creditor as referred to in Article 54 paragraph 3 objecting to the Plan or to an impaired shareholder objecting to the Plan receives any value under the Plan; or
   (c) the creditor or shareholder objecting to the Plan receives less value than he would receive if the Plan was not adopted; or
   (d) there is insufficient certainty that the Plan can and will be implemented.

Article 56
Appeal proceedings
The law of the Member State of the court which decides on the confirmation determines whether the judgment in which confirmation is rejected or granted is subject to appeal and the same law applies to such appeal.

Article 57
Default under the Plan
The law of the Member State of the court which decides on the confirmation determines the consequences of any failure to observe the provisions of the Plan.
RESCUING COMPANIES INVOLVED IN INSOLVENCY PROCEEDINGS WITH RESCUE PLANS

by Prof. dr. Stephan Madaus, professor of Civil Law, Civil Procedure and Insolvency Law, University of Regensburg

“Bankruptcy Law cannot work miracles, and more harm than good comes from seeking that which cannot be had.”
Douglas G. Baird, 2001

I. Introduction

I feel very honoured to be allowed to speak to such a distinguished audience, and I would like to thank Prof. Bob Wessels and the NACIL for giving me this opportunity. The subject of my report is how rescue plans rescue companies.

I would like to use this opportunity to explain my views on rescue by first outlining the fundamentals of rescue efforts in insolvency proceedings. From there, I will recommend creating a distinguished set of rules for two very different scenarios in rescue cases: prepared and unprepared cases, both of which should nonetheless be addressed by insolvency law. In closing, I will discuss the ideas of the European Parliament and INSOL Europe regarding rescue plans, which offers the opportunity to translate the fundamentals of rescue efforts into detailed remarks on the proposed European Rescue Plan.

II. The idea of rescue and the insolvency regime

In times of crisis, the common wish to preserve the good times as much as possible often prevails. Companies are no exception. When a larger business is hit by changing markets, its management hope to see a business survive as much as their employees or local politicians. They wish to see the status quo preserved. There is good reason for this wish because the redistribution of assets, even if economically necessary, will not happen without cost incurred and social distortions. The shutting-down of a local steel factory can be as threatening for a local politician as the failure of a car producer like GM for an entire state in the United States. Therefore, it is no surprise that, even at the moment of insolvency, the ultimate crisis, the desire for a rescue still prevails.

Despite all the political and social pressure, it seems clear that the rescue of a company or business is a management issue. Recognising a crisis and implementing a turnaround is the type of fundamental management skill taught at every business school. It is relevant in every phase of a business crisis, and the insolvency phase is no exception. If a crisis, particularly in the strategy or the earnings of a company, is not addressed properly, illiquidity and thus insolvency will eventually occur. There might still be the chance for a turnaround, but a major difference in this stage of a company’s life is, however, that the law tends to find legitimate reason to interfere, providing insolvency law as a special form of regulation.

To understand why lawmakers impose a legal regime on debtors in insolvency cases, one has to consider how insolvency law has changed dramatically over the past 2,000 years in terms of its purpose. Initially, insolvency was mostly held to be a criminal offense in cases where debtors defaulted on their obligations. Therefore, insolvency law provided for the punishment of the debtor. The resulting negative image of insolvency – in Germany termed “Makel der Insolvenz”\textsuperscript{2}, which roughly translates to “the stain of insolvency” – persists in the mind of continental Europeans to this day, associating every insolvency with a picture of failure and disgrace.\textsuperscript{3}

The second purpose of insolvency law has always been the orderly liquidation of an insufficient estate and the equal distribution of the proceeds among creditors. Since Roman law, insolvency proceedings have therefore been based on mandatory rules to prevent unequal distribution of the limited debtor’s estate by setting up a judicial forum. This aspect of insolvency law has not since lost its authority.

1. Rescuing insolvent companies by auction (liquidation)

In this context, the idea of rescue has never been a specific purpose of insolvency law. The rescue of a business was held to be an event that should occur outside of bankruptcy. Yet the purpose of insolvency law does not actually conflict with the idea of rescue as long as the rescue option promises a superior payoff for creditors. The rescue


\textsuperscript{3} See Austria, changing the name of the proceedings from “Zwangsausgleich” to “Sanierungsverfahren”.
of a business is a possible solution in the liquidation of a debtor’s estate in insolvency proceedings if the debtor’s business can be sold as a going concern to a single buyer, resulting in a higher price than achievable in piecemeal liquidation. This efficient way of rescuing insolvent companies by auction has dominated the German insolvency practice for decades; additionally, it has seen a huge comeback with the rescue of Chrysler and GM in the United States, as well as in many pre-pack sales in the UK. After all, both the notion of business rescue and the purpose of insolvency law converge in such cases, maximizing creditors’ payoffs.

2. Rescuing insolvent companies by arrangements (reorganisation)

Lawmakers soon discovered that an actual sale is not always necessary to achieve the goal of both rescuing a business and maximizing creditors’ payoff. If you allow a debtor to negotiate a price for a virtual sale of a business, you can even achieve a third goal: a fresh start for the debtor. Consequently, the law of developing states and cities in Medieval Europe began to offer the option of an arrangement or a composition in bankruptcy, allowing merchants to continue their business free of old debt following an agreement with their (unsecured) creditors on a fixed sum payable in exchange for a discharge. As a result, creditors receive as much as they would receive in a real sale while the discharged debtors are allowed to continue running their businesses. As a debtor in such cases remained in possession of the business at the end of the insolvency proceeding, a reorganisation was achieved. Thus, insolvency law addressed the problem of financial distress in a debtor-friendly manner without abandoning its fundamental rules.

3. Corporate reorganisation and equity involvement

For centuries, a reorganisation under insolvency law has been achieved by voluntary arrangements between debtors and their creditors. Lawmakers soon discovered that an actual sale is not always necessary to achieve the goal of both rescuing a business and maximizing creditors’ payoff. If you allow a debtor to negotiate a price for a virtual sale of a business, you can even achieve a third goal: a fresh start for the debtor. Consequently, the law of developing states and cities in Medieval Europe began to offer the option of an arrangement or a composition in bankruptcy, allowing merchants to continue their business free of old debt following an agreement with their (unsecured) creditors on a fixed sum payable in exchange for a discharge. As a result, creditors receive as much as they would receive in a real sale while the discharged debtors are allowed to continue running their businesses. As a debtor in such cases remained in possession of the business at the end of the insolvency proceeding, a reorganisation was achieved. Thus, insolvency law addressed the problem of financial distress in a debtor-friendly manner without abandoning its fundamental rules.


creditors. Within the past hundred years, however, corporations have begun to dominate the practice of business reorganisation. This type of a debtor allows for the issuing of shares of the reorganised company instead of cash being paid in a virtual sale, which makes a reorganisation much less cash dependent. Yet, in order to issue new shares in a reorganisation proceeding, old equity has to agree to alter the corporation’s ownership structure accordingly. Consequently, the way to involve equity interest in insolvency proceedings has become a widely discussed topic.

The role of equity in corporate insolvency seems well defined. In insolvency proceedings, it is the estate of the debtor that is to be distributed among creditors. Equity interest in a company or corporate debtor is not part of that estate and therefore out of creditors reach in an execution as well as in insolvency proceedings. How insolvency affects shareholders rights is to be determined solely by company law. As a common company law principle, the company dissolves after liquidation and equity interest thereby disappears.

In a corporate reorganisation, however, the company debtor does not dissolve, and equity interests do not disappear. A reorganisation plan would commonly provide for the company to survive and the creditors to be paid from the earnings of the discharged debtor. There is no need to involve equity holders. This, of course, could create a windfall profit for equity holders if they do not contribute to the reorganisation and keep their entitlements untouched, while creditors would bear the burden of the debtor’s discharge. Considering this, creditors might only be willing to consent to a reorganisation plan if equity holders are also impaired. As a result, there is a conflict between creditors and equity holders during the reorganisation process and various ways to address this.

4. How to treat equity in a corporate reorganisation

One option is to follow the fundamental principle of respecting out-of-insolvency entitlements in insolvency proceedings. As we accept property rights and liens, we would respect the rights of equity holders provided for by company law and leave them immutable. This traditional position was held in German insolvency law until the major reform act of early 2012. It is still the state of the law in many countries such as Austria, where equity interest may not be impaired by rescue plans over the course of insolvency proceedings.
The second option is to treat equity holders in a reorganisation scenario in the same manner as in a liquidation scenario. In the latter, they would only receive or retain property from the debtor’s estate if all creditors receive property or payments equal to the full amount of their claim (the absolute priority rule). In an insolvency situation, a full payment to all creditors is next to impossible. Hence, equity interest does not have any value, and equity holders should not be allowed to vote on a rescue plan or even veto a reorganisation plan even if such a plan would wipe out old equity for the sole benefit of the creditors. This position is held by Chapter 11 of the U.S. Bankruptcy Code and has been a model example for insolvency reform in many other countries, especially Germany.

The third option is to allow negotiations between creditors and equity holders within the insolvency arena as well as outside, without applying a strict priority rule. In such cases, both sides are asked to negotiate and then vote on a rescue plan, thereby sharing the extra value of a going-concern solution that keeps the debtor in business instead of selling the business in an auction process as part of the liquidation of the debtor’s estate. The Law in the UK has some similarities with this approach in its scheme of arrangement, which applies to insolvent debtors as well as solvent and thus requires every side to negotiate and consent. Consequently, a cram-down, in particular, would be restricted to creditors or equity holders, who represent a minority in their class and are treated fairly by the terms of the plan.

In my opinion, the third option is most favourable.

a) The need for equity involvement in case of their impairment

Firstly, modern reorganisation law seems imperfect without the ability to address the dispute between creditors and equity holders directly. Although a reorganisation plan may, of course, only provide for the virtual sale of the debtor’s business (asking creditors to agree on a fixed payoff much less than the face value of their claims), a plan may also contain a far more sophisticated solution by providing for
a restructuring of secured credit as well as turnaround efforts (e.g. a new strategy, new products, less employees) or the restructuring of ownership in companies (e.g. a debt-to-equity-swap). In doing so, a rescue plan may bring about questions of property law or – in case of the impairment of shareholders’ rights – Company law. Every person impaired by the plan should than be allowed to participate in the negotiating process, and their final consent should result in a single rescue plan that solves all relevant problems.

Secondly, we need a single forum where all parties involved in a reorganisation meet and negotiate. When creditors and equity holders meet separately, every agreement of the part of creditors depends on the belief that equity holders will meet the pre-conditions of the creditor’s agreement and vice versa. As has been experienced in German Insolvency Law, implied uncertainty leads to a deadlock in which every side looks to the other to act first. Instead, it would be much more efficient to let every party talk to each other directly to better enable the negotiation of a single binding agreement.

As a first result, most would likely agree that even in insolvency, a rescue plan may require the impairment of secured credit or equity interest, which leads to the necessity to involve both creditors and equity holders, thus eliminating the first option mentioned above.

\[ b) \text{No principal subordination of old equity on solely economic reasons} \]

The decision to bring equity to the insolvency table then results in a widespread reflex to subordinate equity interest according to the absolute priority rule as seen in the second option. I believe there is good reason to do otherwise if the relationship between insolvency and company law is reflected thoroughly. Therefore, the special purpose of a reorganisation should be explained first.

\[ (1) \text{Who is entitled to claim a reorganisation surplus value?} \]

As mentioned in the first chapter of this report, a business rescue does not require a reorganisation. The business may in most cases be sold as a going concern by a quick and therefore cost efficient auction procedure, that is to say liquidation. However in a few cases, a reorganisation plan may amount to a higher value because the
business entity is allowed to continue its operations in its contractual environment, thus allowing the reorganised debtor to capitalize on favourable contracts and concessions. Such reorganisation surplus value requires two things to be realised: a discharge of old debt and the continuation of the company. Outside of bankruptcy, creditors decide on the first; equity holders, the latter. Thus, this special surplus value can only be realised in cooperation. Do these principles change as soon as insolvency proceedings are opened?

a. The economic view on bankruptcy

Most practitioners would see no problem in making a difference as soon as a corporate debtor arrives in the state of insolvency. Since old equity is “under water” here, their interest is to be wiped out. This view is founded by a (solely) economic valuation of the positions of old equity and creditors in regular insolvency proceedings, that being a liquidation scenario. Here in deed, old equity would only receive or retain any property from the debtor’s estate if all creditors receive property or payments equal to the full amount of their claim and in an insolvency situation, a full payment to all creditors is next to impossible. Hence the argument seems quite convincing that in every insolvency proceeding equity interest does not have any value, and therefore equity holders should not be allowed to vote on a rescue plan or even veto a reorganisation plan even if such a plan would wipe out old equity for the sole benefit of the creditors.

Based on this economic approach to insolvency proceedings, a reorganisation surplus value is to be distributed to creditors only because it is a value generated in the course of insolvency proceedings.

b. The legal view on bankruptcy

The economic approach may seem convincing, yet it is a quite one-sided as it treats a person’s right solely according to the value this right holds in a possible liquidation. However, legal rights are independent of their economic value. This fact is particularly relevant in company

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9 These different views on bankruptcy proceedings represent a fundamentally different understanding of the role of bankruptcy in the legal system; see Douglas G. Baird, Bankruptcy’s Uncontested Axioms, 108 Yale L.J. 573, 576 et subseq. (1998-1999), distinguishing “traditionalists” from “proceduralists”.

83
law, where shareholders may not be entitled either to sell their share\textsuperscript{10} or to receive dividend distribution on behalf of their share.\textsuperscript{11} An equity holder is a member of a company, perhaps even their founder, and membership rights consist of much more than a proprietary interest only. It is the right to participate in decision-making (voting rights) in particular that has importance and enjoys special legal protection under company law (shareholder protection provisions).\textsuperscript{12} In case of a corporate debtor, this protection is brought to the insolvency arena. Here it is respected by the principal rule to accept out-of-bankruptcy entitlements. At the same time, company law does not provide for any termination of equity holders’ rights due to insolvency as a general rule. The legal position of equity holders principally remains unaltered by insolvency proceedings. It is the mere fact of the dissolution of the company in the course of liquidation which leads to the impairment of equity rights. But if there is a principal rule that equity holders’ rights are not subject to alterations under insolvency law, it constitutes an exception to such rule to allow an insolvency plan to impair equity interest. Thus, it is no surprise that some states’ law does not allow any insolvency plan to impair equity interest.\textsuperscript{13}

As a first conclusion it is important to state that old equity is not wiped out at the very moment a corporate debtor is insolvent and enters insolvency proceedings. Insolvency in itself does not alter or eliminate the rights of equity holders. Consequently, the economic approach does not reflect all relevant rights in insolvency cases aiming at corporate reorganisation. Here it is the undiminished right of the shareholders to decide whether their company should continue operating. Thus, it is up to them to decide on a reorganisation surplus value being generated (the “shareholders’ choice”).

\textsuperscript{10} See e.g. public companies or corporations issuing registered share with restricted transferability (§ 68 Aktiengesetz). For private limited companies and partnerships, the transferability of shares may be reduced to the point where they become untransferable – see Günter H. Roth/Holger Altmeppe, GmbHG, (7th ed. Munich 2012), § 15 Rn. 107.

\textsuperscript{11} In Germany in a limited partnership with a limited liability company as general partner (“GmbH & Co. KG”), tax provisions lead to the exclusion of the general partner from any dividend distribution in many articles of incorporation.

\textsuperscript{12} On the European level see Art. 25 of the Second Council Directive 77/91/EEC for publicly held companies.

\textsuperscript{13} An example for such law may be found in Austria. It was also the state of the law in Germany until March 2012.
(2) Should creditors be entitled to claim a reorganisation surplus value?

The state of law is not immutable as German insolvency law illustrates. There would be good reason to amend insolvency law according to the economic approach if creditors are indeed entitled to receive a reorganisation surplus value because of (a) their claims or (b) their priority to old equity in insolvency distributions.

a. The limits of creditors’ entitlements

It is quite obvious that creditors are not entitled to a reorganisation surplus value by the legal position based on their claim against a debtor as equity interest is not part of the debtor’s estate and thus not part of a creditor’s entitlement under the law of execution or insolvency law. Creditors may liquidate all the assets of the debtor, which may lead to a sale of the debtor’s business. If the auction price reflects a going concern value of the business, it is to be distributed among creditors only. This auction option creates a liquidation level that is guaranteed to every creditor under insolvency law as well as by their right of property under constitutional law. In a plan confirmation hearing, the court applies a “best interest test”\(^\text{14}\) to ensure that no dissenting creditor receives less.

b. No absolute priority of creditors over old equity

Even though creditors’ entitlement does follow from substantive law, it could be based on a priority deriving from procedural law. For insolvency proceedings, the absolute priority rule (APR) could establish such priority. The priority set by the APR reflects the priority in insolvency law as well as company law in case of liquidation: senior credit, unsecured credit, junior credit, and equity. The company ends in the course of its liquidation with its estate distributed according to this ranking.

However, in a reorganisation scenario, a principally different situation arises owing to the sole fact that the company survives. At the same time

\(^{14}\) U.S. Bankruptcy Courts were only allowed to confirm a composition agreement between the debtor and its creditors under the Bankruptcy Act 1867 (§ 5103A), if such agreement was “for the best interest of all concerned”. For a detailed history of the “best interest test” under U.S. Bankruptcy Law – see Jonathan Hicks, Foxes Guarding the Henhouse: The Modern Best Interests of Creditors Test in Chapter 11 Reorganizations, 5 Nev. L. J. 820, 822 et seqq. (2005).
time, there is no distribution of the estate as the future earnings of the company debtor pay creditors. Thus the situation is much more analogous to an arrangement or composition, where a debtor enters insolvency and negotiates a discharge in a “virtual sale”. But this “virtual sale” does not justify treating the participants according to liquidation rules in order to set aside old equity, because there would be no “virtual sale to the owners” in the first place without their consent. Thus if creditors need the continuation of a business in the hand of a debtor to realise a surplus value, they need to negotiate and consent with their debtor, and then you may very well picture this as a “virtual sale”. The debtor again may decide either to resume their business activity under the agreement reached with their creditors or cease this activity to do something else. I would advocate that the same rules should apply to a debtor, be they an individual or a company. The owners of a business should decide on its continuation (“debtor’s or shareholders’ choice”) while the creditors decide on a discharge (“creditors’ choice”). This balance of power illustrates that there is no similarity in a reorganisation to a liquidation scenario, calling for the APR to be applied.

By accepting a fundamental difference between reorganisation and liquidation scenarios, the very purpose of the APR in a reorganisation is in question as it is widely accepted to be “the spirit” of the absolute priority rule “to keep the priority order in reorganisation proceeding in line with the liquidation and non-bankruptcy priority order”. Instead, a “best interests of creditors test” provides sufficient protection for the non-bankruptcy rights of creditors (their claims) by guaranteeing the distribution of value to the amount that they would have received in liquidation inside or outside of bankruptcy. Additional protection by an APR against a distribution of wealth under insolvency law to the benefit of other parties than creditors does not seem necessary as creditors cannot claim additional value under non-bankruptcy law. It is the liquidation value guaranteed by the “best interest test”


17 Thomas H. Jackson, The Logic and Limits of Bankruptcy Law (Harvard University Press 1986) p. 215, also stresses the importance of a guaranteed liquidation value.
that ensures that (secured and unsecured) creditors only agree to a reorganisation plan if they would receive additional value as this comes with the additional risk of reorganisation costs.\textsuperscript{18} Again, the APR is not needed to create the incentive for creditors when they decide whether to liquidate or reorganise the debtor’s company.\textsuperscript{19}

c. No legal transplant of the American absolute priority rule

As a further remark on the APR, it is necessary to remember that this rule was not made for reorganisation scenarios and does not work well in reorganisation scenarios. It should therefore not be seen as key feature of any future European reorganisation law.

As a rule governing liquidations, the U.S. Supreme Court brought the APR into a reorganisation context in 1913 in a decision regarding the rights of unsecured creditors in an equity receivership proceeding.\textsuperscript{20} At the end of the 19\textsuperscript{th} and beginning of the 20\textsuperscript{th} century, failing railroad companies were restructured by a procedure called equity receivership, in which the estate of the railroad was essentially sold in a court-approved foreclosure sale. Because of the huge value of nationwide railroad assets, the auction process was hardly ever an open process. Instead, a corporation appeared as the sole bidder and buyer, founded and structured according to a lengthy negotiated “reorganisation plan” by old equity and bondholders of the railroad. While these groups were well organised and represented by Wall Street banks and law firms, unsecured creditors lacked the representation needed to participate in the new corporation. They were left to share the little amount of cash brought up in the sale.\textsuperscript{21} In 1913, the U.S. Supreme Court tried to protect unsecured creditor’s rights by applying the APR to such sales. By this ruling, no sale could be confirmed where equity holders receive

\textsuperscript{18} On costs of reorganisations see Thomas H. Jackson, The Logic and Limits of Bankruptcy Law (Harvard University Press 1986) pp. 216-217. His assumption that shareholders would have an incentive to delay negotiations as they have nothing to lose by delay is basically true but needs to consider that shareholders will only win in case of a successful reorganisation while creditors may always decide to liquidate without shareholders’ consent. The overall incentives should therefore favour a speedy decision process.

\textsuperscript{19} It is held to be the second aspect of the APR to ensure this incentive; see Yongqing Ren, Wealth Distribution in Chinese Bankruptcy Reorganization Law and Practice, 20 Int. Insolv. Rev. 91, 98 (2011).

\textsuperscript{20} Northern Pacific Railway Company v. Boyd, 228 U.S. 482 (1913).

something before creditors are paid.\textsuperscript{22} As the foreclosure sale in equity receivership was a liquidation sale in nature, the priority of creditors before shareholders was obvious. The estate of the debtor as well as the proceeds from a liquidation sale can be claimed by the creditors as part of their claim entitlements protected by the constitutional right of property.\textsuperscript{23} The origin of the APR thus illustrates once more its scope: it is a rule in a liquidation scenario.

Driven by the wish to ultimately end the practice of equity receivership, the Chandler Act 1938 incorporated the APR into the Bankruptcy Act and allowed its application in every bankruptcy reorganisation. That was not altered by the Bankruptcy Code 1978, resulting in a rule created for a special practice but applied outside of its original and legitimate scope in every Chapter 11 proceeding. Not surprisingly, such a regulation creates problems in reorganisations as it gives a veto right to junior creditors in a scenario where the cooperation of old equity is required and welcome to arrange for a rescue plan, and for that reason, equity rights are to be left unimpaired. Under such a plan, equity holders receive something before all creditors are paid the full amount of their claims. Although such plans are quite common, they violate the APR.\textsuperscript{24} To prevent junior creditors from vetoing a fair solution, a “new value exception” to the APR has being widely discussed ever since the APR was brought to reorganisation scenarios in the 1930’s. By that rule, a violation would be cured if old equity holders bring up new value, at least to the amount of what they receive.\textsuperscript{25} This discussion should finally result in the awareness that the APR neither fits into reorganisation scenarios nor promotes company rescues.

\begin{thebibliography}{99}

\bibitem{22} \textit{Northern Pacific Railway Company v. Boyd}, 228 U.S. 482, 502 (1913).
\bibitem{23} 228 U.S. 482, 508 (1913).
\bibitem{25} The U.S. Supreme Court initially supported a “new value exception” in \textit{Case v. Los Angeles Lumber Co.}, 308 U.S. 106, 121-122 (1939). Under the current Bankruptcy Code 1978, the Supreme Court has been considering the exception in two cases, but did not reach the issue in each of them; see \textit{Norwest Bank Washington v. Ahlers}, 485 U.S. 197 (1988); \textit{Bank of America Nat’l Trust & Sav. Ass’n v. 203 LaSalle St. Partnership}, 526 U.S. 434 (1996). For academic literature on the issue, see \textit{Douglas G. Baird}, Bankruptcy’s Uncontested Axioms, 108 Yale L.J. 573, 584 (1998-1999), with references in note 37.

\end{thebibliography}
d. APR as a punishment

Finally, equity holders should not be held junior to all creditors in a reorganisation scenario because they have chosen not to save the company by contributing additional funds and thus “surrendered the company”.\textsuperscript{26} Again, insolvency is held synonymous with failure – a reason for punishment. Again, if we accept that rescue by reorganisation is an option for every debtor as is widely believed; a reorganisation under insolvency law becomes a management tool – an option to choose in serious crisis. Here, the decision to invest additional funds is adjourned until negotiations with all stakeholders lead to a plan that makes such investments rational. At the same time, regulation wants every troubled debtor or its management to seek help in reorganisation proceedings before all hope is lost and the estate fully depreciated. Thus, there must not be punishment imposed on a debtor and their owners who at an early stage, voluntarily, and in a prepared manner, enter into insolvency proceedings to reorganise under court protection and with improved bargaining power towards creditors by depriving such owners of their rights and entitlements. In this respect, the APR gives owners and management every reason to stay out of insolvency proceedings for as long as they can, rendering reorganisation impossible in many cases.

(3) Conclusion: No entitlement on a reorganisation surplus value

In conclusion, there is no reason to change the legal treatment of equity holders’ rights in insolvency proceedings in the case of an intended reorganisation. It is the creditors’ as well as the debtor’s/shareholders’ choice to reorganise an insolvent debtor and access a special reorganisation surplus value. Insolvency law should let them negotiate a solution with all creditors, and a judge should confirm this solution if it meets a rather general “fair and equitable” standard. The plan will have to distribute the special surplus value of a reorganisation amongst creditors and equity holders on a fair scale: the plan shall be proposed and negotiated in good faith and, considering creditors’ rights, the best-interest-test will have to be completed. Besides these conditions, there is no need for a strict APR to protect creditors from

\textsuperscript{26} See Robert van Galen, International groups of insolvent companies in the European Community, IILR 2012, 376, 391.
equity in a reorganisation.²⁷

c) A cram-down rule for a class of equity holders

In a model insolvency regime, equity holders should participate in negotiating a rescue plan as well as in voting on a proposed plan as a class provided that the debtor is a company and the plan provides for the impairment of equity interest. If the majority in a class of equity holders voted against such a plan, a cram-down rule has to be considered in order to overcome an unreasonable holdout. As for a class of creditors, a negative vote should and may only be overturned by the court confirming the plan, if the dissent of a class constitutes an abuse of (holdout-) power. A cram-down is an exception to the right of each class to reject a proposed plan.

As the APR should not be applied against a group of equity holders for the sole benefit of creditors, a cram-down rule cannot be based on the idea of subordination of old equity. Respecting the fundamental difference between liquidation and reorganisation, the liquidation value of equity rights (which comes down to zero in the hypothetical liquidation of most insolvent companies) may only be seen as a minimum standard to protect equity rights. However, the liquidation value represents the solely economic view on equity rights and does not, therefore adequately protect these positions in a reorganisation. Insolvency regimes that protect equity rights by the “best interest test” only, such as U.S. Chapter 11²⁸ or the German Insolvency Code²⁹, result in a lack of protection concerning the main aspect of equity rights in a company. As non-economic membership rights are to be protected against involuntary impairment, a plan proposed in good faith can only be considered fair and equitable and be confirmed against the vote of an impaired class of equity holders if:

1. each equity holder in that class receives or retains, under the plan on account of such interest, property of a value that is not less than the amount such holder would so

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²⁷ Douglas G. Baird and Robert K. Rasmussen proposed a similar deviation from the APR called “relative priority rule” as they also find insufficient results in reorganisation cases caused by the APR; see Baird/Rasmussen, Chapter 11 at Twilight, 56 Stan. L. Rev. 673, 691-693 (2003-2004); as well as Control Rights, Priority Rights, and the Conceptual Foundations of Corporate Reorganizations, 87 Va. L. Rev. 921 (2001).
²⁹ See § 245 (1) Nr. 1 and (3).
receive or retain in a liquidation as of the effective date of
the plan ("best interest test") and
2. the plan only provides for the distribution of the future
revenue of the debtor while it does not impair ownership
structure of the debtor.\textsuperscript{30}

Such rules would protect equity holders from infringements of
their membership rights that a plan cannot impose without their
(majoritarian) consent.\textsuperscript{31} At the same time they would provide for
creditors’ access to the companies’ future revenue. Ultimately, equity
holders cannot veto a plan solution that would leave their ownership
unimpaired while guaranteeing distribution to creditors according to
their remaining rights. Such a solution appears fair and equitable as
creditors as well as old equity holders would share the reorganisation
surplus value according to their legal positions in insolvency
proceedings: ownership is protected and shares may regain value after
a successful reorganisation; creditors receive payments from future
revenue on their remaining claims before old equity may request any
dividend distribution. Taken as a whole, every class benefits, which
allows for the confirmation of such a plan as being fair and equitable.

\textbf{III. Addressing a prepared rescue case in insolvency
proceedings}

The fundamental set of rules, defined in the first part of this paper,
can be applied to insolvent companies as well as solvent companies
negotiating a rescue plan. As, owing to these preconditions, insolvency
law or insolvency rules would not discriminate equity interest, the
relevance of an insolvency test in a reorganisation is restricted to the final
“best interest test”, where the value of the estate is to be determined
by a hypothetical liquidation to protect the rights of dissenting
creditors and shareholders. As the procedural rights of creditors or
equity holders in a reorganisation would not depend on the matter of

\textsuperscript{30} The issuance of non-voting preferred stock to creditors securing the distribution
to creditors under the plan (debt-to-equity swap) would not constitute such
impairment.

\textsuperscript{31} Such regulation will smoothly meet the standard set by Art. 25 of the Second
Council Directive 77/91/EEC and the interpreting decisions of the ECJ set in
the debtor’s insolvency, court proceedings established by insolvency law offer a viable procedural solution to the problem of coordinating complex negotiations about a rescue plan for a troubled debtor. There is no reason why the rescue plan regarding a solvent debtor should result from a different proceeding than that of an insolvent debtor. Therefore, there seems to be no need for independent but similar court proceedings in pre-insolvency-scenarios. If confidential out-of-court workouts fail to require consent, their negotiated solution can be proposed as a plan in quick insolvency proceedings that should be reduced to a single quick confirmation hearing. In order to cover such “fast-track-proceedings”, insolvency law should add them to its program by addressing perfectly prepared insolvency cases (scenario 1) as well as unprepared cases (scenario 2).

1. Failed out-of-court workouts and prepared insolvency

In the first scenario, the management of a company addresses an occurring business crisis late though properly by negotiating restructuring efforts with key creditors and major equity holders. These negotiations can be kept confidential and restricted to relevant stakeholders. If these out-of-court workouts are successful, insolvency will be averted.

If, on the other hand, workout negotiations fail to result in a consensual resolution of the situation, insolvency proceedings are to be considered. At present, a negotiated rescue plan may have the support of a majority of creditors and equity holders but fail to find consensual support. Here it seems useful to protect the rescue plan by law and allow the management to enter into a confirmation proceeding that will eventually result in a rescue plan backed only by a majority, but still binding to every creditor and equity holder. At the same time, the law should provide for conditions that will keep a business running and its management in place while making the decision about the plan, even if the company becomes temporarily insolvent or voluntarily enters insolvency proceedings for the protection of an automatic stay.

2. Unprepared insolvency

The second scenario is the common insolvency case. Here, the management of a company might have ignored a critical business development while hoping for better times or perhaps even a miracle; in other cases, it might have been surprised by a sudden macro-
economic downturn or a recession. The common attribute is that the company finds itself in insolvency proceedings without preparations. In such cases, it is an open question to everyone involved whether the business is worth reorganising or better to be sold as a whole or even to be wound up in a quick piecemeal liquidation. This precondition is fundamentally different to pre-packaged insolvency cases and requires a very different legal proceeding focussing on unbiased decision-making.

3. Responding to both scenarios with insolvency proceedings

Insolvency law can and should provide regulation for both scenarios. Because this is more obvious (and traditional) for the latter, the prepared rescue scenario shall be explained first.

a) The idea of pre-packaged insolvency proceedings

Out of court workouts are contracts by nature what makes them an ideal tool to address restructuring questions because they have binding authority to every participant. The number of participants can be chosen as needed. At the same time, negotiations can be kept out-of-court and confidential. In this legal background, restructurings are negotiated successfully every day.

On the other hand, a contract is binding only to creditors who consent. It cannot be enforced on dissenting creditors. Thus a workout creates the incentive to take a ‘free ride’ on the contributions other creditors are willing to make. If some creditors agree to reduce their claims or to prolong a debt, all creditors benefit from the recovery of the debtor. This may lead to a holdout because every creditor may want to wait for others to move first. To break up this lockup, a mediator may help. However, an agreement that is binding to all creditors prevents such problems.

In order to make an agreement binding to all, two things are required: a rule providing for the majority vote to decide for all (also called a collective action clause) and a confirmation by court decision.
The Collective Action Clause may be inserted by the legislature.\textsuperscript{32} There are numerous examples of such regulation. In Germany, bondholders decide by majority vote on the restructuring of bonds, § 5 Schuldverschreibungsgesetz (SchVG). In the UK, creditors are bound to a scheme of arrangement by majority vote.\textsuperscript{33}

The need for confirmation by court derives from the protection of the right of property in constitutional law. The impairment of a claim or equity right under a majority vote without the direct consent of an impaired creditor or equity holder requires for effective means of minority protection. Thus, this impairment is only legitimate in due process guaranteeing the compensation of the value of the deprived right. Consequently, regulations containing a Collective Action Clause also provide for a confirmation by court granting minority protection.\textsuperscript{34} As an additional benefit, the court decision gives res judicata effect to the confirmed arrangement, thus increasing legal certainty.

The implementation of such proceedings can be done by creating a special proceeding for such workout cases as can be seen in the UK with the scheme of arrangement (sec. 895 ff. CA 2006), in France in a proceeding called “procédure de sauvegarde” or in Germany in § 5 SchVG. Thus, a proceeding concerning the confirmation of a rescue plan would take place outside of insolvency and without its inherent stigma, yet such a proceeding may deem its implicit shadow of insolvency to be the only option in the case of a non-confirmation.

In my view, confirmation should be assigned to insolvency courts on grounds of a special option in insolvency proceedings: pre-packaged

\textsuperscript{32} It may also be incorporated in contracts or the articles of incorporation. Alan Schwartz has created an alternative approach to insolvency on this idea – contract theory; see Schwartz, Bankruptcy Workouts and Debt Contracts, 36 J.L. & Econ. 595 (1993); Contracting About Bankruptcy, 13 J. L. Econ. & Org. 127 (1997); A Contract Theory Approach to Business Bankruptcy, 107 Yale L.J. 1807 (1997-1998); Bankruptcy Contracting Reviewed, 109 Yale L.J. 343 (1999-2000) and A Normative Theory of Business Bankruptcy, 91 Va. L. Rev. 1199 (2005). In reality, this concept has decisive shortcomings because it cannot be applied to non-contractual creditors and the contract solution might not be best choice anymore in a future event of insolvency. The first weakness can only be cured by legislation; the latter requires for constant updates of the contractual agreements, which is costly and therefore in most cases less efficient than the common insolvency approach providing for a codified insolvency proceedings in court.

\textsuperscript{33} Sec. 899 (1) CA 2006.

\textsuperscript{34} See sec. 899 (1) CA 2006. § 20 SchVG provides for the right to contest the majority vote in court.
bankruptcy. The task for the court is to decide whether a proposed plan that is supported by a majority of creditors (and equity holders) is fair and equitable to all it will bind. Because this is precisely the kind of a decision an insolvency court has to make in plan proceedings, these courts appear specialised and experienced in this exact issue. Thus, an efficient approach would assign the confirmation of non-bankruptcy plans to the courts most related to the matter of such decisions—insolvency courts.

To prevent the stigma of insolvency, the special proceeding should be called “rescue proceeding” or “confirmation proceeding”. It must provide for the “debtor in possession” and ensure for as little interruption in the continuation of the business as possible. To initiate such a proceeding, no insolvency test should be required and no liquidator or trustee should be appointed. Instead the proceeding should be condensed to a confirmation hearing and a confirmation order which would take no longer than a couple of days or weeks. Appeals should principally not have the effect of a stay of proceedings to ensure that no delay could occur from a single creditor’s appeal. Therefore, the insolvency court or the court of appeal could issue a stay pending appeal only in the exceptional case of disproportionate and irreversible harm caused by an immediate implementation of the confirmed plan to a single opposing creditor, equity holder or the debtor.

The plan should then be confirmed if fair and reasonable, requiring good faith (bona fide), and a “best interest test” to ensure the liquidation value, with the peculiarity to be mentioned that all creditors as well as equity holders could be in the money because no insolvency test is needed. The APR should not be applied for the reasons discussed above.

b) Protecting unprepared rescue negotiations in insolvency proceedings

When a company enters insolvency proceedings without preparation, the situation is very different. Unfortunately, these differences are widely ignored by German Insolvency Law as well as some other

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35 This idea follows the legal system of U.S. Bankruptcy Law where appeals against confirmation orders do not stay any proceeding unless the bankruptcy court or the court of appeal issues a stay pending appeal; see 28 U.S.C. § 158(c)(2)(D) – Federal Rules of Civil Procedure, Rule 8005 of the Federal Rules of Bankruptcy Procedure.
legal systems, especially that of the U.S. The inability to respond to a relevant group of exceptional cases marks the dark side of a unified insolvency proceeding.

(1) Administrator to keep the ship afloat

In an unprepared insolvency, business failure is obvious and leads to the assumption of a management failure. On this ground, it is legitimate to appoint a liquidator or administrator to take over the debtor’s estate. As rescue may still be a valuable option, the administrator has to continue operating the business until the decision to wind it up is made or obviously the only option. Here insolvency law provides for quick and effective piecemeal liquidation.

As long as there is a valuable rescue option on the table, insolvency law must provide for its protection by imposing an automatic stay on all creditors and keeping a business running until a potential buyer or/and a rescue plan is presented, or all hope is lost.

Because the success of rescue efforts is very uncertain in this scenario, the appointment of an administrator should be the principal rule as a safeguard for an efficient and unbiased administration of the estate. Allowing a debtor to remain in possession can be an alternative in exceptional cases only where such persons are essential to the success of a business (as may be the case in small business insolvencies). It should be in the discretion of the court to allow a “debtor in possession” on request.

(2) Auction solution

Eventually there are two ways to rescue an insolvent business. Firstly, the business assets are sold as a whole to a single buyer in an auction process. As this is the fastest solution, insolvency regulation must provide for an auction procedure in insolvency proceedings, as does every insolvency law with which I am familiar. The question in which they differ is who has to decide about the deal. In U.S. bankruptcy law, it is the court who has to approve a sale of property of the estate out of the ordinary course of business, 11 U.S.C. § 363(b). In Germany, the creditors’ committee needs to approve it unless there are special circumstances that create the need for an approval by all creditors in a meeting of creditors, §§ 160-163 InsO. In the UK, the administrator
has the power to facilitate a sale without court or creditors’ approval.36

Under most legal systems, the sale of the debtor’s business assets does not require a plan to be accepted and confirmed, but the deal may be the subject of a plan. Only the U.S. Bankruptcy Jurisdiction had a more restricted view on this issue until the doctrine of “sub rosa plans”37 was broken up by the confirmation of the sales in the cases of Lehman Brothers Holdings Inc., Chrysler and GM.38 This new development contradicts to the explicit intention of the Bankruptcy Code to resolve the crisis in a Chapter 11 proceeding by a reorganisation plan only which dates back to the times when equity receivership and its foreclosure sales dominated the reorganisation practice in the U.S.39 By reintroducing equity-receivership-like procedures, the U.S. bankruptcy law handled the critical cases of Lehman, Chrysler and GM in a fast and pragmatic manner. At the same time, the courts emphasised the exceptional nature of these cases,40 which makes it hard to guess how bankruptcy courts would handle less prominent cases under Chapter 11. The old-familiar call for auction procedures to be introduced into Chapter 11 might therefore still be relevant and justified.41

(3) Plan solutions

The second way to rescue a failing business is to reorganise it under a rescue plan. Insolvency regulation should offer both auction and plan solutions and most legal systems do so. Again, there are some

36 Therefore best practice principles are being discussed address a conflict of interest, see Peter Walton, Pre-packin’ in the UK, 18 Int. Insolv. Rev. 85, 93 et seqq. (2009); Bo Xie, Role of Insolvency Practitioners in the UK Pre-pack Administrations: Challenges and Control, 21 Int. Insolv. Rev. 85–103 (2012).

37 See In re Braniff Airways, Inc., 700 F.2d 935, 940 (5th Cir. 1983); In re Continental Air Lines, Inc., 780 F.2d 1223, 1226 (5th Cir. 1986).


40 In re Chrysler, 405 B.R. 84 (Bankr. S.D.N.Y. 2009); In re General Motors Corp. 407 B.R. 463 (Bankr. S.D.N.Y. 2009).

differences in detail, but generally a plan solution always requires the acceptance of a proposed plan by a qualified majority of creditors and its confirmation by court.

\textit{a. Right to file a plan}

In this second scenario, a plan is not prepared or introduced on the first day of insolvency proceedings. The rescue plan needs to be developed within the first weeks of insolvency under the protective umbrella of a moratorium or automatic stay. To ensure the timely development of a well-designed plan, the right to design and file a plan should therefore be assigned to those who know the debtor and their business in great detail and are interested in a plan solution. These requirements lead to a right restricted to the debtor, the administrator, and very few creditors with background knowledge such as financial institutions. As in this scenario the right solution to the business situation is still to be found, a competition of plans about the appropriate distribution of value and loss seems favourable. The expenses of designing and negotiating a plan proposal should result in a very few cases of competing plans anyway. But as experiences under U.S. bankruptcy law suggest, it is effective to negotiate a debtor’s plan proposal with a competing proposal of a creditors’ group as it balances the level of negotiations.

\textit{b. Voting instead of an expert’s testimony}

It is a common principle that a plan needs to be accepted by the creditors involved and (apart from the exception of a cram down) equity holders if their rights are impaired under the plan. This creates quite a costly route to a rescue solution that could have been more efficiently taken by an expert’s testimony on the fairness and feasibility of the plan. So why, it seems logical to question, ask a large group of people with very different backgrounds, interests, and knowledge about debtor’s business and plan instead of asking a rescue expert?

The answer is based in the nature of the decision. A rescue plan distributes value and loss, but most importantly it offers a surplus value to creditors and shareholders that is realised only in the case of a successful reorganisation. So basically the decision about supporting or opposing a proposed plan is not only a decision about the distribution of the debtor’s current and future estate but also a projection of future business developments with numerous predictions and hopes and
thus a choice under uncertainty in decision theory terms.

Additionally, the decision to accept or reject a rescue plan does not only require a prediction of uncertain future events; every single creditor and shareholder also needs to take into account the strategic behaviour of the other creditors and shareholders. Such complex decisions are subject to decision theory as well as game theory. Decision theory offers varied and often mathematically based solutions to give a single competent decision maker a better chance to choose correctly even under uncertainty. At the same time, game theory approaches try to utilise findings in behavioural economics (especially the prisoners’ dilemma\textsuperscript{42}) to help the decision maker to avoid bad decisions based on errors and stalemates caused by strategic behaviour. However, other, more recent ideas based on findings in human psychology and behavioural economics (e.g. from the “public goods game”) suggest that human behaviour in decisions about the distribution of assets is dominated by a (“gut”-) feeling of fairness rather than rational calculation.\textsuperscript{43} It seems therefore superior to ask the parties involved to decide on a plan that they can accept as being fair instead of an expert’s testimony that imposes a plan solution on them.

The importance of fairness compared to rational calculations also supports the idea that a cram-down rule should only impose a plan on a dissenting class if the plan distribution seems fair overall, while the sole rational (economic) argument of taking equity holders’ rights that would have been wiped out in liquidation anyway does not provide or prove such fairness. The fairness of a plan is a human feeling rather than a rational calculation and should therefore ultimately be determined be humans (judges) not calculations.

It is not only the aspect of fairness and the resulting consistency of plan solutions that makes a voting process superior to an expert’s decision. The effects of pooling information also support this view; a phenomenon that has recently become prominent under the term


of the “wisdom of crowds”. The idea was first brought up by the French philosopher and mathematician Marie Jean Antoine Nicolas Caritat, Marquis de Condorcet in 1785. He proved mathematically that aggregating independent votes on a binary decision such as guilty or not guilty in a jury trial creates a high probability of making the right decision up to 99 per cent provided that every juror is well informed and thus has a chance of voting appropriately above fifty per cent of the time. More recent studies show that jurors with average expertise are sufficient to demonstrate the same effect. Strategic behaviour by decision makers, who do not vote according to the best interest of the result but in favour of the outcome that is in their best self-interest, does not interfere with these results as the best possible insolvency solution should be the one that is in the best interest both of every creditor individually as well as of all creditors collectively by maximizing creditors payoff.

Thus, the aggregation of information offers a superior approach to the problem of choice under uncertainty, especially considering questions of future economic development. Voting on a plan is an excellent way to aggregate the votes of many individuals on a single yes-or-no subject (plan feasibility) provided that creditors and shareholders make their individual decisions independently and having received sufficient information.

45 Marie Jean Antoine Nicolas Caritat, Marquis de Condorcet, Essai sur l’application de l’analyse ala probabilite des decisions rendues a la pluralite des voix, Paris (1785).
As a result, a plan regulation should be preferred that both provides for a large group of independent individuals to vote instead of a single expert’s testimony on a plan and ensures sufficient information as the basis for decision-making.

c. Classification

So, if the vote of all creditors and equity holders is required, why put them into classes? The classification requirement is the consequence of involving a larger group of individuals to vote, which makes it close to impossible to reach a unanimous decision that would serve as legitimate ground for the impairment of everyone’s rights under the plan. Instead, the best that can realistically be hoped is a solid majority to support the plan.

At the same time, the plan does not usually impair all creditors equally. Often a rescue plan provides for very different pay-offs and entitlements for secured, unsecured and junior creditors, as well as equity holders. The bankruptcy principle of “par condition creditorum” is not feasible with so many different interest groups involved.

This in mind, classification can achieve two things: firstly, it enables the maintenance of the “par conditio creditorum” rule as a fundamental principle of equity as far as possible because creditors with similar entitlements are still to be treated equally under a plan. Secondly, classification improves the authority of a majority vote, if the majority rule is applied in each class only. Given the fact that only creditors with similar claims or even similar interests are to be put in the same class, and according to the “par condition creditorum” rule all these similar creditors are impaired equally by the plan, a qualified majority vote in a single class supporting the plan allows for the assumption that the plan treats this group of creditors fairly and reasonably. For example, if a class of unsecured creditors accepts a plan by a majority vote, their impairment under the plan was not caused by the secured creditors’ vote or the vote of equity holders or junior credit. It is only the acceptance of the class of unsecured creditors that has built a legitimate ground for the plan to impair their type of claims.

d. Voting

As a result, regulation should provide for the classification of claims and equity based on similarity in claims, rights or interest. At the same
time, the majority-voting rule should only apply to each class separately while the consent of every class should principally be necessary for the acceptance of a plan. In each class, a qualified majority of favourable votes should be required to ensure the assumption of fairness. To prevent a blocking minority from vetoing or filibustering a plan solution, a majority of two-thirds of the amount of claims or shares seems appropriate. A simple majority of creditors or equity holders in number would protect creditors with small claims from being pushed aside by a single major creditor.

\[e. \text{Cram down}\]

While classification and voting can obviously be adopted from Chapter 11 of the U.S. Bankruptcy Code, a cram down against a dissenting class should constitute an exception allowed only in case of an arbitrary opposition. To conclude arbitrary behaviour from dissenting votes, courts should be required to argue more specifically than only referring to a couple of basic tests they run. The “best-interest-test” can only give a very basic orientation for a fair and equitable plan. The other “test”, the absolute priority rule, should not be applied at all against a dissenting class of old equity.\(^49\) Primarily, it is up to the court to decide specifically whether the plan was proposed in good faith and treats a dissenting class fairly and reasonably on the findings in each case.

A regulation that is contrary to these ideas by providing for an easy cram down as in the case of Chapter 11 might in fact create a high rate of confirmed rescue plans in insolvency because it basically requires only one class to actually vote in favour of the plan. Yet it results in a significant number of confirmed plans that are substantially flawed, thus leading to significant rate of unsuccessful reorganisations.\(^50\) A more strict view on cram down options might therefore seem preferable.

\[^49\] The strict application of an absolute priority rule may also seem unjust towards junior creditors as they are excluded from restructuring negotiations as well; see Chi-Ling Seah, The Re Tea Corporation Principle and Junior Creditors’ Rights to Participate in a Scheme of Arrangement – A View from Singapore, 20 Int. Insolv. Rev. 161-183 (2011), urging courts in the UK to scrutinize whether companies and their majority creditors are acting bona fide and respecting procedural fairness as Singapore courts would do, when sanctioning a scheme of arrangement (at p. 174).

\[^50\] An empirical study conducted by Michael Bradley and Michael Rosenzweig, The Untenable Case for Chapter 11, 101 Yale L.J. 1043 (1991-1992), concluded that four years after filing voluntarily for bankruptcy, only about 60% of the firms filing are still in business (at 1075).
f. Confirmation and appeal

The confirmation of a plan by a court is necessary to protect the constitutional property rights of every single plan opponent. If such an opponent has already been voted down in their respective class, the plan is widely accepted as fair and equitable by creditors or equity holders with similar claims or interests indicating a fair distribution. Hence, the “best interest test” is the only shelter such a creditor or equity holder may seek. As this test is already a part of the judge’s task in a cram-down against a dissenting class, the objection of members of such classes do not require special treatment.

Since each rescue plan is the result of judicial proceedings, courts are required to deem a plan valid as it would have met all legal requirements enabling these questions to be subject to the res judicata effect of the courts order. Thus, objections on these grounds are only to be heard in the confirmation hearing.

To prevent unnecessary delay when implementing a confirmed plan, appeals must principally not have the effect of a stay of proceedings. Therefore, the insolvency court, or the court of appeal may issue a stay pending appeal only in such exceptional cases where they deem disproportionate and irreversible harm to involved parties caused by an immediate implementation of the confirmed plan.51

IV. Progress and shortcomings in the German Insolvency Reform Act 2012 (ESUG)

After developing a model for reorganisation law, it is now time to visit the real world of modern German insolvency law. Of course, there is no space to adequately include an introduction to German insolvency law here. Instead, two major issues will be highlighted: where the difficulties in German reorganisation cases originate, and how German legislation recently tried to respond to these issues in the form of the German Insolvency Reform Act that came into force in March 2012, called the “Act to Further Facilitate the Restructuring of Companies” (ESUG).

51 This idea follows the legal system of U.S. Bankruptcy Law where appeals against confirmation orders do not stay any proceeding unless the bankruptcy court or the court of appeal issues a stay pending appeal; see 28 U.S.C. § 158(c)(2)(D) – Federal Rules of Civil Procedure, Rule 8005 of the Federal Rules of Bankruptcy Procedure.
1. No special protection for prepared insolvencies

With respect to the ideas developed above, the first and major shortcoming of German insolvency law is the lack of any special protection for a prepared insolvency case.

The Insolvency Code (Insolvenzordnung) 1999 introduced provisions to the German Law that allow the insolvency court on request to keep the “debtor in possession” instead of appointing an administrator. Unfortunately, the law does not provide for a debtor’s right to stay in possession while being in insolvency proceedings. The deep-rooted suspicion and mistrust of both German courts as well as the administrator’s branch regarding the ability of a failing debtor or its management to successfully complete an administration in insolvency has led to a near non-existence of “debtor in possession” cases in German insolvency.52 This in mind, debtors went on trying to avoid insolvency proceedings at all costs and for as long as possible, which often made it impossible to rescue businesses when they went insolvent. Consequently, there was hardly any use of the insolvency plan that the Insolvency Code 1999 had introduced. The classic combination of a prepared insolvency proceeding consisting of a pre-packaged insolvency plan presented with the request for the proceeding and the debtor remaining in possession has never really worked in Germany, although the insolvency code would allow such a strategy.

The German Insolvency Reform Act 2012 has tried to overcome this restrictive practice by implementing some changes to the provisions regarding the appointment of the debtor in possession. Unfortunately, it leaves the decision as to whether to appoint an administrator or a “debtor in possession” at the discretion of insolvency courts. A widespread fear of abuse and strong opposition from insolvency judges and practitioners to proposals for a fundamental change in this question allowed only for a shifting of the burden of proof.53 Now, on the debtor’s request to be appointed as a debtor in possession, the creditors are asked to submit facts to the court that suggest a damaging effect a “debtor in possession” would pose to their interests. The court is not allowed to investigate the existence of such facts on

52 A “debtor in possession” is appointed only in about 7 percent of all business insolvency proceedings in Germany; see Peter Kranzusch, Die Eigenverwaltung im Insolvenzverfahren - Anwendung und Hindernisse, ZInsO 2008, 1346, 1347-1348.

53 See InsO § 270 (1) and (2).
its own. Only in cases where the debtor’s request is supported by a unanimous vote of the preliminary creditors’ committee is the court bound to appoint the debtor as “debtor in possession” as well as a supervisor for oversight.54

At the same time, the Reform Act responds to a critical deficiency in the original Insolvency Code by now allowing the debtor to stay in possession of the estate through all stages of the proceedings. German Insolvency Proceedings are never opened immediately. Instead, there is a preliminary proceeding after the request for an insolvency proceeding is filed to investigate whether a debtor is indeed insolvent and whether their estate will at least cover the administration costs incurred case. In this stage of the proceeding, the court has considerable discretion concerning how they may handle such cases and how they may protect and investigate the estate. Usually, a court appoints a preliminary administrator to investigate the estate and control a debtor’s business. This preliminary proceeding may last for up to three months in order to fully capitalize on public funds that cover unpaid wages and salaries up to these three months before the opening of insolvency proceedings. Therefore, many crucial decisions on the future of the business are made during preliminary proceedings and only implemented on the first day when insolvency proceedings are opened. As regards a debtor who wants to remain in possession of a business in a German insolvency case, the Insolvency Code 1999 only provided for a “debtor in possession” in insolvency proceedings but not during preliminary proceedings, thus interrupting the debtor’s control over the business with the broad discretion of the judge hearing the case. The Reform Act addresses this fundamental deficiency by extending the rules of a “debtor in possession” into the preliminary hearing.55

These improved rules on appointing a “debtor in possession” also apply to the new procedural option the German Reform Act created. The new § 270b provides for a “breathing period” for debtors who are not yet insolvent but face insolvency in the near future. Such debtors may now turn to an accountant firm or lawyer in order to get a certification on the basis that they are not insolvent at that given time and saveable by reorganisation. On the grounds of such certification, they may file for insolvency proceedings with the insolvency court and request their appointment as debtor in possession, something only granted

54 See InsO § 270 (3) 2.
55 See InsO § 270a.
according to the rules explained above. If a court decides to appoint a debtor as debtor in possession, it has to set a period of maximum 90 days for a debtor to propose a plan while staying in the stage of preliminary proceedings. As soon as (and not before) this period expires or a plan is proposed, the court may decide to open insolvency proceedings in order to wind up a debtor’s business or to vote on the proposed plan by the regular rules for insolvency plans. Thus, the new “breathing period” created by the Reform Act 2012 does not enhance a debtor’s chance to be appointed debtor in possession. It provides time to negotiate under a protective umbrella.

After all, the Reform Act 2012 tries to balance the advantages of a “debtor in possession” in respect to attracting an early commencement of the case, with its risk of abuse resulting in a set of new or amended provisions and the procedural option of a “breathing period”, an aspect that unfortunately does not resolve the heart of the problem: the reliability and predictability of the restructuring process for a debtor. Provided a debtor or their management cannot be certain to keep control of their business while in insolvency proceedings to reorganise, debtors have a huge incentive to avoid such proceedings for as long as they possibly can. Therefore, the decision regarding whether to appoint a debtor as “debtor in possession” should not be left to the discretion of the court but should be stated by law.

The new Austrian Insolvency Act gives a wonderful and successful example: under Austrian law, a debtor will be appointed as “debtor in possession” if they propose a feasible plan that pays creditors at least 30 cents on the dollar together with a request to start insolvency proceedings. Thus, the chance to become a “debtor in possession” is restricted as well as guaranteed in prepared insolvency proceedings with an attractive payoff. Such regulation follows the basic distinction between prepared and unprepared insolvency cases and offers different provisions as suggested in this report.

Against this background, even the new procedural option in § 270b, the “breathing period”, is a provision aimed primarily at unprepared insolvencies, as it is designed to offer a protected period of time for a debtor to design and negotiate a rescue plan with their creditors and equity holders. It does not present a special solution to prepared insolvency cases, which is therefore still lacking in German law.

As a final remark, a debtor cannot avoid the lack of certainty about
the administration of the estate in German reorganisation cases by simply choosing the right administrator because debtors themselves may not choose or even propose a person to be appointed. Under German law, the court decides which practitioner will be appointed as administrator of the estate. The Reform Act 2012 established a preliminary creditors’ committee to be set up in larger cases with the purpose of giving these committees the power to direct a court’s decision towards a certain practitioner – a new regulation widely criticized by judges. There remains no right for the debtor to be heard.

2. Equity rights and insolvency proceedings

While the German Insolvency Reform Act 2012 might not have a larger impact on the way a request for an appointment as “debtor in possession” is treated by judges, it fundamentally changed the extent to which an insolvency plan may govern the reorganisation of an insolvent debtor. While an insolvency plan was not allowed to impair equity rights under the Insolvency Code 1999, the Reform Act 2012 adds equity holders to the scope of the plan. Now the insolvency plan constitutes not only of a contract between a debtor and their creditors, but may also include equity holders of the debtor if their rights need to be impaired to rescue a business. A solution plan may now include a debt-to-equity-swap as well as a merger or a split-off of the debtor company. For such purposes, the Code now provides for the participation of equity in the proceedings by pooling them in a special class and granting rights to negotiate, to vote, and to object to the plan. Unfortunately, all these rights to participate are eventually devaluated by the fact that the opinion of the equity class can be overturned in a cram down that is based on the absolute priority rule. Therefore, shareholders will not have any bargaining power in negotiating the future of their insolvent company. This regulation follows the example of Chapter 11, and I have already provided my thoughts on why it is flawed and conflicts with the German Constitution as well as European Law.

56 See InsO § 27 (1) 1.
57 See InsO § 56a.
58 See InsO § 222 (1) 2 Nr. 4.
59 See InsO §§ 235 (3) 3, 244 (3), 251, 253.
60 See InsO §§ 245 (3), 246a.
3. Conclusion: Disappointment

The Insolvency Reform Act 2012 addressed two crucial obstacles for successful reorganisation under German insolvency law: the rare appearance of a “debtor in possession” and the participation of old equity in plan proceedings. Allowing an insolvency plan to impair equity interest directly made real progress. Yet the definition of equity holders’ position in the proceeding invalidated this step. At the same time, the amended provisions for appointing a “debtor in possession” did not significantly improve a debtor’s chance to predict the course their business takes once an insolvency request is filed. Finally and most significantly, the Reform Act failed to contain any new regulation for the protection of prepared insolvency cases. This question in particular should be the subject of evaluation and revision when the German Parliament is due to revisit this topic in five years time.

V. The ideas of the European Parliament regarding rescue

Over the course of the current financial crisis, European Institutions also realised the significance of business rescue under insolvency law. In its report from October 2011,\(^{61}\) the European Parliament states that “the approach in relation to insolvency proceedings is now centred more on corporate rescue as an alternative to liquidation”,\(^ {62}\) so insolvency law “should be a tool for rescue of companies at Union level”.\(^ {63}\) As European Insolvency Regulation\(^ {64}\) has yet to provide for rescue, the Report proposes the “harmonisation of aspects of the establishment, effects and content of restructuring plans” as the “rapporteur would like to take up the idea of restructuring plans which has been developed in the laws of some Member States.”\(^ {65}\) Beyond these basic outlines, the report does not specify the idea of restructuring plans in any detail. Instead, the report wants harmonisation to be restricted to the following fundamental aspects of a plan proceeding in insolvency cases:

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61 Report with recommendations to the Commission on insolvency proceedings in the context of EU company law (2011/2006(INI)), PE467.008v03-00
62 See consideration I on p. 4 of the report.
63 See consideration J on p. 4 of the report.
65 See p. 17 of the report.
1. “as an alternative to complying with statutory rules, debtors or liquidators may present a restructuring plan;”
2. “the plan must contain rules for the satisfaction of the creditors and for the debtor’s liability after the insolvency proceeding have been concluded;”
3. “the plan must contain all relevant information enabling the creditors to decide whether they can accept the plan;”
4. “the plan must be approved or disapproved in a specific procedure before the relevant court;”
5. “unimpaired creditors, or parties that are not affected by the plan, should not be entitled to vote on the plan or, at least, should not be able to impede it.”

These very basic aspects of plan proceedings reflect common principles in most EU member states and leave out many controversial questions, including those concerning the role and procedural rights of equity or debtor’s right to become “debtor in possession”. The right to file a plan in such cases is restricted to the debtor and the liquidator. A distinction between prepared and unprepared insolvencies is not to be found, rendering the harmonised European rescue plan very much a classic composition in appearance.

VI. The idea of a “European Rescue Plan”

In stark contrast to the very basic ideas on harmonisation issued by the European Parliament, INSOL Europe developed a detailed proposal for a European Rescue Plan (ERP) to be introduced into the revised version of the European Insolvency Regulation (EIR). Although the ERP is designed to address insolvency cases involving an international group of companies, the proposal contains substantive provisions concerning the plan and plan proceedings that do not completely correspond to the ideas developed in this report. Some changes to the proposal should therefore be suggested.

Essentially, the idea of a European Rescue Plan addressing the complex issue of group insolvency on community law level should be welcomed as it reduces the incentives for forum shopping and manipulations aimed at a special venue. At the same time, experiences in the United States show that plan provisions on a federal level allow for the resolution of the task to rescue valuable business structures in complex group insolvency. Having said that, let us turn to the details.

66 See pp. 10/11 of the report.
1. The right to file an ERP

INSOL Europe intends to grant the right to file a European Rescue Plan only to the ultimate parent company of the group (the debtor) and its liquidator, thus resembling the structure of decision making of the group. This approach simplifies negotiations regarding a plan solution, as they are to be initiated only by a very limited group of individuals. Still, a regulation should be adopted that handles a case of a prepared insolvency differently than unprepared insolvency proceedings. If a debtor files for insolvency proceedings in order to have a prepared rescue plan confirmed, there should not be a competing plan interfering as long as a debtor’s plan has a chance of being accepted. Such regulation would not only keep matters simple but also provide an incentive for troubled debtors to enter insolvency proceedings at an early stage and more sufficiently prepared.

In a case of unprepared insolvency proceedings, the best solution for a debtor and a given group of companies is still in question. In this scenario, it would level bargaining to allow creditors to file a plan as well. This might lead to competing plans, but it would not distract the proceedings, as the competition will usually be solved by negotiations, an issue made evident in the Lehman Brothers Case. By extending the right to file a plan to creditors with sufficient intellectual and financial resources to design a plan, the proceedings should not be delayed as only a small group of creditors are prone to designing a plan of their own, e.g. consortium banks or financial investors. The right to file a plan in unprepared group insolvency should therefore be extended to a group of at least three creditors with aggregated claims of at least 50,000 Euro.

2. The scope of the ERP

As the ERP is a plan under community law, it can only be applied if debtors in at least two jurisdictions of the EU are involved. Thus the ERP only addresses cases concerning international group insolvencies.

The ERP may include provision, regarding as many companies of the group as necessary for the pursued rescue task. As it is intended to substantially coordinate insolvency proceedings within the EU, the ERP may only involve debtor companies, who are subject to insolvency proceedings in EU member states. Solvent subsidiaries as well as their creditors and equity holders are only bound to the ERP if they actually
consent to those plan provisions that concern their rights.

The ERP may affect all creditors of insolvent group companies, secured and unsecured, as well as their shareholders. Their fundamental rights are guaranteed by the “best interest test”, ensuring that each of these persons receive at least as much under the plan as they would have received in liquidation.

The ERP may contain every feasible resolution, ranging from orderly piecemeal liquidation of the group (as in the Lehman Brothers case) to the sale of shares or assets, or even the restructuring of the group. Every action that is legal under local insolvency or company law may be contained in the ERP. This may require different settings for subsidiaries located in different member states.

Finally, the ERP should not replace reorganisation plans under domestic law. It may therefore occur that the main liquidator faces several plans for different subsidiaries under the law of different member states. This may in fact balk all hopes for a coordinated solution under the ERP, especially in the likely case that the valuable pieces of the business are concentrated in some subsidiaries which can be more easily restructured under a local plan. The main liquidator cannot veto such plans if control in the group was exercised by controlling the majority of shares property of shares, and domestic law does not give real entitlements to equity with respect to the decision on a reorganisation plan. As far as I can see, the INSOL Europe proposal does not specifically address this question. In my view, the right solution would address the need for equity consent for the acceptance of reorganisation plans. As that is not the case in some domestic laws, the EIR should address this problem directly by staying domestic plan proceedings as soon and as long as an ERP has been filed.

3. Classification

The proposed classification of creditors follows the good example of Chapter 11 proceedings in the U.S. As a group of companies is subject to the plan, creditors of different group companies are to be set in different classes. The proposed provision in Article 48 emphasises this fact, which otherwise would be a logical consequence of the need to only place substantially similar claims in a particular class. The proposed Article 48 does not yet contain a provision regarding a class of equity holders. This seems to follow from the idea that this
group should not be entitled to receive anything under the plan and therefore not be entitled to vote on the plan. I would maintain that both assumptions are unconvincing. As explained above, the absolute priority rule cannot justify such discrimination. At the same time, it may quite frequently occur that equity is willing or even needed to participate in the restructuring of a company and should therefore be considered in plan provisions as well as plan distributions. The ERP would not offer a regulation for such solutions at all if equity was to be excluded from a plan solution in the first place. With this result, the ERP provisions appear unbalanced and insufficient.

4. Court procedure

a) Venue

As a basic principle, INSOL Europe proposes to have the ERP submitted to a single court, that being the court of the group main proceedings. This principle reflects the structure of the group as well as the possible content of the ERP.

b) Hearings

After filing, INSOL Europe wants the court to set a date for a hearing involving shareholders and creditors affected by the plan to make preparatory decisions on the allowance of disputed claims as well as on the approval of the information memorandum and the classification of creditors by the plan. After these decisions are made, the creditors at the hearing shall vote on the plan in presence of the court.

In my opinion, this hearing is unnecessary and thus a probable cause of delay. Firstly, the filing of claims is irrelevant in proceedings on the grounds of a filed plan, as the plan contains a list of all claims and equity rights that are considered allowed. The objection of creditors that either dispute other creditors’ claims or find their own claims inadequately listed shall be heard at the confirmation hearing and only lead to a dismissal of the plan if the amended claim would result in a different voting outcome. This way of handling claims and voting rights is successful practice under 11 U.S.C. § 1111 (a) and should be adapted.

Secondly, the approval of the information memorandum follows the U.S. example that requires any disclosure statement to be approved by
the court as containing adequate information unless the voting on the plan had already occurred prepetition (pre-voted bankruptcy). The approval of classification before voting is only found in German Law. I would stress that such court approval before voting is unnecessary as these questions can be discussed in the confirmation hearing. In particular, there is no need for a hearing on these issues as the court may decide them by examining the proposed plan. The delay and the costs caused by an additional hearing would, in my view, suggest that these issues be addressed in the context of the confirmation. Of course this would mean that the court decides after knowing the outcome of the voting, which may sway the court towards a more plan-friendly attitude. However, the outcome of the vote is hardly ever an open question at a voting hearing as the support for such a plan needs to be organised by then. In addition, it is the fundamental task of a judge’s decision making to maintain an independent opinion while facing the arguments of both sides. Thus, the argument of a plan being support by the majority vote should not create a particular level of fear over the court’s independence in deciding only on facts of law.

Thirdly, the acceptance hearing is deemed to create the forum for the creditors’ voting on the plan. In my view, there is no need to have oral voting in the presence of court. It requires creditors to attend a hearing that might even take place in another country, thus aggravating the problem of rational apathy. This comes with no particular advantage over a voting procedure requiring every creditor and equity holder to submit their acceptance or rejection of the plan to the court in writing within a time fixed by the court as seen in Chapter 11 cases. In pan-European proceedings in particular, voting procedure should allow all creditors and shareholders to take part without exorbitant travelling expenditures.

The proposed acceptance hearing should therefore be waived. Instead, the court should examine a file plan and reject filing in case of plans that fall short of the legal requirements concerning the content. Proper plans should immediately be sent to all listed creditors and equity holders together with the information memorandum and a voting ballot to be sent back within a time fixed by the court. U.S. rules

67 11 U.S.C. § 1125(b). In Germany, InsO § 231 (1) Nr. 1 provides for a court decision approving that a filed plan observes all formal legal requirements including classification and adequate information.

68 See Article 54 Nr. 1 of the INSOL Europe proposal.

may provide a detailed example for such ballots.

In the case of prepared insolvency, regulation should provide for a rule to accept vote solicited prepetition on the grounds of adequate information as the U.S. Law does in 11 U.S.C. § 1126 (b), thus reducing insolvency proceedings to a single confirmation hearing.

5. Acceptance of the ERP

As soon as the voting period expires, the court has to decide about the acceptance or rejection of a plan. The INSOL Europe proposal requires a majority of at least two thirds in amount and one-half in number in each class of creditors to vote in favour of the plan to have a class of impaired creditors accept the plan. These requirements follow the example of U.S. Law in 11 U.S.C. § 1126(c), and just as in 11 U.S.C. § 1126(f), unimpaired creditors do not vote on a plan as they are presumed to have accepted it. Another presumption applies to any class of creditors (and shareholders) who receive no value under a plan as they are deemed to have rejected it. These classes may therefore not consent to the impairment of their rights. The court must consider their adequate protection in the context of the confirmation order.

6. Confirmation of the ERP

Court confirmation is required for a consensual plan that was accepted by all classes as well as for non-consensual plans.

a) Consensual plans

If all classes accept the proposed plan, the court would have to confirm the plan according to Art. 55 Nr. 1 of the proposal without stating that the plan meets the general requirements of the Regulation or that it was presented in good faith. Only on objection would the court hold a hearing at which all parties of interest are heard (Art. 55 Nr. 2). And only on objection would the court be required to perform a “best interest test” and to apply the APR with regard to the objecting party. Additionally, the court would also consider the fairness and feasibility

70 See Article 54 Nr. 4 of the INSOL Europe proposal.
71 See Article 54 Nr. 2 of the INSOL Europe proposal.
72 See 11 U.S.C. § 1126(g). The INSOL Europe proposal does not yet specify these presumptions, but assumes them – see Robert van Galen, International groups of insolvent companies in the European Community, IILR 2012, 376, 391.
of the plan (Art. 55 Nr. 3).

It should be noted that the proposal would have the court confirming a consensual plan without any substantive reasoning where no objection is commenced. In such cases, it would not be deemed that the plan meets all legal requirements, as this question is also not a topic at the acceptance hearing, where the court only decides on the recognition of creditors, establishes a class schedule (Art. 53) and supervises the voting process (Art. 54 Nr. 1). Such confirmation would disregard the honour of the court and purpose of its participation and has no precedent in present law.

Instead, the application of the APR should be waived for the reasons discussed above, and the court must always conclude that an accepted ERP meets all legal requirements in order to confirm such a plan. Indeed, a “best-interest-test” should only be required if a creditor or equity holder impaired by plan provision submitted an objection. Such deviation from Chapter 11 proceedings seems adequate.\(^73\)

*b) Non-consensual plans*

As soon as one class does not accept the plan, cram-down rules should be applied. The INSOL Europe proposal provides for a cram-down rule that basically follows the model of U.S. Law as it differs in the treatment of a class of creditors and a class of equity.

In consideration of an opposing class of creditors who shall receive value under the plan, a cram-down under the proposal requires (i) a “best interest test” to guarantee liquidation value, (ii) compliance of the APR for adequate distribution of the going concern value between different classes with respect to the same company of the group and (iii) no rejection in good faith.\(^74\) Only the latter condition differs from U.S. Law and would make a cram down more difficult than under the Chapter 11 system.\(^75\)

A class of creditors that does not receive any value under the plan is deemed to have rejected the plan, which should only entitle

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\(^73\) Under 11 U.S.C. § 1129 (a) (7) even the confirmation of a consensual plan requires such a test, regardless of an objection being commenced.

\(^74\) See Article 54 Nr. 5 of the INSOL Europe proposal.

\(^75\) See *Robert van Galen*, International groups of insolvent companies in the European Community, IILR 2012, 376, 390.
The differential treatment of voting and non-voting (“deemed”) classes does not seem justified. All of these classes share the fact that none of them actually accepted the same plan as a fair solution. It should therefore require the same legal standards and reasoning to overturn their opposition.

A cram-down against a dissenting class (Art. 54) should only be allowed in a case of an arbitrary opposition. As argued above, a court should be required to deem the plan fair and equitable against this class by arguing specifically on the grounds of each individual case. The “best interest test” can only indicate fairness, but not conclude a fair treatment with respect to the distribution of the reorganisation surplus value; neither can the APR. Hence, it is up to the judges to argue on grounds of the objections raised on the fairness of a plan that was rejected by at least one class. A good-faith-condition as considered by INSOL Europe as a deviation from the Chapter 11 scheme might be considered a step in this direction as it indicates an arbitrary opposition. Such indications or tests could be enumerated in a cram-down provision. Still, a cram-down should only occur if a judge deems a plan’s treatment of a respective class to be fair and reasonable and therefore concludes that the class’ opposition is arbitrary.

Objections of class members may principally be seen as additional information pointing to relevant consequences of the plans’ implementation on individual rights. Concerning a dissenting class, the objection of a class member should be considered in the judge’s findings about the fairness of plan distributions in the course of a cram-down decision. If a cram-down is granted, such objection cannot have any further relevance, as the “best interest test” had already been applied.

The objection of members of consenting classes may only result in a “best interest test” applied, as the liquidation value of a claim or equity interest cannot be impaired by majority-decision. Additional protection does not seem necessary as the distribution of value to this

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76 See the commentary to Art. 54.2.
77 See the commentary to Art. 54.1.
78 See Article 54 Nr. 5 in contrast to Article 55 Nr. 3 of the INSOL Europe proposal.
class under the plan has already been accepted by majority-vote and is therefore deemed fair. Art. 55 should be amended to reflect these principles.

7. Delay by objections and appeals

Finally, it needs to be considered that excessive rights to object and appeal are a major cause of delay and costs in a plan proceeding. The new German Law therefore restricts the right to object to those who have actually rejected the plan by voting against it and furnish prima facie evidence that they do worse under the plan than in liquidation. The very same restrictions apply to the right to appeal a confirmation order. In Chapter 11, an appeal does not usually stay the implementation of the confirmed plan, so it cannot be the cause of delay. The INSOL Europe proposal contains no safeguard against strategic objections and appeals to delay, eventually preventing the accepted plan from becoming effective. For the right to appeal, the law of the Member State must be referenced, where the court decides on confirmation. I would prefer a provision regulating the right to appeal according to the Chapter 11 system while leaving the right to object unimpaired in order to provide courts with a complete picture before confirming or rejecting a plan.

VII. Conclusions

In conclusion, a European Rescue Plan could be a useful tool in complex group reorganisation cases. However, the provisions regarding such plan should account for the two very different situations of planned and unplanned insolvency procedures: they should allow for a fast track proceeding with little effect on the debtor in prepared cases while providing for full administration to enhance the search for the most beneficial solution in unprepared cases. At the same time, equity interest should be respected over the course of a proceeding and its negotiations, meaning that no absolute priority rule should be applied against a class of old equity in the case of a reorganisation plan with respect to the fundamental difference between a liquidation and reorganisation. Moreover, the INSOL Europe proposal should waive

79 See InsO § 251 (1).
80 See InsO § 253 (2).
81 Therefore a confirmed plan is implemented 10 days after the order confirming the plan unless the court orders otherwise – see Rule 3020 of the Federal Rules of Bankruptcy Procedure.
82 See Article 56 of the INSOL Europe proposal.
unnecessary court hearings, allow voting in writing and restrict the staying effect of appeals for all jurisdictions.
REPORT OF THE SECOND ANNUAL MEETING OF THE NETHERLANDS ASSOCIATION FOR COMPARATIVE AND INTERNATIONAL INSOLVENCY LAW

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1. Introduction

The Netherlands Association for Comparative and International Insolvency Law (NACIIL, in Dutch: Nederlandse Vereniging voor Rechtsvergelijkend en Internationaal Insolventierecht, or NVRIIL) decided to organize its second annual meeting on 8 November 2012 around the topic of “Corporate Rescue”. This theme has been at the heart of recent developments, such as INSOL Europe’s proposal for a European Rescue Plan and the amendment of German insolvency law as of March 2012 in order to further facilitate the restructuring of companies (Gesetz zur weiteren Erleichterung der Sanierung von Unternehmen).

The main part of the programme consisted of the presentation of and discussion on the reports prepared by Stephan Madaus (professor of Civil Law, Civil Procedure and Insolvency Law at the University of Regensburg) and Robert van Galen (partner at Nauta dutilh and member of the board of NACIIL). The meeting was chaired by Marcel Windt (partner at Houthoff Buruma).

2. Madaus - Rescuing companies involved in insolvency proceedings with rescue plans

The contribution of Stephan Madaus focused on two recommendations for the development of insolvency law. His first recommendation is to actively involve shareholders in the process of plan negotiations and voting and his second recommendation is to create a distinguished set of rules for insolvency cases initiated by the debtor by presenting a prepared or even pre-voted rescue plan, a so-called “fast track insolvency”. Madaus concluded with remarks on the latest German insolvency reform act and the ideas of INSOL Europe regarding rescue plans.
A reorganisation plan may not only provide for a virtual sale of the debtor’s business (asking creditors to agree on a fixed payoff much less than the face value of their claims), but also may involve a more sophisticated solution by providing for a restructuring of secured credit as well as the restructuring of ownership in companies (e.g. a debt-to-equity-swap). Consequently, the way to involve equity interests in insolvency proceedings has become widely discussed. Madaus points out that a modern reorganisation law seems imperfect without the ability to address this topic directly. Equity interests are often subordinated according to the absolute priority rule (APR). This gives creditors the power to make the final decision without shareholders consent.

Madaus believes there are good reasons to take another approach. If the debtor is a company and the plan provides for the impairment of equity interests, equity holders should be allowed to participate in negotiating a rescue plan and voting on a proposed plan.

If the majority of equity holders vote against such a plan, the plan can only be confirmed by a cram-down rule if it is fair and equitable by giving them a fair share of the surplus value realised by the plan. The plan should also be drawn up and negotiated in good faith. Considering creditors’ rights, the best-interest-test will have to be completed. This means that no (dissenting) creditor receives a payment under the plan that is less than it would have received in a liquidation of the company in an insolvency proceeding. Besides these conditions, there is no need for a strict APR to protect creditors from equity in a reorganisation.

In reaction to a question of Yanying Li (Leiden University) Madaus clarified his view on the “fair and equitable” standard. The reorganization plan should be fair to all classes impaired. This means that the creditors should receive at least the liquidation value of the company (also known as the “best-interest-test”) and that equity holders should be protected in their choice to continue the company (the “debtor’s choice”). If this basic level is upheld, a plan should be held fair and equitable. Beyond that, the distribution of extra value is open to arrangements, negotiations and consent.

Madaus’ proposition is based on the argument that equity interests are not part of the debtor’s estate and thus not part of the creditors’
entitlement under insolvency law. While the creditors decide on the discharge of old debt, the owners of a business decide on the continuation of the business. Any reorganisation surplus value following from the continuation of the business in its contractual environment can only be realised in cooperation between the creditors and equity holders. Furthermore, there is no good reason to apply the APR in such reorganisations. Madaus argues that the APR does not fit in reorganisation scenarios, nor does it promote corporate rescue. Rather, it gives owners and management every reason to stay out of insolvency proceedings as long as they can, making reorganisation impossible in many cases.

The argument that equity interests are not part of the creditors’ entitlement was questioned by Rolef de Weijs (Houthoff Buruma). In the discussion that followed Madaus stressed his view that an insolvency proceeding does not provide creditors with more rights with regard to the equity interest. Although it might be preferable to create extra value for the creditors without the possibility that equity will block this, the rights of investors deserve serious protection. As demonstrated in case law by European courts, insolvency in itself is not a reason to put the rights of equity holders aside.

In reaction to a question by Rolf Verhoeven (ABN AMRO) Madaus indicated that the participation of old equity in the reorganisation could take many shapes or forms. First, the equity holders must be willing to continue the business. Second, the aim should be to have all equity invest in the reorganisation, as well as new investors and creditors.

Xinyi Gong (Leiden University) raised the issue of considering some form of protection for potential investors in a reorganisation. In Madaus’ view, special protection for new investors would be difficult to arrange. To create an incentive to invest in a reorganization one could give priorities to new investors for a limited period of time.

Fast track insolvency

The second major topic concerned the need for fast track proceedings to confirm prepared rescue plans. Madaus distinguishes the common scenario of an unprepared insolvency from the scenario of a failed out-of-court workout and prepared insolvency. A negotiated rescue plan may have the support of a majority of creditors and equity holders, but
may fail to find consensual support. According to Madaus, insolvency law should provide a regulation for both scenarios. In a failed work-out case, the rescue plan may be declared binding on every creditor or equity holder through a confirmation proceeding. Such a proceeding can be implemented as a special proceeding for work-out cases, such as the British Scheme of Arrangement, the French procédure de sauvegarde or the German procedure under § 5 of the Gesetz über Schuldverschreibungen aus Gesamtemissionen.

Madaus recommends that plan voting should take place outside of insolvency as well as outside of special court-supervised proceedings. Obtaining a majority-vote, subsequent confirmation proceedings would only consist of a confirmation hearing quickly followed by a confirmation order. To ensure fast implementation, a stay of proceedings during appeal should only be granted in exceptional cases of disproportionate and irreversible harm to a single opposing creditor, equity holder or the debtor. The task of judicial confirmation of such fast track proceedings should be assigned to insolvency courts as these courts are specialised and experienced in deciding whether a rescue plan is fair and equitable to all it will bind. Yet to prevent the stigma of insolvency, the confirmation proceedings could be called “rescue proceedings” or “confirmation proceedings”, must provide for a debtor in possession and ensure for as little interruption of the debtor’s business as possible.

*German Insolvency Reform Act 2012 (ESUG) and the idea of a European Rescue Plan*

Madaus then applied his thoughts on a model reorganisation law on modern German insolvency law and INSOL Europe’s proposal for a European Rescue Plan (ERP).

German insolvency law has been amended as of March 2012 in order to further facilitate the restructuring of companies. The insolvency code now provides for participation of equity in plan proceedings. To Madaus’ regret, equity holders’ vote can be overturned by creditors’ vote in a cram down based on the absolute priority rule. The reform act also improved the debtor’s chance to be appointed as debtor in possession. However, the law still does not guarantee for a debtor’s right to stay in possession during prepared insolvency proceedings as, finally and most significantly, the reform failed to introduce protection for prepared insolvency cases.
Erik Boerma (Judge with the District Court of Breda) drew attention to the current lack of reorganization plans in the Netherlands. According to Madaus, the situation has been very similar in Germany. The total number of reorganization plans has been low and recent reform aimed to raise these numbers. So far however, most corporate rescues have been realized through a going concern liquidation sale by auction.

Madaus concluded his presentation with a brief remark on INSOL Europe’s proposal for a European Rescue Plan to be added to a revised version of the European Insolvency Regulation. Although Madaus supports the basic idea of such a rescue plan, he is opposed to applying the absolute priority rule against equity interest in the case of a reorganisation plan. Furthermore, the proposal should waive unnecessary court hearings, allow voting in writing and restrict the staying effect of appeals for all jurisdictions. Moreover, the proposal should allow fast track proceedings with little effect on debtor’s business and management in prepared cases, while providing for full administration in prepared cases.

3. Van Galen - Insolvent groups of companies in cross border cases and rescue plans

The presentation of Robert van Galen mainly concerned two topics. Firstly, Van Galen described five different regimes and four different scenarios of dealing with group insolvencies within the European Union. Secondly, Van Galen addressed the European Rescue Plan as proposed by INSOL Europe. As a preliminary remark Van Galen pointed out that the situation in the European Union is somewhat special. On the one hand, there is the principle of community trust, which under the European Insolvency Regulation entails that member states should trust decisions taken by courts in other member states. In this regard, there is a difference with cross border cases where there no such trust exists. On the other hand the EU situation differs from a domestic situation because a COMI is designated which may cause a shift in the law applicable to the insolvency.

Five regimes of dealing with group insolvencies

Van Galen started by distinguishing five different regimes of dealing with group insolvencies. The first regime is based on coordination between courts. Although there are several sets of rules and guidelines on coordination, it is still a rather weak instrument. It can easily be overruled by national laws and cannot overcome the problem that
trustees of subsidiaries may exploit hold out positions in the interest of their own creditors. The second regime is based on coordination powers for the trustee of the main proceedings. It is required that one of the proceedings is designated as the group main proceedings, probably that of the parent company. The trustee of the main proceedings has powers in the subsidiaries’ insolvencies. The court of the subsidiary probably decides on such requests. This the regime favored by INSOL Europe. The third regime consists of the appointment of a mutual trustee in all group proceedings. This may be an efficient option, but there are some disadvantages in the sense that conflicts of interest between the companies within the group would have to be handled by one and the same liquidator. Also, the mutual trustee might have to deal with different laws, languages and legal cultures which may hinder effective communication with the courts. Therefore, it should not be the standard solution according to Van Galen. The fourth option is a joint administration regime. If this would entail that the law of the bankruptcy court applies, there would be a shift in the law applicable to the insolvency proceedings of the individual companies of the group. On the other hand, applying the law of the individual subsidiaries would burden the court. The fifth and final regime is based on substantive consolidation. All the assets and liabilities will be thrown on a pile and are no longer attributed to individual companies. The general view is that this should rather be the exception than the rule.

Van Galen then elaborated on the second regime of the liquidator with coordinating powers. Under such a regime four restructuring scenarios are possible according to Van Galen. A coordinated asset sale by the individual group companies provides the first scenario. The trustee with coordinating powers can, for example, ask the court of the subsidiary proceedings to suspend any asset sale by the trustee of the subsidiary. The former can then try to agree on a coordinated sale with the trustees of the individual companies. However, it might be difficult to align all trustees and courts in the various insolvencies of companies of the group. A second scenario is a coordinated rescue plan with respect to the individual group companies. For example, the liquidator of the group main proceedings can propose rescue plans in all subsidiary proceedings. This might be very difficult to achieve and serious limitations may be posed by national law. A third option. The liquidator of the parent company would have the power to sell all or part of the assets of the group. There may however be conflicts of interests between (creditors of) the different group companies. A final
scenario is one consolidated plan for the whole group. The proposal for the European Rescue Plan (ERP) by INSOL Europe is based on this idea.

**European Rescue Plan**

The European Rescue Plan is a specimen of a consolidated plan for the whole group of companies in different jurisdictions. Adoption of the plan takes place under the supervision of the court of the main proceedings of the parent company. Under the ERP, creditors are placed in classes and each class votes on the plan. The interests of the different classes should essentially be the same. If all classes accept the plan, the court will confirm the plan. If a creditor opposes confirmation, the court will still confirm, unless:

i. the plan unfairly favors one or more creditors, or
ii. the creditor receives less value than he would receive in a liquidation (the best interest test), or
iii. the plan is not feasible.

If one or more classes do not accept the plan, the court will decide on a cram down. INSOL Europe has accepted the absolute priority rule in this respect. From this rule follows that no cram down may take place if a lower ranking creditor would receive anything under the plan whilst a higher ranking creditor does not receive full value (he is “impaired”). However the meaning of this rule is limited because with respect to different creditors of different companies, it is not possible to say that one creditor is higher ranking than another. Therefore, a rule has been added that a rejection by a class can only be overruled if the rejection was not in good faith.

The procedure of the ERP has three stages. In short, first the trustee of the group main proceedings submits the plan, an information memorandum and the class schedule to the court. This is followed by an acceptance hearing. The court decides on recognition of the claims that are disputed and it will establish a definite class schedule. After that, creditors will vote on the plan. With respect to creditors that have rejected the plan, the court will decide on cram down. As a third stage, the court will confirm the plan unless a creditor or shareholder opposes confirmation. The court will then apply the best interest test, the feasibility test and the test whether the plan unfairly favors one or more creditors or shareholders.
Van Galen then responded to the objections to the ERP raised by prof. Madaus. First and foremost, Madaus is of the opinion that the APR should not only be absent at the confirmation test (as it is under the ERP), but also at cram down. This would enable equity’s involvement. However, according to Van Galen, the fact that the APR is absent when a class accepts the plan gives the different classes enough opportunity to bargain over any surplus value. In Van Galen’s view, in insolvency proceedings equity is absent and it is up to the creditors to decide whether equity is still allowed to retain something. The fact that the creditors are placed in classes that have more or less the same interest justifies this. The question whether the court will overrule a rejecting class must be seen in the key of abuse of right. In a group of companies it can be hard to establish a ranking order between the creditors, so then the court must apply the test whether the rejection is in good faith.

In response to Madaus’ submission that one (confirmation) hearing is sufficient, Van Galen explained that eliminating the acceptance hearing would imply that the court would decide on classification after knowing the outcome of the voting. This could sway the court towards a more plan-friendly attitude.

The role of equity

Marcel Windt and Reinout Vriesendorp (Tilburg University and De Brauw Blackstone Westbroek) asked prof. Madaus whether he had taken the economic perspective into account when proposing to give shareholders a permanent role in a reorganization. Prof. Madaus explained that in his view, the economic perspective is a too one-sided view on a reorganization. There is no justification not to apply the legal rules outside of insolvency to the company in a reorganization. This is confirmed by the European Court of Justice, as well as the German Bundesverfassungsgericht, who would judge that the membership rights of shareholders have to be considered, even if they are out of the money, as they are protected by the constitution or EU directives.

Rolef de Weijs brought up the question whether the fact that equity brings new value to the company is a prerequisite for equity to be allowed to keep some value. Also, De Weijs asked if it was indeed the case that under present German law, equity does not have any bargaining power. Madaus explained that it is not a condition for equity
to bring value to the table. In his view, there should not be a cram down only because equity is out, but that in stead the fair and equitable test should be applied. If a cram down is in accordance with the fair and equitable standard, the dissent of equity can be overturned by a judge.

*(The role of the judiciary)*

Erik Boerma was wondering how the many courts in Europe can be coordinated. When applying the ERP, how can we make sure that every court in the European Union would decide in the same manner and how are these decision made accessible? Robert van Galen answered that the trustee of the parent company has certain powers with respect to the subsidiaries. He can propose a group plan, but no proposals for coordination between courts are included in there. The reason for that is that a group of INSOL Europe is still discussing this matter. It would be harder to attain than the ERP, because the latter only applies in a limited number of cases, namely group cases in multiple jurisdictions. Therefore a plan for coordination between courts has not been put forward by INSOL Europe up until now.

*(The future of the ERP)*

Bob Wessels (Leiden University) then posed a practical question to each of the day’s speakers: the first about the chances of success of the ERP to make it through the European Commission, and the second on the success of reorganization plans in Germany so far. Madaus answered to the second question that there were no numbers yet, because the new law (ESUG) has only been in force for six months. So far, the two cases that he is aware of regarded small family businesses. It is expected that in January or February 2013 the first results of the insolvency plans will be published by the courts. In response to the first question Van Galen answered that INSOL Europe opted to draft provisions that represent the best way forward. INSOL Europe preferred to start the debate about the optimal solution for a European plan rather than not have a debate at all. If the proposal will not make it into legislation this time, it may be taken into account in the next round, regarding the fact that the Commission has to evaluate the regulation every five years.

On 12 December 2012, not long after the annual meeting of the NACIIL, the European Commission published its proposal for amending the European Insolvency Regulation. The Commission has not adopted INSOL Europe’s suggestion for a European Rescue Plan.
Rather, the proposal focuses on a regime of intensified coordination and communication between courts and liquidators in case of an insolvency of a group of companies.83

4. Concluding remarks

The need for fast track corporate rescue proceedings and a solution for cross-border insolvencies of groups of companies is clear. The future developments of this area of insolvency law are both challenging and exciting. Prof. Madaus and Van Galen provided the NACIIL with valuable reports on corporate rescue and the cross-border reorganization of groups of companies. Their presentations and the lively debate that followed formed the heart of another successful annual meeting of the NACIIL.
