

SCHULTZE & BRAUN INSOLVENCY LAW

Self-reorganisation in insolvency?

Introduction

As the term “self-reorganisation” implies, the legal entity of an enterprise is assumed to be capable of reorganising itself under its own steam. This does not necessarily have to happen without any “outside assistance”. At the least, the option of process control must be available, without putting oneself to the mercy of others.

This is an approach which the former bankruptcy and total judicial execution law did not follow. The way this law was understood in Germany meant, for instance, that the 30-year period of limitation was maintained even after bankruptcy or total judicial execution proceedings had been completed. It also meant that claims for liabilities could be filed virtually “in perpetuity”. The idea of a “fresh start”, the self-reorganisation of the common debtor, led but a shadow existence.¹

On the other hand, the insolvency law with its §§ 217 to 269 and the insolvency plan it defines therein, provides a universal tool which, in insolvency proceedings, offers a reasonable alternative to the debtor’s asset utilisation and distribution of the proceeds.² In analogy with the US insolvency law³, the legislator has included the insolvency plan as an option in insolvency proceedings which permits the debtor to actively handle the insolvency liquidation without – initially – being subject to any restrictions in terms of content. What the legislator intended was that the insolvency plan procedure should also (and especially) be amenable to the debtor and so allow the self-reorganisation with the appropriate reduction of indebtedness.

Self-reorganisation with the help of the insolvency plan as alternative to regular liquidation (breakup)

Until recently, the (common) debtor faced the stark dilemma of having his administrative powers and his right of disposal withdrawn from him as soon as bankruptcy or total judicial execution proceedings are instituted.⁴ He had to stand by and watch how others, without the need to give any further reasons, simply ignored his alternative proposals for handling the insolvency. The one and only aim of the bankruptcy and total judicial execution law was the breakup of the debtor’s assets. At least in practice, alternatives to the breakup were seen for utilising the assets, one of the reasons why the “transferring reorganisation”⁵ eventually became established in practical insolvency proceedings. In spite of this, self-reorganisation remained the rare exception.

¹ The Court Composition Law allowed a fresh start or an ordered and disencumbered withdrawal of the common debtor only in very specific, tightly restricted and rare cases.

² § 1 Sentence 1 InsO. Anyone wishing to delve into the insolvency schedule procedure should read the following: Braun/Uhlenbruck, “Muster eines Insolvenzplans”; Braun/Riggert/Kind, “Die Neuregelungen der Insolvenzordnung in der Praxis”, 2nd edition 2000, p. 115ff; Braun, in Hottwald (publ.) “Insolvenzrechts-Handbuch”, 2nd edition 2000, p. 829ff; Braun, in Nerlich/Römermann, “InsO” §§ 217ff InsO.

³ Reorganisation in the USA is allowed via the Chapter 11 BC procedure.

⁴ Still holding today with the opening of insolvency proceedings, unless another new feature of the insolvency law is used, namely the self-administration under §§ 270ff InsO. Cf. also in detail Riggert, “Der Syndikus”, 15th edition (September/October 2000) p. 36ff.

⁵ Transfer of substantial portions of fixed or current asset items to a new entity, e.g. a rescue company.

Another option offered from the onset by the new insolvency law is normalising a minimum measure of what the creditors must receive from the debtor's assets.⁶ Beyond that, the denial of any other economically reasonable insolvency liquidation is declared to be non-permissible because this is not seen as protecting the interests of the creditors, but simply as abusive practice which totally ignores the laws of the market. In other words: besides the regular liquidation (breakup), all other options of insolvency liquidation are conceivable and permitted with equal rank⁷ to the extent the creditors agree to it⁸ or to the extent that individual creditors reject the scheduled proposal for the insolvency liquidation without, however, their negative vote being decisive for the alternative solution because they would, in any case, receive the minimum of that which they would have received during the regular liquidation (breakup)⁹.

The actual design in terms of its content of the insolvency plan is left to the "ingenuity" of the person submitting the plan, and ultimately also to the private autonomy of the creditors who decide on whether to reject or accept the proposed insolvency plan. There are only a few points where the insolvency law defines the framework for the content of the insolvency plan¹⁰, the remainder deals with issues of procedure.

Due to the fact that the outcome is relatively open, transfer plans¹¹, liquidation plans¹² or standstill agreement plans¹³ as well as mixed forms are all conceivable options. What is important for the debtor is to realise that, detached from the many structuring options in terms of content, he will now have the chance to prepare and enforce his own self-reorganisation plan. And if the debtors combines the insolvency plan with an application for self-administration¹⁴, submitting both together upon the application to file for insolvency¹⁵, he is left with the initiative which he previously enjoyed as entrepreneur.

If the indebted enterprise is worth keeping alive, it may be advisable in many instances to combine the insolvency plan procedure with the self-administration procedure¹⁶ because the debtor keeps the powers of administration and disposition in the self-administration procedure¹⁷. It is in this constellation that the debtor is best placed to utilise the freedom of scope which the insolvency law provides¹⁸. What is more, both customers and suppliers tend to perceive self-administration as the endeavour for continuity. They also see that the breakup solution is no longer pursued and that the enterprise will be kept afloat. The market appearance of the indebted

⁶ Name, inter alia, the expected regular liquidation value, cf. § 245 Section 1 No. 1 and § 251 Section 2 InsO.

⁷ § 1 Sentence 1, 2 Alt. InsO.

⁸ § 244 InsO.

⁹ Simplified, the regulations of the obstruction prohibition pursuant to § 245 InsO. The consent by the creditor with negative vote is in these cases constructively assumed.

¹⁰ For example in § 222 InsO (Grouping) or § 226 InsO (Equal treatment of the creditors within a group).

¹¹ The „transferring reorganisation“ practised in the former bankruptcy or total judicial execution law as a substitute solution for lack of legal standardisation.

¹² With objectives identical to that of the regular proceedings, but with different designs in content.

¹³ Respite, without waiver, of the creditors' claims.

¹⁴ §§ 270ff InsO. On the conditions for self-administration, see also Riggert, *ibid.* p. 36ff.

¹⁵ § 218 Section 1 Sentence 2 InsO.

¹⁶ § 284 Section 1 Sentence 1 InsO stipulates that both procedures may be combined. See also Riggert, *ibid.* p. 38

¹⁷ The self-administration procedure is an „administrator-less“ insolvency method.

¹⁸ The to and fro involved in the administrative powers and the powers and disposition between the insolvency administrator and the debtor is so avoided. There is also the beneficial cost savings effect (the fees of the creditors' trustee are about half of those of an insolvency administrator).

enterprise is less spectacular at this stage, with the effect that the operative business needed for the self-reorganisation can be freely controlled¹⁹.

Early plan preparation and submission of the plan by the debtor

The debtor is free to submit the insolvency plan at the earliest stage possible, i.e. as soon as insolvency proceedings are instituted²⁰. This gives the debtor the chance to keep a decisive degree of control over the further insolvency proceedings at a point in time when the essential groundwork can still be laid²¹. If, furthermore, the debtor also succeeds in agreeing the insolvency plan with the (principal) creditors ahead of proceedings, the chances of success are much greater than in those instances where the planning work is initiated after the insolvency proceedings have been opened or even later²².

The provisional insolvency administrator (normally identical with the insolvency administrator once the proceedings have opened) will usually be the first “external” to judge whether preparing an insolvency plan and hence alternative (reorganisation) actions makes sense or not. This shows quite clearly that, apart from his “home advantage”, the debtor also has a lead in terms of time. Very much the same applies to the creditors who, quite apart from the lack of information available to them in most cases, are not authorised to submit an insolvency plan. The creditors’ meeting can only indirectly initiate and control the planning procedure via the insolvency administrator²³.

The aspect of the time advantage should not be underrated: There is one thing the indebted enterprise has in very short supply: time. This is why a prudent and responsible debtor will begin at the earliest possible time to prepare an insolvency plan if he wishes to continue “at the helm” of his enterprise.

Group formation – the key to success

The essential feature of an insolvency plan is to be able to account for the various interests of the creditors by treating the creditors with a certain degree of differentiation according to their economic interests. The person submitting the plan can, without being obliged to, allocate the various economic interests to different groups.

Keeping in mind also that the decision to reject or accept the plan rests with the individual groups, it becomes evident that the group formation is the crucial key to enforce the alternative solution submitted to the creditors. It is neither the collective of creditors, nor the owners of a

¹⁹ Naturally and for the sake of the creditors’ interests alone, the debtor will not be easily entrusted with the powers of administration and disposition. He is usually joined by a creditors’ trustee who supervises the debtor’s management; see Riggert, *ibid.* p. 38

²⁰ § 218 Section 2 Sentence 2 InsO. The only other person authorised to submit a plan is the insolvency administrator, cf. §§ 218, 157 Sentence 2 InsO.

²¹ For instance, because utilisation actions by the insolvency administrator for the self-administration of any necessary business and operational equipment can as yet not be taken, or because the creditors have been notified at an early point in time and have so been motivated to give their consent / to co-operate.

²² The tendency is to view the debtor’s plan proposal the more critical, the closer the date for plan submission lies to the final deadline (§ 218 Section 1 Sentence 3 InsO). The chances of implementing the plan submitted are in this instance significantly worse.

²³ Cf. § 157 Sentence 2 InsO.

preferential settlement, nor the insolvency creditors who decide whether they wish to waive the regular liquidation or insist upon it, but each group (of creditors) alone.

In order to avoid the abusive conduct of the person submitting the plan in the group formation, the criteria of a proper economic delimitation must be stated in the insolvency plan²⁴. The review does not focus on whether there are any “better” or even “other” distinguishing criteria for the group formation. If the distinguishing criteria are economical in nature, the group formation is lawful and cannot be faulted. Again: the debtor as the person submitting the plan has defined the necessarily wide room for manoeuvre to take the chance offered by his self-administration by relying on his creditors’ consent.

In spite of all this, the debtors must take the (expected) negative vote by a creditor as the yardstick for his decision under § 245 InsO. The negative vote delivered by such creditor must be capable of being replaced via § 245 InsO²⁵. If this aspect is ignored, the insolvency plan has no chance of being realised.

The moment of truth: the discussion and voting hearing

The decision on whether to reject or accept the plan is taken by the creditors during the discussion and voting hearing²⁶. This means that the insolvency plan procedure remains – for the debtor as the person submitting the plan – a creditor-driven procedure. This is the point where the debtor can show that he has done his “homework”, that he has ensured that the plan has been agreed with the (principal) creditors, or that the creditors agreeing to the plan attend the hearing²⁷. Nonetheless, the debtor can at this point still make his presence felt: the discussion and voting hearing gives the person presenting the plan and the stakeholders the opportunity to discuss the plan and to do some last persuasion work before the vote is taken. Careful preparation and the appropriate presentation can make all the difference²⁸.

Summary: the insolvency plan procedure constitutes the legal framework for self-reorganisation in insolvency

With the insolvency law, and hence with the insolvency plan, the legislator did not intend to rescue delinquent enterprises from liquidation by intervening in the rights of the stakeholders. The intention was rather to create a modern and viable insolvency law which integrates without discord into the existing legal and economic order. The laws of the market are also meant to control the judicial handling of the insolvency. The insolvency plan lends the stakeholders a legal structure which meets these requirements. Making the appropriate preparations, the debtor as the person submitting the plan can achieve the rescindment of the insolvency proceedings within the

²⁴ § 222 Section 2 Sentence 3 InsO. If these details are not given, the plan (following a period allowed by the court to remedy) will be dismissed by the court, § 232 Section 1 No. 1 InsO.

²⁵ Granting the expected regular liquidation value. To this extent the advance agreement with the creditors and probing which creditor may vote against is indispensable

²⁶ §§ 235ff

²⁷ Only votes cast during the hearing will be counted, with the effect that efforts to make agreeing creditors attend the hearing and to reach a certain advance consent is a duty. If the vote hearing is determined separately by the court (§ 241 InsO), votes may also be cast in writing, § 242 InsO.

²⁸ The person submitting the plan should on no account rely on this aspect alone.

shortest possible time and – through a “cleansing thunderstorm”, as it were – start the self-reorganisation²⁹.

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²⁹ Just two press releases by way of example: FAZ 12 Aug 2000, p. 20 “Insolvency plan underrated as a reorganisation tool”M Wirtschaftswoche 27 July 2000, p. 101: “Under one’s own steam”.