MASTER THESIS

Titel der Master Thesis / Title of the Master‘s Thesis

The Importance of Debtor-Friendly Bankruptcy and Insolvency Regimes: An Examination and Comparison of Bankruptcy and Insolvency Laws in the U.S. and Germany“

verfasst von / submitted by

Jared Quinn

angestrebter akademischer Grad / in partial fulfilment of the requirements for the degree of

Master of Laws (LL.M.)

Wien, 2020 / Vienna 2020

Studienkennzahl lt. Studienblatt / Postgraduate programme code as it appears on the student record sheet:	UA 992 548
Universitätslehrgang lt. Studienblatt / Postgraduate programme as it appears on the student record sheet:	Europäisches und Internationales Wirtschaftsrecht
Betreut von / Supervisor:	Assoz. Prof. Mag. Dr. Dr. Thomas Ratka

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List of Abbreviations

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Business – Bus.

Debtor in Possession – DIP

International – Int'l.

Journal – J.

Law – L.

Review – Rev.

United States - U.S.

Introduction

Bankruptcy is a mechanism in which a debtor may reorganize its debts or even liquidate entirely.[1] It is a common legal mechanism in almost every modern society. It serves many purposes and provides protection for individuals and large corporations around the world. Many governments are "aware of the need for more forgiving insolvency systems", and "many governments are implementing such systems" too.[2] This is because bankruptcy and insolvency laws in general are of vital importance in today's contemporary economies.

Bankruptcy and insolvency regimes are necessary not only because of the faults of debtors being unable to pay their debts when they become due, but also because of market imperfections and uncertainty.[3] Bankruptcy and insolvency laws provide for an orderly process to organize an insolvent debtor's assets and to prevent a race to the courthouse by creditors of the debtor.[4] Without such laws, there would be a chaotic panic and rush by creditors to take as many assets of the debtor before any other creditor had a chance to collect and without any orderly process.

A majority of bankruptcy filings are consumer filings, or in other words, individual people who need bankruptcy protection from creditors. However, they are not the only ones that need protection. Although they are not a high percentage of all total bankruptcy filings, corporate bankruptcy filings involve significantly more assets and money compared to consumer filings. The applicable bankruptcy laws within a jurisdiction are especially important for small to large transnational corporations who may be subject to laws in multiple jurisdictions because of activities in numerous countries or directed activities in various jurisdictions.

The U.S. and German jurisdictions are two of the strongest and most important bankruptcy regimes for many multi-national corporations around the world based on the

[1] In this paper, I will refer to bankruptcy and insolvency interchangeably. Thus, there should no difference between the meaning of bankruptcy or insolvency unless otherwise stated. U.S. law tends to use the word "consumer bankruptcy" more often, while German law uses the term "consumer insolvency." Furthermore, this paper will not focus on liquidation, but rather the reorganization process of corporations which are insolvent.

[2] *See* Rafeal Efrat, *Global Trends in Personal Bankruptcy*, 76 Am. Bankr. L.J. 81, 91-92 (2002).

[3] Müge Adalet McGowan and Dan Andrews, *Insolvency Regimes and Productivity Growth: A Framework For Analysis*, ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT, http://www.oecd.org/officialdocuments/publicdisplaydocumentpdf/?cote=ECO/WKP(2016)33&docLanguage=En (last visited Dec. 31, 2019).

[4] *See id.*

number of filings in each country relatively.[5] Many new bankruptcy laws and the principles for many of the new insolvency codes in Germany have been transplanted from the United States into the German regime (which has a unique attitude toward debt forgiveness all together[6]) and even into other jurisdictions.[7] This is also true for German insolvency laws and themes to be transplanted visa versa into the U.S. and other jurisdictions.

Now that it is clear that there are two main different types of entities filing for bankruptcy protection, the next question that should be asked is what is the purpose for such regimes? Both of the U.S.'s consumer and corporate bankruptcy laws strive to "preserve reorganization" or "going concern value" over the corporation's "liquidation value."[8] Importantly, the drafters of the U.S. Bankruptcy Code's modern Chapter 11[9], and thus the German Code drafters since they incorporated the U.S. laws into the German regime, must have assumed that the "most successful way to achieve that result was to retain the corporation's management and enable multiple outcomes either through a plan of reorganization, a series of going concern sales, or even a liquidating plan."[10] This uniquely U.S. idea often leads to "debtor friendly" laws passed by the U.S. legislature with respect to Chapter 11.

Insolvency proceedings ("Insolvenzverfahren") pursuant to the German Insolvency Code are the "only judicial proceedings available in Germany" when a corporation needs to filed for insolvency.[11] The aim of these insolvency proceedings is not to protect the corporate

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[5] *Id* (They were using completed surveys by insolvency practitioners, laws, and public information, in addition to information provided by the World Bank and European Commission, a ranking of the strongest bankruptcy regimes placed the U.S. and Germany as the countries with the two strongest bankruptcy and insolvency laws. The factors used included: corporate insolvency, triggers, the proceedings, rights of creditors, debtor management and incentives, information available to creditors, new financing, financial structure, and other factors.) *Id*.

[6] "The current U.S. bankruptcy system grew directly out of the United States' unique capitalist system … which rewards entrepreneurialism as well as extensive consumer spending." Nathalie Martin, *The Role of History and Culture in Developing Bankruptcy and Insolvency Systems: The Perils of Legal Transplantation*, 28 B.C. INT'L & COMP. L. REV. 1, 3 (2005).

[7] *See id*.

[8] *Comparison of Chapter 11 of the United States Bankruptcy Code with: The System of Administration in the United Kingdom, The Rescue Procedure in France, Insolvency Proceedings in Germany, and The Extraordinary Administration for Large Insolvent Companies in Italy*, JONES DAY, https://www.jonesday.com/files/Publication/1ec093d4-66fb-42a6-8115-be0694c59443/Presentation/PublicationAttachment/e5b46572-7aeb-4c34-ab2e-bee2f8f3d3c2/Comparison%20of%20Chapter%2011%20(A4).pdf (last visited Dec. 31, 2019). Jones Day is one of the leading firms that practices Chapter 11 bankruptcy law for corporate clients. The Code attempts to preserve the value of the business as a whole rather than selling it for its individual parts. It assumes that some businesses can reorganize in a manner that can allow it to become profitable.

[9] Chapter 11 of the U.S. Code is applicable to corporations who want to reorganize after facing financial difficulty.

[10] *See supra* note 8.

[11] *See supra* note 8.

debtor from its creditors[12], but "to maximize the insolvency dividend payable to the creditors."[13] Thus, the German regime is often labeled more "creditor friendly."

A regime may be more debtor-friendly if the code provides more rights to debtors in bankruptcy than creditors, and the opposite is true for creditor-friendly codes. This idea of what is "debtor-friendly" or "creditor-friendly" is important. Obviously, no two states' bankruptcy or insolvency laws are identical. They will differ in some respects, but also be similar in others. When even slight difference occur that may even seem non-material, either due to the ideals of the state, cultural or historical reasons, or even economic reasons, the result will be a variant of a debtor-friendly or creditor-friendly regime that either favors debtors in the bankruptcy process or it will favor creditors. Some regimes can fall partially on either side of the spectrum, but many, like the U.S.'s, shift clearly in one direction than the other (as the U.S. has been labeled a "debtor-friendly" regime by many commentators). Again, this will depend on the jurisdiction.

Regardless of the jurisdiction, all laws should have a purpose in order to be enacted. Bankruptcy (and insolvency) laws are no different. Many bankruptcy laws are centered around the purpose of allowing a debtor to restructure or liquidate in order to receive a discharge of his or her debts. Both the U.S. and German regimes have this in mind. But what are the details that make each regime truly different, and more or less "debtor-friendly"?

This thesis will thus explain some of the basic, and even the complex concepts, vital to bankruptcy laws in both the U.S. and German bankruptcy and insolvency regimes. This will require an analysis into the U.S.'s federal Bankruptcy Code and case law regarding bankruptcy law. In addition, the German insolvency code will be explained in in a similar manner as I will compare the similar and different aspects of each relative bankruptcy regime. These areas include the goals of each regime, who can utilize each regime, the process to begin bankruptcy proceedings in the U.S. and Germany, and even creditors' rights among other topics. This paper does not go into detail on the similarities on the entire regimes, but rather targets some of the most important and critical aspects of U.S. bankruptcy and German insolvency laws that are also deemed "debtor-friendly" and "creditor friendly."

[1212] The term "creditors" includes secured creditors and unsecured creditors. A "secured creditor" has a lien on an item of property of a debtor. *Bankruptcy Resources*, AMERICAN BANKRUPTCY INSTITUTE, http://bankruptcyresources.org/content/what-difference-between-secured-creditors-and-unsecured-creditors (last visited Dec. 19, 2019). A "lien" is an interest in property that allows a creditor to have your property sold to satisfy a debt in the case of default. *Id*. Common examples of secured creditors include mortgage and car lenders. *Id*. An "unsecured creditor" does not have interest in any of a piece of property of a debtor. *Id*.

[13] *See supra* note 8.

This thesis will also explain why the U.S.'s style of a debtor friendly bankruptcy regime is the most economically friendly legal regime, especially for corporate restructurings. As it will be discussed, debtor-friendly regimes provide many benefits to jurisdictions who enact such regimes. Thus, the German insolvency laws should be amended to reflect this style of regime to improve the economic impact within Germany when a company utilizes the German Insolvency Code.

In order to cover all of this, I have structured of this thesis and divided it into five main parts. First, in Part I, I will give a relatively brief explanation of the purpose of U.S. and German bankruptcy and insolvency laws. In Part II, I will follow with a discussion of the most important aspects of U.S. Chapter 11 bankruptcy laws. In Part III, I then discuss the related German insolvency laws relative to the U.S. law discussion. Next, In Part IV, I explain why debtor friendly bankruptcy regimes should be preferred. Fifth and finally in Part V, I give recommendations as to what should be adopted in each regime (mainly German law) to create a more debtor-friendly bankruptcy and insolvency legal system.

I. The Purpose of Bankruptcy and Insolvency Laws?

While bankruptcy or insolvency is not ideal for any and all businesses, bankruptcy laws are essential to modern economies and legal systems. Nearly all jurisdictions have some form of bankruptcy laws or codes to deal with insolvent debtors such as companies and individuals. Just like all other laws in different jurisdictions, none of them are exactly the same. While there can be striking similarities between two different jurisdictions, there are also differences in the text of the law and its application by the respective courts. However, one thing about bankruptcy laws that is consistent across the board is that they usually are drafted and passed by governing bodies or legislatures in a jurisdiction in order to relieve potential debtors of debts they can no longer bear.

Bankruptcy regimes provide corporate and non-corporate debtors:

> a procedure by which [many] insolvent debtors can reorder their affairs, make peace with their creditors, and enjoy 'a new opportunity in life and a clear field for future effort, unhampered by the pressure and discouragement of preexisting debt.[14]

Thus, bankruptcy laws in most jurisdictions have the dual purpose of providing for a fresh start to an honest but unfortunate debtor and providing for equal treatment to creditors during the process. This dual purpose is the foundation for governments and legislatures when they enact bankruptcy laws. Thus, this should always be kept in mind by governments, legislatures, and courts when passing and enforcing the laws.

A. Fresh Start for The Honest But Unfortunate Debtor

As previously mentioned, bankruptcy laws serve two main purposes. The first of the two are the "fresh start for the honest but unfortunate debtor"[15] in bankruptcy.[16] Bankruptcy laws will allow a debtor to pay his or her creditors a portion, a small faction in many cases[17], of what they are owed depending on the debtor's financial status and situation.[18] This can be

[14] Grogan v. Garner, 498 U.S. 279, 286 (1991) (citing Local Loan Co. v. Hunt, 292 U.S. 234, 244 (1934)).
[15] The main purpose of the U.S. Bankruptcy Code is to grant a "fresh start" to the "honest but unfortunate debtor. Grogan v. Garner, 498 U.S. 279, 286-87 (1991). *See, e.g.*, Elizabeth Warren, *A Principled Approach to Consumer Bankruptcy*, 71 AM. BANKR. L.J. 483, 483 (1997) (describing "a 'fresh start' for debtors and equality of distribution for creditors" "the two competing goals of consumer bankruptcy").
[16] What are the main purposes of bankruptcy?, American Bankruptcy Institute, http://bankruptcyresources.org/content/what-are-main-purposes-bankruptcy (last visited Dec. 20, 2019).
[17] Many creditors will not receive 100% of the debt owed to them by a debtor in bankruptcy. In fact, some creditors may receive nothing at all from the debtor in many scenarios.
[18] *Id.*

measured by the debtor's ability to pay.[19] After bankruptcy, the discharge, in essence, prevents the debtor's creditors from trying to collect the remainder of what the debtor owes them.[20] Ideally, bankruptcy laws give an "honest but unfortunate debtor" a "fresh start" by canceling many of his or her debts through a court order.[21]

This is a "debtor-friendly" principle of bankruptcy or insolvency. If the law is to allow the debtor to be able to reorganize, it must be given a fair chance to enjoy "a new opportunity in life and a clear field for future effort."[22] In order to achieve this, a jurisdiction's bankruptcy regime must favor the debtor to allow it the opportunity to restructure if possible. Like in the U.S. and German codes, there are different ways to try to achieve this, but the most that is most likely to allow a debtor to reorganize is the U.S. for reasons that will be explained below because its laws are more debtor-friendly.

B. Equal Treatment of Creditors

The second purpose is equal treatment of creditors of the debtor.[23] The "equality of creditors" proverb is a historic idea in the law. It was developed overtime, as it came from older English insolvency laws, and it did not disappear over time but it has been a mainstay in the modern age of bankruptcy law as well. In addition to the historical meaning, it took on a new and distinct American style in the law. Equality of creditors is the principle that stands for the fact that similarly situated creditors should be treated similarly.[24] For example, if one unsecured creditor will be paid 20% of what the creditor is owed, others with similar claims should also receive 20%; nothing more but nothing less. "Equity is equality."[25] "That maxim … means that unless a creditor can clearly demonstrate that it deserves some priority in the bankruptcy payout, it should be assumed that all creditors are equal."[26] Thus, there would be a level of equality among creditors, but still not all in the same way.[27]

Unlike the first principle, this principle is more creditor-friendly. However, it still does not mean that bankruptcy codes must favor creditors over debtors. This principle only means

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[19] *Id.*
[20] *Id.*
[21] The court order, known in the U.S. as a discharge, releases the debtor from personal liability for certain specified types of debts. Discharge in Bankruptcy – Bankruptcy Basics, United States Courts, https://www.uscourts.gov/services-forms/bankruptcy/bankruptcy-basics/discharge-bankruptcy-bankruptcy-basics (last visited Dec. 31, 2019).
[22] *See supra* note 14.
[23] *See supra* note 16.
[24] David A. Skeel, Jr., *The Empty Idea of Equality of Creditors*, Penn Law: Legal Scholarship Repository. 2018.
[25] Elizabeth Warren ET AL., *The Law Of Debtors And Creditors* 58 (7th ed. 2014).
[26] *Id.*
[27] *See generally id.*

that similar creditors of a debtor should be treated fairly amongst others in the process. Thus, this principle does not necessarily lead to a creditor-friendly regime.

C. Should Laws be Debtor or Creditor Friendly Based?

What is interesting to note is that there is no principle that defines whether bankruptcy law should definitively be "debtor-friendly" or "creditor-friendly." In other words, there is no principle that defines whether the applicable bankruptcy and insolvency laws should be more favorable to the debtor in bankruptcy or the creditors of the debtor in bankruptcy, or if there should be a balance between the two options. It is up to the respective jurisdictions to favor debtors or creditors with their bankruptcy or insolvency codes. The result thus has been a diverse amount of debtor-friendly and creditor-friendly regimes around the world.

The U.S. and Germany have some of the most robust bankruptcy regimes in the world. The World Bank ranked the U.S. Bankruptcy Code and the U.S.'s legal system in general as "one of the 'best' insolvency regimes in the World Bank league table."[28] It is utilized in great numbers, especially recently. On the other hand, business insolvencies in Germany have been on the rise as well due to its highly regarded insolvency regime. The amount of insolvencies has traditionally been "on a nearly continuous and strong rise since the beginning of the 1990's."[29] However, the number of corporate bankruptcies in Germany did decline by 6.1% in 2016.[30] This was most likely due to the German economy which reaped the benefits of the structural reforms it implemented more than a decade ago and a weak Euro.

Both regimes are relatively similar, but they do have important differences. Some of the similarities arise due to the main principles stated above and from each regime adopting aspects from the other. However, it is their differences have led commentators to describe the U.S.'s Bankruptcy Code as more debtor-friendly, and the German Code as more creditor-friendly. But should one ideology be preferred over the other? If so, what aspects should be changed to create a more debtor-friendly or creditor-friendly?

To further understand whether a debtor-friendly, a creditor-friendly, or possibly even a balanced bankruptcy regime should be preferred, a closer examination of the relevant

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[28] Keith Pind, *Bankruptcy Protection is the USAA the debtor's friend*, THE LONDON INSTITUTE OF BANKING AND FINANCE, https://www.libf.ac.uk/news-and-insights/news/detail/2018/09/28/bankruptcy-protection-is-the-usa-the-debtor-s-friend (last visited Dec. 20, 2019).
[29] Rigmar Osterkamp, *Insolvency in Selected OECD Countries: Outcomes and Regulations*, CESIFO-GROUP, https://www.ifo.de/DocDL/dicereport106-forum5.pdf (last visited Dec. 31, 2019).
[30] Global Bankruptcy Report 2017, DUN&BROADSTREET, https://www.dnb.com/content/dam/english/economic-and-industry-insight/global-bankruptcy-report-2017.pdf (last visited Dec. 30, 2019).

bankruptcy and insolvency laws is required while keeping in mind the dual purpose of bankruptcy laws as well as the economy and public policy in general.

II. The Basics of Chapter 11 of the U.S. Bankruptcy Code

Bankruptcy laws in the U.S. can be a useful solution for many "honest but unfortunate debtors.[31] For most debtors, the U.S. Bankruptcy Code is a means to achieve a stay[32] on debt collection by creditors. The automatic stay, which is effective immediately after the bankruptcy is filed with the court, grants the debtor a "breathing spell" against the creditors of the debtor.[33] As a result, the creditors may not seek payment of the debt during the automatic stay. This gives the debtor a chance to organize assets to either liquidate or restructure itself with the help of other provisions in the Bankruptcy Code.

The U.S. Bankruptcy Code has existed for decades. The modern Chapter 11 scheme "developed from the [U.S.'s] distinctively capitalist economy, which rewards entrepreneurs and encourages wide consumer spending."[34] The Code's most recent and substantial amendments came in 2005.[35] That last significant change was the "Bankruptcy Abuse Prevention and Consumer Protection Act of 2005."[36] Only relatively minor modifications have occurred since then.

There are six types of bankruptcy in the U.S. regime that can be used by debtors. While each come at a cost to debtors, many debtors seek debt relief through one of these modes of bankruptcy. Each can be useful in different situations and for various types of debtors, but the

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[31] Jared Quinn, *Congress Should Have an Interest in This Interest*, 16 PITT TAX REV. 285, 288 (2019) (citing Grogan v. Garner, 498 U.S. 279, 287 (1991)).

[32] *See generally* Carron Armstrong, *Removing Bankruptcy's Automatic Stay*, THE BALANCE, https://www.thebalance.com/removing-bankruptcy-s-automatic-stay-introduction-316179 (last updated May 31, 2018). In bankruptcy, the stay prevents creditors and debt collectors from contacting a debtor in an attempt to collect money owed. *Id*. This can be formall attempts to collect assets or payment, or even informal calls that threaten the debtor for payments. *See generally id*.

[33] The U.S. Bankruptcy Code's aims to "provide a procedure by which [numerous] insolvent debtors can reorder their affairs, make peace with their creditors, and enjoy 'a new opportunity in life and a clear field for future effort, unhampered by the pressure and discouragement of preexisting debt." Grogan, 498 U.S. at 286 (citing Local Loan Co. v. Hunt, 292 U.S. 234, 244 (1934)).

[34] Nathalie Martin, *The Role of History and Culture in Developing Bankruptcy and Insolvency Systems: The Perils of Legal Transplantation*, 28 B.C. Int'l & Comp. L. Rev. 1, 3 (2005).

[35] *See supra* note 31 (citing Grogan v. Garner, 498 U.S. 279, 287 (1991)) (citing Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, 119 Stat. 23; Bankruptcy Amendments and Federal Judgeship Act of 1984, Pub. L. No. 98-353, 98 Stat. 333; Bankruptcy Reform Act of 1978, Pub. L. No. 95-598, 92 Stat. 2549).

[36] Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, 119 Stat. 23; Bankruptcy Amendments and Federal Judgeship Act of 1984, PUB. L. NO. 98-353, 98 Stat. 333; Bankruptcy Reform Act of 1978, PUB. L. NO. 95-598, 92 Stat. 2549.

most prominent and vastly used chapters of the Bankruptcy Code in the U.S. are Chapters 7, 11, and 13.[37] The modern version of Chapter 11 is applicable to many corporate restructurings in the U.S., and Chapter 11 is the chapter focused on in this paper because of its focus on corporate businesses. The other two, Chapter 7 and 13 are for liquidations and individual restructurings relatively.

A. The Main Goals of Chapter 11

The main goal of any debtor who files for any type of bankruptcy in the U.S. is to obtain a discharge of debts. Otherwise, bankruptcy would be relatively unattractive to many. "A discharge releases the debtor from personal liability for certain specified types of debts." Specifically, a Chapter 11 generally provides for reorganization, rather than liquidation. Thus, the business will not sell off all of its assets and close its business. But rather, it will reorganize itself to create a new business that is financially heathy.

To many, the Chapter 11 procedure has been criticized as inefficient, complex, and costly. To many others, Chapter 11 of the United States Bankruptcy Code has been viewed as a highly successful regime that allows overindebted corporations to shed unprofitable aspects of the business, and come out of bankruptcy as profitable. It is the latter approach that is more widely adopted.

B. Who Can Utilize Chapter 11

Chapter 11 is typically used to reorganize large businesses and corporations; however, this could include smaller companies, sole proprietorships, and even partnerships too. Chapter 11 may even be used by individuals as well if they possess a significant amount of debt or assets as well.[38] This is less common that businesses though.

In the U.S., in order for any business or person to file for Chapter 11 bankruptcy, the entity seeking this type of protection must qualify to file for a Chapter 11. There are limitations as to what types of entities can file for certain chapters under the U.S. Bankruptcy Code. Limitations include uninsured state member banks, or corporations organized under § 25 of the Federal Reserve Act.[39] Railroads have also been historically treated differently under the

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[37] *Bankruptcy Law—Chapter 7, 11, 13*, HG.ORG, https://www.hg.org/bankrpt.html (last visited Dec. 6, 2019).
[38] *See Chapter 11—Bankruptcy Basics*, U.S. COURTS,, http://www.uscourts.gov/services-forms/ bankruptcy/bankruptcy-basics/chapter-11-bankruptcy-basics (last visited Dec. 18, 2019). It is rare for an individual person to file for Chapter 11, as most people file for Chapter 7 or 13 due to the amount of debt, and assets such as income that they possess.
[39] 11 U.S.C. § 103(e).

Bankruptcy Code, as Subchapter IV of Chapter 11 applies only to them.[40] Usually, these limitations are non-material to many debtors and most debtors can overcome these specific limitations as they usually do not apply. To most corporations and businesses, they can easily file for Chapter 11 under the U.S. regime.

More importantly, in the U.S., there is no prerequisite for a debtor to actually be insolvent in order to utilize and file for Chapter 11. Having no "objective test" to determine who is eligible for bankruptcy and allowing even a solvent debtor can file for bankruptcy protection allows any debtor to theoretically file for bankruptcy protection as early as possible. Thus, once a debtor knows that it is facing financial trouble now or in the future, it can file for protection. This is a debtor-friendly aspect of the U.S. regime. This gives the debtor the ability to control when to file for protection.

C. Beginning the Chapter 11 Process

In order to begin the Chapter 11 process, the debtor in a Chapter 11 bankruptcy, called the "debtor in possession (DIP)[41]," files a petition for bankruptcy in the jurisdiction where the debtor is domiciled or has residence.[42] There is also a flat fee to file the petition.[43] This is relatively small for many businesses. Thus, the fee does not change if the case turns out to be relatively short and simple, or even if it is lengthy and complex.

Once the petition is filed, the debtor in possession maintains the property of the estate and is in control of the property to a limited extent.[44] The property of the estate includes (1) all property specified in 11 U.S.C. § 541 that the debtor acquires after the commencement of the case, but before the case is closed, dismissed, or converted to a different chapter; and (2) earnings from services performed by the debtor after the commencement of the case but before the case is closed, dismissed, or converted.[45]

As previously stated, a Chapter 11 bankruptcy case begins with the filing of a petition in the relevant bankruptcy court.[46] However, cases can be filed voluntarily or involuntarily.

[40] 11 U.S.C. § 103(h).
[41] 11 U.S.C. §§ 1101(a) and 1107.
[42] *See Chapter 11—Bankruptcy Basics,* U.S. COURTS, http://www.uscourts.gov/services-forms/bankruptcy/bankruptcy-basics/chapter-11-bankruptcy-basics (last visited Dec. 18, 2019).
[43] All U.S. Bankruptcy Courts charge a $1,167 case filing fee and a $550 miscellaneous administrative fee.
[44] 11 U.S.C. § 541.
[45] *Id.*
[46] Chapter 11 Bankruptcy, An Overview, Nolo, https://www.nolo.com/legal-encyclopedia/chapter-11-bankruptcy-overview.html (last visited Dec. 30, 2019).

Most commonly, Chapter 11 cases are "voluntary."[47] In a voluntary Chapter 11 case, the debtor is the party who takes the initiative and seeks bankruptcy relief.[48] This means that the debtor is not forced into the bankruptcy process by the debtor's own creditors. The business makes its own decision to seek bankruptcy protection.

On the other hand, creditors may also file an involuntary Chapter 11 petition against a defaulting debtor if specific requirements can be met by the creditors.[49] This means that the debtor is forced into the bankruptcy process. Some of the specific requirements include at least three entities that hold a claim against the debtor are involved and at least $10,000 is owed in claims if there are fewer than 12 claim holders.[50] This acts as a safe harbor against any bad faith involuntary bankruptcy filings by creditors. Involuntary cases are relatively rare compared to voluntary cases.

A Chapter 11 case is relatively short compared to a Chapter 7 or 13. A Chapter 7 usually lasts only a few months, but in a Chapter 13, a case can last anywhere from three-to-five years.[51] However, the debtor does not control the process as much as a debtor in possession in a Chapter 11 case.[52] There is no "absolute" limit on the duration of a Chapter 11 case.[53] For example, some cases wrap up within a few months after the petition is filed; however, it usually takes at six months to two years for a Chapter 11 case to finally come to a complete close and the plan is confirmed.[54]

The goal in the end, again, is to receive a discharge of debts. The general rule to determine the debtor in possession's discharge is that a judicial order confirming the debtor's plan operates as a discharge.[55] The time that this occurs will depend on the circumstances of the case, as some plans are confirmed sooner than others.[56] How the debtor gets through the process to plan confirmation, can be difficult. However, the Bankruptcy Code provides for an orderly process, from the petition to plan conformation, that is relatively debtor-friendly.

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[47] 11 U.S.C. § 301(a). "A voluntary case under a chapter of this title is commenced by the filing with the bankruptcy court of a petition under such chapter by an entity that may be a debtor under such chapter". *Id.*
[48] 11 U.S.C. § 303(a). "An involuntary case may be commenced only under chapter 7 or 11 of this title, and only against a person, except a farmer, family farmer, or a corporation that is not a moneyed, business, or commercial corporation, that may be a debtor under the chapter under which such case is commenced." *Id.*
[49] *See* 11 U.S.C. § 303(b).
[50] 11 U.S.C. § 303(b)(1) and (2).
[51] See supra note 31.
[52] *Id.*
[53] *See supra* note 46.
[54] *Id.*
[55] *See surpa* note 42.
[56] *See supra* note 31 (citing *Chapter 11—Bankruptcy Basics*, U.S. COURTS,, http://www.uscourts.gov/services-forms/ bankruptcy/bankruptcy-basics/chapter-11-bankruptcy-basics (last visited Dec. 18, 2019)).

Furthermore, the fact that the cost to file is relatively low and fixed for every case allows for more debtors to seek protection. Most cases are also voluntarily made with strict requirements for involuntary cases when they occur. Finally, the process overall is also relatively quick in the U.S. Especially with pre-packaged plans that are negotiated between the debtor and creditors even before filing, the amount of time from entering to exiting bankruptcy is not long in most cases. Thus, the U.S. regime is debtor-friendly in these respects.

D. The Automatic Stay

Once there is a filing of a Chapter 11 bankruptcy petition by debtor in the U.S., the "automatic stay" comes into force immediately. The automatic stay is a relatively powerful for debtors. This all too important aspect, the automatic stay, prevents the continuation of all litigation and stops the enforcement of all judgements against the debtor without leave of the court.[57] Thus, "the stay" stops the continuation of any and all existing legal actions that were commenced against the debtor before the petition was filed, but not after.[58] Any creditor that attempts to or does take any action in violation of the stay risks court actions and penalties.[59] In addition, any action that a creditors commits that violates the automatic stay can be made void or voidable by the Bankruptcy Court.[60]

One of the most important aspects of U.S. bankruptcy law is that the stay is effective for the whole duration of the case.[61] However, creditors may make motions to lift or modify the stay.[62] Such an affected party can apply to the court for relief. Once a motion is made, the stay will expire after 30 days unless the court continues the stay or the moving party consents to continuation.[63]

The court may terminate the stay, modify it or subject it to conditions.[64] Motions to lift or modify the stay are based on: (1) a showing of "cause"[65], which includes the lack of adequate

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[57] 11 U.S.C. § 362(a).
[58] *See supra* note 31 (citing *Chapter 11—Bankruptcy Basics*, U.S. COURTS,, http://www.uscourts.gov/services-forms/ bankruptcy/bankruptcy-basics/chapter-11-bankruptcy-basics (last visited Dec. 18, 2019)).
[59] 11 U.S.C. § 362(k). "Any willful violation of a stay provided by this section shall recover actual damages, including costs and attorneys' fees, and, in appropriate circumstances, may recover punitive damages. *Id*. "If such violation is based on an action taken by an entity in the good faith belief that subsection (h) applies to the debtor, the recovery under paragraph (1) of this subsection against such entity shall be limited to actual damages." *Id*.
[60] *See supra* note 8.
[61] 11 U.S.C. § 362(c).
[62] *Id*. § 362(d).
[63] *Id*. § 362(c)(4)(b).
[64] *Id*. § 362(e)(1) and (2).
[65] *Id*. "Cause" does not have a firm definition in the Bankruptcy Code, but does include "the lack of adequate protection of an interest in property of such party in interest." 11 U.S.C. § 362(d)(1).

protection of an interest in property, or (2) with respect to property securing a lien, (i) the stay will be lifted if the debtor company does not have equity in such property and (ii) such property is not necessary to an effective reorganization. The court may lift the stay for cause early in a case, but it is normally reluctant to do so during the initial stages of the case.[66]

The power of the automatic stay is another significantly debtor-friendly aspect of the U.S. regime. From its immediate implementation, to its scope, and the burden on creditors to remove it on an asset, the automatic stay is beneficial for debtors, rather than creditors. Due to its widely acknowledged and respected importance in the U.S. regime, it is another debtor-friendly aspect.

E. The Chapter 11 Plan for Reorganization

Once the debtor has filed a petition for a Chapter 11 bankruptcy, another one of the most important aspects of the entire process begins, the negotiation and voting upon the plan for reorganization ("the plan"). The Chapter 11 plan is what permits a debtor to reorganize and restructure its financial affairs under the U.S. Bankruptcy Code.[67] In simple terms, a Chapter 11 plan is a contract between the debtor and its creditors that will bind all parties in the future.[68] This contract will determine how the debtor will operate and pay its obligations to creditors moving forward.[69]

Once a Chapter 11 bankruptcy case has been filed, the debtor is given the exclusive opportunity to file a plan for reorganization with the court.[70] This so called "exclusivity period" lasts for 120 days after the initial filing for bankruptcy.[71] The debtor may be able to extend this period, but the court must approve the extension (which often does occur in most cases).[72] An extension may allow the debtor to file exclusively for up to 18 months after the initial filing.[73]

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[66] "There is a general presumption that a debtor should be given a chance to reorganize and prepare a plan." *Comparison of Chapter 11 of the United States Bankruptcy Code with: The System of Administration in the United Kingdom, The Rescue Procedure in France, Insolvency Proceedings in Germany, and The Extraordinary Administration for Large Insolvent Companies in Italy*, JONES DAY, https://www.jonesday.com/files/Publication/1ec093d4-66fb-42a6-8115-be0694c59443/Presentation/PublicationAttachment/e5b46572-7aeb-4c34-ab2e-bee2f8f3d3c2/Comparison%20of%20Chapter%2011%20(A4).pdf (last visited Dec. 31, 2019).
[67] *See supra* note 46.
[68] *Id.*
[69] *Id.*
[70] *See* 11 U.S.C. § 1121(b). The contents of the plan are plentiful. The plan must include a designation of the classes of claims, treatment of the classes, provide for same treatment of claims in a class, provide for adequate means of implementation of the plan, etc. 11 U.S.C. §1123(a)(1)-(8).
[71] 11 U.S.C. § 1121(b).
[72] Upon a showing of good cause, the court can extend the debtor's "exclusivity period" to file a Chapter 11 plan to up 18 months after the petition date. The court also can shorten the exclusivity period depending on the circumstances.
[73] *See supra* note 46.

Yet, this time period could also be shortened by the court if appropriate circumstances are present.[74]

Other parties such as creditors, the trustee, the creditor's committee, equity security holders, or any indenture trustee may file a plan in some instances.[75] But, this right is limited to situations where: (1) a trustee has been appointed under this chapter; (2) the debtor has not filed a plan before 120 days after the date of the order for relief; or (3) the debtor has not filed a plan that has been accepted, before 180 days after the date of the order for relief, by each class of claims or interests that is impaired under the plan.[76] Thus, once the "exclusivity period" expires, the creditors' committee or other parties can propose competing reorganization plans. Competing plans are relatively rare in Chapter 11 cases.[77] This gives the debtor must more power in the process to be the only one offering a plan to be voted upon.

The exclusivity period and the limited ability for creditors, or other parties, to file competing plans adds to the U.S. regime's debtor-friendliness. Giving debtors the exclusive ability to file the plan for conformation shifts power to the debtor. For every day that the plan is not confirmed, creditors miss out on obtaining payments from the debtor for pre-bankruptcy debts. Thus, creditors have an incentive to work with the debtor during the exclusivity period and agree upon a plan for confirmation. Thus, it is a debtor-friendly aspect of the U.S. regime.

F. Appointment of a Trustee in a Chapter 11 Bankruptcy

In most chapters of the U.S. Bankruptcy Code, a trustee is appointed to administer the estate of the debtor.[78] This is a third party who manages the property of the estate. However, usually in Chapter 11 cases, no trustee is appointed.[79] Instead, under this rather unique chapter, the debtor continues to operate the business, but only in the ordinary course, as the "debtor in possession"[80] (also known as the "DIP").[81] This is an extraordinary power that is afforded under the U.S. regime because the debtor's managers can maintain control.

[74] *Id.*
[75] 11 U.S.C. § 1121(c).
[76] *Id.* § 1121(c)(1)-(3).
[77] Creditors or other parties dissatisfied with the debtor's progress are more likely to move to dismiss or convert the case to Chapter 7. A case can be dismissed for numerous reasons. While a conversion may not occur in every scenario, it is a possibility that must be mentioned and realized by the debtor. A Chapter 11 or even a Chapter 13 case can be converted upon a motion by a creditor or sua sponte by the court in some circumstances.
[78] In a Chapter 7 case, a trustee is appointed to manage the estate of the debtor. In a Chapter 13 case, a standing trustee will also manage the debtor's estate.
[79] *See* 11 U.S.C. § 1101(1).
[80] *Id.*
[81] *See supra* note 46.

Still, the bankruptcy court can appoint a trustee to take over operations and management of the estate from the debtor, but only if it finds sufficient "cause."[82] Cause for appointing a trustee, according to the statute, includes fraud, dishonesty, incompetence, and gross mismanagement of the debtor's affairs.[83] The appointment of a trustee also may be for the interests of creditors, equity security holders, and other interests of the estate.[84]

Given that a trustee is not automatically appointed for the debtor, and the debtor's management maintains control, the U.S. regime is debtor-friendly. This is because the debtor can control the reorganization process during the bankruptcy in accordance with the Code. Again, the DIP or a trustee would be the party who manages control of the estate during bankruptcy. This will be discussed further in the next section.

G. Control of the Debtor's Estate in Chapter 11

It was previously mentioned that the DIP usually maintains operations in the ordinary course. This includes day to day operations, but the court, rather than the DIP, maintains control over major and extraordinary decisions made by the business during the bankruptcy.[85] However, the debtor loses control over decisions that are outside of the ordinary course of business to the bankruptcy court.[86] For example, the court must approve:

> (1) any sale of assets, such as property or real property (except for items such as inventory sold by a retail debtor in the ordinary course of business), (2) entering into or breaking a lease of real or personal property, (3) mortgage or other secured financing arrangements that allow the debtor to borrow money after the case is filed, (4) shutting down or expanding business operations, (5) entering into or modifying union, vendor, licensing, and other contracts and agreements, and (6) the retention of, and payment of fees and expenses to, attorneys and other professionals.[87]

This is consisted to be one of the most debtor-friendly and unique aspects of U.S. bankruptcy law. In conjunction with the DIP over a trustee, leaving possession and control of day to day operations with the debtor is one of the most unique aspects of bankruptcy law developed in the U.S. This allows the debtor to determine the best course of action and to utilize

[82] 11 U.S.C. § 1104(a)(1). A trustee may be appointed upon a motion by a creditor or party of interest, and upon a proper showing of cause. However, the court can also take it upon its own initiative to appoint a trustee if causes exists. It must be noted that in accordance with due process, a trustee can only be appointed in any case if proper notice and a hearing occurs.
[83] *Id.*
[84] *Id.* § 1104(a)(2).
[85] *See supra* note 46.
[86] *Id.*
[87] *Id.*

its business judgement, rather than have a third-party decide for it. This eliminates the risk that a third-party trustee, who may not understand the business as well as the debtor, makes poor decisions for the restructuring business. This may lead to a higher success of restructuring because of the debtor's managers' industry specific knowledge.[88] Thus, this is another, and significantly, debtor-friendly aspect.

H. Chapter 11 Creditor's Rights and Committees

Another noteworthy aspect of the Chapter 11 process is the appointment of a "creditors committee."[89] Creditors play an important role in the Chapter 11 process. Unsecured creditors usually participate in the Chapter 11 case through a committee that is appointed to represent the creditors' interests. Creditors, shareholders, and other parties in interest may support or oppose actions in the case and aspects that may require bankruptcy court approval.[90] The bankruptcy court is entitled to consider the input from the creditors' committee and other parties of interest when deciding how to proceed in the bankruptcy case.[91] Formal votes by creditors and equity holders, however, are taken only in connection with proposed Chapter 11 plans.[92]

The creditors' committee can employ others to help them in the process. They can retain attorneys and other professionals to assist it at the debtor's expense.[93] In some cases, equity security (otherwise known as the shareholders) and other committees may even take a vigorous role too.[94]

The creditors committee is often faced with the challenge of voting for an acceptable plan.[95] What causes problems for the creditors, but is beneficial for the debtor, is that the debtor can impair claims in the plan.[96]

> The debtor can impair claims that (1) leave unaltered the legal, equitable, and contractual rights to which such claim or interest entitles the holder of such claim or interest; or (2) cures any such default that occurred before or after the commencement of the case, reinstates the maturity of such claim or interest as such maturity existed before such default, compensates the

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[88] Matej Marinc and Razvan Vlahu, *The Economics of Bank Bankruptcy Law*, Springer 16 (2011).
[89] *See generally* 11 U.S.C. § 1102.
[90] *See supra* note 46.
[91] Chapter 11 Bankruptcy, An Overview, Nolo, https://www.nolo.com/legal-encyclopedia/chapter-11-bankruptcy-overview.html (last visited Dec. 30, 2019).
[92] Chapter 11 – Bankruptcy Basics, United States Courts, https://www.uscourts.gov/services-forms/bankruptcy/bankruptcy-basics/chapter-11-bankruptcy-basics (last visited Dec. 30, 2019) (citing 11 U.S.C. § 363(c)).
[93] *See supra* note 46.
[94] *Id.*
[95] *Id.*
[96] *Id.*

> holder of such claim or interest for any damages incurred as a result of any reasonable reliance by such holder on such contractual provision or such applicable law, if such claim or such interest arises from any failure to perform a nonmonetary obligation, and does not otherwise alter the legal, equitable, or contractual rights to which such claim or interest entitles the holder of such claim or interest.[97]

Usually, the plans voted upon will treat similar creditors equally, but not all creditors. It is highly unlikely that a Chapter 11 plan will provide for full and or immediate payment of all creditors.[98] It is even unlikely that some creditors will be paid half of what they are owed. Because the debtor has the exclusive right to file the plan for a significant amount of time, the creditors' committee often must vote on the debtor's plan which is likely to pay many creditors that it represents less than 100% than what is owed.[99] The bright side for creditors is that at least one class of "impaired" claims must vote in favor of a Chapter plan for it to be approved by the bankruptcy court.[100]

Thus, creditors still have rights under the U.S. regime. These rights give power back to creditors. However, the debtor still can influence the decisions of creditors. Given the fact that the plan treats creditors of the same class equally, the debtor can usually structure the plan to the likes of many creditors, impair others, and still have the plan confirmed, these are more reasons why the U.S. regime is debtor-friendly.

I. Confirmation of the Chapter 11 Plan

The final important procedural step in the U.S. regime that I will discuss is confirmation of the Chapter 11 Plan. Approval of a proposed plan by the court is a term of art in bankruptcy referred to as "confirmation."[101] To confirm a Chapter 11 plan, the bankruptcy court must find that it meets numerous requirements, including: (1) feasibility, (2) good faith, (3) best interests of creditors, and (4) fair and equitable treatment.[102] Some confirmation requirements (including the "fair and equitable treatment test") apply only if the affected creditors vote against the proposed plan.[103]

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[97] 11 U.S.C. § 1124(1) and (2).
[98] *See supra* note 46.
[99] *Id.*
[100] *Id.*
[101] *Id.*
[102] *See* 11 U.S.C. § 1128.
[103] *See supra* note 46.

With respect to feasibility, the bankruptcy court must find that the proposed plan is feasible.[104] Thus, the plan must be likely to succeed. The burden of proof is on the debtor to prove to the bankruptcy court that it will be able to raise sufficient revenues over the duration of the plan to cover its expenses, including payments to creditors.[105]

Next, the debtor must file the plan in good faith.[106] The court must find that the plan has been proposed in good faith, not in bad faith, and not by means forbidden under applicable law.[107] For example, the debtor must be attempting to reorganize due to financial problems rather than to avoid paying creditors without a good and legally acceptable reason.

Next, the court must find that debtor must act in the best interests of its creditors.[108] In Chapter 11, the "best interests" test is misleading. It only requires that creditors receive at least as much under a proposed plan as they would if the debtor's case were converted to a Chapter 7 liquidation (this is usually a not a tough standard to achieve).[109] However, in some cases, the "best interests" test requires the debtor to pay all of its creditors in full.[110] Most Chapter 11 debtors are financially underwater and can meet the "best interests" test by paying creditors only a small fraction of what they owe.[111]

Finally, the plan must be fair and equitable. Under the "fair and equitable" test: (1) secured creditors must be paid, over time, at least the value of their collateral; and (2) the debtor's owners may not retain anything on account of their equity interests unless all obligations are paid in full, either immediately upon plan confirmation or over time (and with interest).[112]

This final aspect is one of the most creditor-friendly aspects so far discussed, because the debtor, in most cases as the plan proponent, must prove that the plan is (1) feasible, (2) made in good faith, (3) provides for the best interests of creditors, and (4) and provides for fair and equitable treatment. However, because the debtor has so much control during the process before confirmation, the U.S. regimes overall is highly debtor-friendly overall.

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[104] *Id.*
[105] *Id.*
[106] *Id.*
[107] *Id.*
[108] *Id.*
[109] *Id.*
[110] *Id.*
[111] *Id.*
[112] 11 U.S.C. § 1128. The bankruptcy court can allow equity holders to retain ownership interests in the debtor in exchange for "new money" contributed to pay reorganization expenses. Otherwise, however, equity holders lose all ownership rights upon plan confirmation.

III. The Basics of the Germany Bankruptcy Code

German insolvency law is governed by the comprehensive Insolvency Code ("Insolvenzordnung").[113] This code came into force on January 1, 1999 and it has been amended often, with the last major reform of the Insolvency Code being the Act for the Further Facilitation of the Restructuring of Companies ("ESUG") which was enacted on March 1, 2012 with further modifications on 1 July 2014 and April 5, 2017.[114]

The Insolvenzordnung replaced the three separate legislative regimes previously in force: (1) the Bankruptcy Act ("Konkursordnung"), (2) the Composition Act ("Vergleichsordnung") for debtors situated in former West Germany, and (3) the Joint Execution Act ("Gesamtvollstreckungsordnung") for debtors located in former East Germany.[115] Because of the recent history of Germany, including the reunification of East Germany with the rest of the country, a lot of developments in the Insolvenzordnung occurred relatively quickly and in a short amount of time in the past.

The insolvency proceedings ("Insolvenzverfahren") that arise under the German Insolvency Code are the only judicial proceedings available in Germany for bankrupt companies.[116] Plus, German insolvency cases are heard by a bankruptcy court.[117] This is like the U.S. regime.

Insolvency proceedings are terminated by the insolvency court once the insolvency administrator has realized the assets of the insolvent estate and a final distribution of the proceeds to the creditors has been made, unless a plan of restructuring has been proposed.[118] The insolvency court stops the insolvency proceedings once the plan has been confirmed, similarly to the U.S. regime's Chapter 11.

Under the plan, different groups of creditors will be paid. Unlike the U.S. regime, insolvency proceedings "usually last between two to three years."[119] While there is no fixed

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[113] Insolvenzordnung [Insolvency Act] from October 5, 1994 (BGBl. I 2866). The Insolvenzordnung, made effective January 1, 1999, has been amended numerous times since its passage in 1994. The best place to find an up-to-date version of the law is online. For an English translation, the Ministry of Justice's has a version http://www.bmj.bund.de/images/11317.pdf (last visited Dec. 19, 2019). For the German version, http://www.insorechtspfleger.de/inhalt/04_materialien/inso_text/indexa.html (last visited Dec. 19, 2019).
[114] *See supra* note 8.
[115] *Id.*
[116] *Id.*
[117] *See* Richard F. Broude et al., *The Judge's Role in Insolvency Proceedings: Views from the Bench: Views from the Bar*, 10 Amer.Bankr. Inst. L. Rev. 511, 518-19 (2002)
[118] *See supra* note 8.
[119] *Id.*

time frame, proceedings may take longer or in case of a pre-packaged plan of restructuring, may complete in a shorter time.[120]

The regime has been labeled relatively creditor-friendly by commentators for numerous reasons, especially compared to the U.S. Bankruptcy Code.[121] It has both debtor-friendly and creditor-friendly aspects. But what makes the German Insolvency Code more creditor friendly than the U.S. regime?

A. The Main Goals of the German Insolvency Code

As it will be noted below, there are specific similarities, and numerous nuanced differences between the U.S. Bankruptcy Code and the German Insolvency Code. The first are the goals each of the regimes. Importantly, the main aim of insolvency proceedings under the German Code is not to protect the corporate debtor from its creditors. The aim of the regime in fact it is to maximize the insolvency dividend payable to the creditors.[122] In order to achieve this aim, insolvency proceedings may result in either liquidation of the business or a reorganization of the business via restructuring plan ("Insolvenzplan"). The former is similar to the U.S.'s Chapter 7, and the latter option is similar to the U.S.'s Chapter 11 plan for reorganization.

Thus, the German code is much less debtor-friendly but rather creditor-friendly.[123] Because the goal of an entire regime is to maximize the amount paid to creditors, the laws will be less focused on allowing the debtor to reorganize, but rather it will attempt to siphon as much money from the debtor's estate to pay off creditors to the greatest extent as quickly as possible.

B. Who Can Utilize the German Insolvency Code

Another major difference between the German Insolvency Code and the U.S. Bankruptcy Code is that there is only one primary uniform insolvency procedure, rather than the numerous options in the U.S.[124] Thus, this procedure applies to both individuals and companies alike.

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[120] *Id.*
[121] *See supra* note 29.
[122] *See supra* note 8.
[123] The German Code contains less debtor-friendly, but more creditor friendly tools.
[124] *See supra* note 8.

Furthermore, only those who have ceased making payments or are over-indebted can file for insolvency.[125] This is very different than the U.S. where there is no "objective test" and even a solvent debtor can file for bankruptcy protection.[126] In addition, the debtor must have some chance of success at reorganizing.[127]

The German Code is creditor-friendly because of the limits it places on how, who, and when debtors can file for insolvency. First, having only one procedure for insolvency lacks the dedicated tailoring that the U.S. Code has for different types of debtors (such as Chapter 7, 11, and 13). Second, it is also creditor-friendly in that only debtors who have ceased making payments or are over-indebted can file. This limits the debtor's ability to prospectively limit financial trouble but reorganizing before the landslide of debt overwhelms the debtor. The longer the debtor has to wait to reorganize, more issues are likely to occur with creditors and the debtor will have less of an ability to pay back the money owed. The debtor will usually have a better chance of successfully organizing before the debtor reaches the point where it stops making payments or is over-indebted.

C. Beginning the Insolvency Process

Insolvency proceedings may be started by an application[128] by the insolvent company (or business) or a creditor to the insolvency court ("Insolvenzgericht"). This is similar to the U.S.'s voluntary and involuntary proceedings. However, any insolvency proceeding may only be commenced if one of the following three grounds ("Eröffnungsgrund") has occurred on part of the debtor: (1) the insolvent company is unable to meet its payment obligations that have become due and payable[129] ("illiquidity" or "Zahlungsunfähigkeit"), … (2) the insolvent company will be unable to meet existing payment obligations as and when they fall due ("imminent illiquidity" or "drohende Zahlungsunfähigkeit"), [or] . . . (3) insolvency proceedings can be commenced with respect to companies (including partnerships) if they are "overindebted".[130]

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[125] *See supra* note 29.
[126] *Id.*
[127] *See supra* note 34.
[128] Only the company's management itself has a right (not an obligation) to file an application based on imminent illiquidity.
[129] This is usually the case. Often times, the insolvent or overindebted company is responsible for at least one or possibly even more suspended payments on more than a temporary basis. The company may have let itself get to the point where the amount of money owed is more is more than the amount that it can pay. Thus, it is considered to be insolvent.
[130] The insolvent company is overindebted if its liabilities exceed the value of its assets. This is often referred to as the balance sheet test. As it will actually look at the blanace sheet of the company, specifically comparing the assets and the liabilities sections. If the liabilities outweight the assets, usually on a short-term basis, the

In addition, unlike the U.S. laws, there are stringent time limits related to applying for insolvency. First, if the company is illiquid or overindebted, the company's mangers must file an insolvency application within a maximum period of only three weeks.[131] Second, in case of an looming illiquidity issue, only the company's management and officers/directors, not a creditor, may file for the opening of proceedings.[132] This may force the debtor to start the insolvency procedure quickly to increase the chances of the business's successful reorganization, but still only after being demmed insolvent.

Plus, for the period of time between the filing of the insolvency application to the court's opening decision (which are called opening proceedings / "Eröffnungsverfahren"), the insolvency court may enact any measures necessary to secure the insolvent company's estate.[133] This gives power to the court to act on behalf of the debtor's estate. This usually includes the appointment of an "interim insolvency administrator" ("vorläufiger Insolvenzverwalter").[134] This interim insolvency administrator will be tasked with helping the insolvency court in deciding whether the proceedings may be opened or not.[135] Furthermore, the insolvency court may allow or impose limits on the managers, directors, and officers of the insolvent company when it comes to whether it may or may not, or may only with the consent of the interim administrator, dispose of any assets.[136] Again, this gives power to the insolvency court to act on behalf of the debtor's estate.

Finally, even if one of the above grounds for the opening of proceedings is established, the insolvency court may be required to reject the insolvency application, but only if the value of the debtor's assets is not sufficient to cover the expected costs of the proceedings.[137] It will not reject the application if a creditor provides sufficient funds to cover the costs.[138] This is another limitation in the German regime to the debtor when filing for insolvency.

These aspects of the German Code are creditor-friendly as well. Again, limiting the debtor to when it can apply for protection is creditor-friendly, and so are placing time limits on the debtor. While this can be seen as debtor-friendly because it forces the debtor to see

company is insolvent. This is not a ground for opening insolvency proceedings with respect to certain partnerships.

[131] *See supra* note 8.
[132] *Id.*
[133] *Id.*
[134] *Id.*
[135] *Id.*
[136] *Id.*
[137] *Id.*
[138] *Id.*

protection, this only occurs after it has become overindebted in most cases, not beforehand when the debtor can better and more easily reorganize.

What is very creditor-friendly about initiating the processes in the German regime is the high likelihood that the court will appoint an administrator, similar to a trustee in the U.S., to manage the debtor's estate. Taking the power away from the debtor to manage itself, and taking the power away to dispose of any assets, leads to a creditor-friendly regime. THe debtor is more likely to understand how to effectively and profitably run its business in its specific industry over a third party trustee who probably does not have such expertise in the field. A more knowledgeable person or management in control would lead to a better chance of a successful reorganization, even during an interim period.

D. The Stay of Debt Enforcement

To secure the insolvent company's assets, the insolvency court usually implements a "temporary stay of debt enforcement" with respect to the debtor's assets.[139] This "temporary stay" also covers the enforcement of security interests.[140] The temporary stay is similar to the U.S. code's automatic stay, but there are differences such as the temporary stay may not be ordered by the insolvency court, but only by the court in charge of the enforcement proceedings ("Vollstreckungsgericht") which requires an application of the interim insolvency administrator.[141] Thus, this is limiting the power of the debtor.

Upon the opening of insolvency proceedings, the is a stay of debt enforcement against creditors ("Insolvenzgläubiger").[142] Like in the U.S., legal actions will be suspended under the stay. However, "with respect to security interests over movables, the right to realization usually rests with the insolvency administrator."[143] The administrator "will pay out the realization proceeds to the secured creditors ("absonderungsberechtigte Gläubiger") after deduction of costs and a contribution to the estate."[144] With respect to security interests on the insolvent company's immovable assets, "the insolvency administrator may again apply for a temporary stay at the court in charge of the enforcement proceedings."[145] Thus, the stay in the German regime is also powerful for debtors and can cause problems for creditors.

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[139] *Id.*
[140] *Id.*
[141] *Id.*
[142] *Id.*
[143] *Id.*
[144] *Id.*
[145] *Id.*

Under the German regime, the debtor's creditors may not have the general stay of debt enforcement lifted, "except for a temporary stay with regard to the insolvent company's immovable assets."[146] The only time that a creditor may actually lift and remove the stay is if it is no longer necessary to have the stay in place.[147] Secured creditors have the ability to demand payment of interest during the stay if the realization of their security interests is delayed under the stay.[148] Furthermore, if the assets are used by the insolvency estate, "the insolvency administrator also has to compensate the secured creditors for a loss in value."[149] There are also equivocal rights that exist with respect to immovable property too in the German Code.[150]

The stay of enforcement in Germany is relatively more creditor-friendly than the U.S.'s automatic stay, like the other provisions so far covered. Comparatively, the stay is smaller in scope, thus it can afford less protection to the debtor than would a DIP receive in the U.S. However, lifting the stay is also relatively difficult for creditors. In the Insolvency Code, there is only one possible reason to lift the stay. This may be a more debtor-friendly aspect of the German regime. But still, the stay "does not aim at giving the insolvent company 'breathing space'," but rather is merely ensures that the distribution of the debtor's assets is justified. It also avoids the untimely sale of assets that are necessary and essential for the continuation of the debtor's business. Therefore, the stay in Germany is not intended to protect the debtor in the same broad scope as in the U.S. that allows U.S. corporations to reorganize effectively and it can be seen as creditor-friendly.

E. The Plan for Reorganization

A plan for the prospective reorganization, a contract between the debtor and creditors, must be created like in the U.S. regime. Unlike the U.S. regime, the creditors determine at the information hearing ("Berichtstermin") the course that insolvency proceedings should take in Germany.[151] The hearing is often held by the court between six weeks and three months of the

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[146] *Id.*
[147] "For example, if the stay is no longer required to allow the insolvent company's assets to be utilized in the best possible manner." *Comparison of Chapter 11 of the United States Bankruptcy Code with: The System of Administration in the United Kingdom, The Rescue Procedure in France, Insolvency Proceedings in Germany, and The Extraordinary Administration for Large Insolvent Companies in Italy*, JONES DAY, https://www.jonesday.com/files/Publication/1ec093d4-66fb-42a6-8115-be0694c59443/Presentation/PublicationAttachment/e5b46572-7aeb-4c34-ab2e-bee2f8f3d3c2/Comparison%20of%20Chapter%2011%20(A4).pdf (last visited Dec. 31, 2019).
[148] *Id.*
[149] *Id.*
[150] *Id.*
[151] *Id.*

opening of insolvency proceedings.[152] As mentioned above, it is the creditors who decide between a sale of the insolvent company's business as a going concern or a winding-up, unless a plan of restructuring is proposed.[153] It is not the debtor or DIP. Creditors will often and frequently follow the administrator's recommendations. Unfortunately, the debtor does not have a say in the process. In order for the creditors to make a decision, "a majority (calculated on the basis of sums of claims) of the creditors voting at the hearing must be passed."[154] This helps the creditors find an acceptable decision between them, but not with the debtor's input or voice being heard.

Unlike the U.S. regime, both the insolvency administrator or the company's management may propose a plan of restructuring; however, the creditors may instruct the insolvency administrator to draft a plan of restructuring to their liking.[155] The debtor's management can and often will submit a pre-packaged plan upon filing for insolvency, which (as previously mentioned) can also occur in the U.S. There are rules about the contents of a plan of restructuring too. The plan can be freely arranged and include all provisions that could be made in an individual contract; these can include waivers and deferrals of claims as well as limitations of security rights.[156]

Also, similar to the U.S.'s restructuring plans, a plan of restructuring in Germany provides for a reorganization of the debtor. The plan will list the creditors of the debtor and will divide them into groups based on their similarities. The Insolvency Code requires that the following groups be included in the plan: (a) secured creditors; (b) unsecured creditors; and (c) subordinated creditors ("nachrangige Insolvenzgläubiger") at a minimum.[157] The plan of restructuring can also include a further division of these groups of creditors who are in the same legal position with regard to the debts owed to them.[158] Since voting on the plan restructuring will be done within these groups of creditors, the creditors' groups influence whether the plan of restructuring is adopted, just like in the U.S.'s debtor-friendly bankruptcy regime.[159]

If a plan of restructuring is proposed, the insolvency court will call for a "creditors' assembly" and instruct them to attend a formal hearing.[160] The voting on the plan of restructuring will follow the court's instruction (either in the same hearing or a separate later

[152] *Id.*
[153] *Id.*
[154] *Id.*
[155] *Id.*
[156] *Id.*
[157] *Id.*
[158] *Id.*
[159] *Id.*
[160] *Id.*

hearing).[161] The creditors will then vote in their respective groups on the plan that they find to be the best, and the plan will only be accepted if *all* groups agree based on a majority in each group.[162] This is similar to the U.S. voting requirements. In addition, the sum of their claims must constitute more than half of the sum of the claims of creditors voting in the group.[163] Again, this aspect is also similar to the U.S.'s requirements. The plan can be adopted without the majority vote of a group if the majority of groups under the plan agree and it is established that the creditors of the nonconsenting group are not disadvantaged by the plan.[164]

If the creditors consent to the plan in the manner described above, it will be "confirmed" by the insolvency court. The plan will then become effective in a manner similar to a confirmation hearing in the U.S. The insolvency court will terminate insolvency proceedings and the different groups of creditors will be paid over time as provided for in the plan, as if it were a contract between the creditors and the debtor. The contract will be what binds the parties moving forward. The debtor will be required to pay the amount listed in the plan and at the time intervals specified until all payments are made. Only then, once all payments are completed, will the entire process be complete.

The most creditor-friendly aspect here is that the debtor does not have the exclusive ability to propose a plan, like in the U.S. Not allowing the debtor to have an exclusive period puts pressure on the debtor. The debtor cannot negotiate with creditors quickly, as it may need to compete with the administrator (and thus creditors) to have a plan proposed and accepted quickly. The debtor thus cannot move on to post-bankruptcy repayments as rapidly as it could in the U.S. While the voting requirements to adopt and confirm a plan are similar to the U.S., the lack of an exclusivity period is what makes the German code's insolvency plan more creditor-friendly.

F. Appointment of an Administrator

This next section highlights one of the most devastating for the debtor and creditor-friendly aspects of the Germany Insolvency Code. In its opening decision, an insolvency administrator ("Insolvenzverwalter") is appointed to control of the debtor's estate by the insolvency court rather than the debtor.[165] The administrator is in charge of the business and responsible for its management going forward, but this control clearly removes power from the

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[161] *Id.*
[162] *Id.*
[163] *Id.*
[164] *Id.*
[165] *Id.*

debtor to run the business as it normally would.[166] As previously mentioned, the administrator may lack the specific business know-how to effectively restructure the business. The insolvency administrator must be an individual, a natural person, who is also qualified and independent of the debtor's creditors and the debtor itself.[167] Thus, it cannot be a company or legal entity associated with any party.

While an administrator is appointed in the vast majority of cases, the Insolvency Code allows for the company's management to apply for self-administration ("Eigenverwaltung"). This U.S. based and developed idea rarely occurs in Germany when compared to its U.S. counterpart. This is the German version of a DIP. Self-administration only occurs if the court is convinced leaving the debtor in control will not harm the creditors. In practice, judges in Germany have been traditionally reluctant to allow for self-administration.[168] Many courts in Germany still believe that the debtor's management, who were the people responsible for leading the debtor into insolvency in the first place, cannot be capable of and should not be allowed to have the responsibility of coping with insolvency.[169] But in the few and far between cases, there has been self-administration in some recent insolvencies.[170] While this trend may grow overtime, for now, it should not be expected that a debtor will be able to have the opportunity to self-administer during insolvency in the same numbers as U.S. companies would.

Again, the appointment of an administrator, who serves nearly the same purpose as a trustee in the U.S. regime, is a creditor-friendly aspect of German insolvency law. While in some cases, it is necessary to appoint an administrator due to lack of competence by the debtor, bad faith by the debtor or its management, or other bad acts, the debtor should be given the chance to control itself once in insolvency. The debtor presumably knows itself and its business more than person could in a short period of time. Plus, a short period of time is all that an administrator would have to turn around an insolvent and struggling business. An administrator is less likely to act in the best interest of the company that wishes to restructure too. It is more likely to act in the best interests of creditors than the debtor. With the automatic appointment and minimal chances to have a self-administered case, the German regime is creditor-friendly in this respect.

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166 *Id.*
167 *Id.*
168 *Id.*
169 *Id.*
170 *See supra* note 147. The most prominent example is the Kirch Media case. *Id.*

G. Control of the Debtor's Estate

Unlike in the U.S. regime, it is clear now that while an administrator is appointed in the vast majority of cases, the Insolvency Code allows for the company's management to apply for self-administration ("Eigenverwaltung") in only some cases.[171] This means that the debtor is left in possession (like the DIP) but it is supervised by a trustee ("Sachwalter").[172] This trustee has power to manage and control the estate of the debtor. A debtor-friendly regime would leave this vast power with the DIP. The question must be asked as to why does the German regime not allow for many self-administrations? Well, "[t]he concept of a debtor-in-possession has been criticized and mistrusted by most of German society for such a long time that it may never be unearthed regardless of what the law says."[173] Thus, it is a historical and cultural reason that has set the minds of many in the German legal community.

However, there has been self-administration in some of the "spectacular insolvency cases of the recent past" involving many large groups of businesses and corporations with huge international activities.[174] Thus, some in Germany do see the benefits of a DIP-like-insolvency-controlled process. But even still, this left self-administration power to exceptional circumstances and a court's discretion and it should not be relied upon by other "normal" businesses.

Clearly, tradition and history play a role in the laws of all countries, even when determining why the law puts control of the estate with someone other than the debtor. This is no different in German insolvency proceedings. While it has been demonstrated in the previous section why the appointment of an administrator is creditor-friendly under the German regime, tradition and history of insolvency in Germany is clearly creditor-friendly too. This can be seen by the ideals of the German people with respect to giving the debtor control during the insolvency process. Until the German legal community changes their feelings towards self-administration, the regime is unlikely to change. Possibly, in the future and after examining the economic success of self-administered insolvencies, the attitudes toward self-administration will become more favorable. Until then, this aspect is more creditor-friendly than debtor-friendly.

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[171] *Id.*
[172] *Id.*
[173] Christoph G. Paulus, *Germany: Lessons to Learn from the Implementation of a New Insolvency Code*, 17 CONN. J. INT'L L. 89, 91 (2001).
[174] *See supra* note 8.

H. Creditor's Rights and Committees and Confirmation of the Plan

Finally, creditors have rights under the Insolvency Code. It is the creditors that determine the course that insolvency should take in the future.[175] It is at this hearing, as mentioned above, that creditors will have to decide between a sale or a winding-up of the debtor's business, unless a plan of restructuring is proposed.[176]

Since the plan usually and most often will provide for a reorganization of the insolvent company, and the creditors are divided into groups according to their legal position within the plan, voting on the adoption of the plan of restructuring is done within these groups of similarly situated creditors.[177] Therefore, the creditors' groups have great power in the process to influence whether the plan of restructuring will be adopted since they can vote on the plan of restructuring themselves.

The creditors at the creditors' assembly hearing will discuss the restructuring and the voting rights of the creditors.[178] The actual voting on the plan of restructuring will follow the discussion. Creditors will vote in their respective groups, like in the U.S., on the plan but it will only be accepted if all groups of creditors agree upon the plan.[179] In each group, the majority of creditors must consent via headcount and the sum of each of their claims must total more than half of the sum of the claims of creditors voting in this group.[180]

> The plan will be adopted without the consent of a group of creditors if the majority of groups have agreed and the insolvency court establishes that the creditors of the nonconsenting group are not disadvantaged by the plan, as compared to their position without the plan, and that they have a reasonable share in the economic outcome of the plan.[181]

If the creditors consent to the plan, it will finally be implemented by the insolvency court and become effective and binding upon the debtor and the creditors.[182] This means that the debtor cannot change the plan and the creditors cannot ask for more than what is listed in the plan. The plan may even provide for "post-approval supervision of the company" by the insolvency administrator if it is deliberately planned that management will not regain total control of its affairs immediately after conformation.[183] This supervision will limit the business post-conformation in its ability to run the business.

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175 *Id.*
176 *Id.*
177 *Id.*
178 *Id.*
179 *Id.*
180 *Id.*
181 *Id.*
182 *Id.*
183 *Id.*

Like in the U.S., this aspect is naturally creditor-friendly, because it gives creditors rights and limits the debtor during the plan confirmation process and even after the plan is confirmed. But, what is more important for the debtor is the amount of rights creditors are given. Like in the U.S., there is a preference that all creditors agree on the proposed plan. But still, there is a possibility for creditors who disagree with the plan, for others to override the minority. Thus, a majority vote can succeed rather and a unanimous vote. The German regimes way of allowing this is relatively similar to the U.S.

However, overall the German regime is a more creditor-friendly code than the U.S. From the stay on debts to the rights of creditors and committees, the German Code has provisions that favor the creditors of the debtor who is in a much more financially weaker position. This leaves the debtor exposed to abuse by creditors in the insolvency process, and does not allow for it to restructure effectively which is one of the main purposes of insolvency proceedings.

Furthermore, this creditor-friendly regime will be less helpful to the German economy overall. In the next section. I will demonstrate the importance of debtor-friendly bankruptcy regimes over creditor-friendly regimes. There are numerous reasons from economic impacts to innovation in the county.

IV. The Importance of a Debtor-Friendly Bankruptcy Regime

Now that the two regimes have been compared, it is important to understand why debtor-friendly or creditor-friendly regimes are implemented. The type of regime will invariably affect the bankruptcy or insolvency process, as seen above. Many bankruptcy regimes can be labeled debtor-friendly or creditor-friendly, but what do these phrases actually mean in practice?

A. The Regime Types

For this paper, a bankruptcy code may be consisted to be more debtor-friendly if the relevant code provides more rights to debtors in bankruptcy than creditors.[184] A more creditor friendly code would exist if the applicable code provides more rights to creditors than the

[184] Viral V. Acharya and Krishnamurthy Subramanian, *Bankruptcy Codes and Innovation*, LONDON BUSINESS SCHOOL, https://conference.nber.org/conferences/2007/si2007/LE/acharya.pdf July 1, 2007 (last visited Jan. 2, 2020).

debtor in bankruptcy. Thus, creditors such as banks or others with security interests or credit and companies without secured interests, may very well lobby politicians for creditor-friendly regimes in the respective legislature. Only creditors may usually have such money and power to influence politicians' decisions. On the other hand, managers, directors, and shareholders may choose a regime that is similar U.S.'s "debtor friendly" system for the reasons listed above. But are there other reasons that politicians and lawmakers should resist the lobbying efforts of creditors and implement a debtor-friendly regime?

The model debtor-friendly regime is the U.S.'s regime. The United States' Bankruptcy Code, based partially on the above information, can be described as a debtor-reorganization-friendly regime for many of the reasons described in this paper.[185] This is in light of the fact that the "Chapter 11 system has become more creditor friendly since the late 1990's."[186] The U.S. earned a reputation of protecting debtors "by allowing its business focused Chapter 11 to be invoked to assist 'reorganization' of business or personal affairs in order to avoid bankruptcy."[187]

In contrast, the German code is a (relatively) less debtor-friendly regime than the U.S., and again is more creditor-friendly, and there are clearly numerous reasons for that. This includes the laws themselves to cultural and ideological traditions of the German people who developed and now enforce the Insolvency Code. But what does this really mean for those debtors and creditors affected by the applicable regime?

B. Benefits of a Debtor-Friendly Regime

There must be benefits to debtor-friendly regimes, or why else would jurisdictions adopt them? To start, a debtor-friendly bankruptcy regime can establish property rights that are "advantageous for the debtor in terms of debt write-off and the possibility for a 'fresh start'."[188] Businesses in jurisdictions that operate with debtor-friendly laws may have "stronger incentives (or weaker disincentives)" to take chances that might lead to success or failure. This would encourage innovation attempts in the economy, or in other words, allow businesses to take risks in order to grow their business. This means that even if a business then does fail, the

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185 *See supra* note 28.
186 Song Ma, Joy Tianjiao Tong, and Wei Wang, *Selling Innovation in Bankruptcy,* TUCK SCHOOL OF BUSINESS, https://www.tuck.dartmouth.edu/uploads/centers/files/Paper_8_Selling_innovation_in_bankruptcy.pdf (last visited Jan. 4, 2020). (citing Viral V. Acharya and Krishnamurthy Subramanian, *Bankruptcy Codes and Innovation*, LONDON BUSINESS SCHOOL, https://conference.nber.org/conferences/2007/si2007/LE/acharya.pdf July 1, 2007 (last visited Jan. 2, 2020)).
187 *See supra* note 28.
188 *See supra* note 29.

failed enterprise "may more often use the existing regulations which are – in a sense – at its disposal."[189] This gives business owners a sense of security that even if the business does not succeed, the legal system that will follow will allow them a fair chance to reorganize and try again.

Without such a security blanket, many business owners would be afraid, or at least disincentivized, to start a business which involves some risk. Without the startup of new businesses, economies could stagnate, people would lose jobs or less people would be employed, and fewer businesses would be able to invest in their business at all. Because business and investments are inherently risky with respect to failure, bankruptcy limits the risk on the business owners and instill some level of confidence in them insolvency will prevent total liquidation.

Insolvency regimes that are debtor friendly also encourage innovation. How would businesses be encouraged to innovate through more debtor-friendly regimes? First, changes in creditor's rights in the law have often times been introduced precisely to promote growth and innovation by legislatures.[190] Second, these changes have often arisen due to lobbying by potential debtors and others with job-saving objectives, exogenous to the issue of promoting innovation.[191] Third, these changes have also often been timed to turn around economies that are in imminent crises or even at the verge of potential growth spurts.[192] But importantly, the changes to the insolvency codes with respect to creditor's right changes have been an important part of the overall stimulus package in these cases.[193]

It is also often the case that countries with a more creditor-friendly bankruptcy code face excessive liquidations.[194] This is true when compared to countries with a debtor-friendly bankruptcy code.[195] There is evidence that when a bankruptcy code is creditor-friendly, excessive liquidations cause leveraged firms to ignore innovation which leads to liquidation in the long run.[196] Thus, a more creditor-friendly regime may result in a lower absolute level of innovation by businesses and relatively lower innovation by other businesses in technologically innovative industries.[197]

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189 *Id.*
190 *See supra* note 184.
191 *Id.*
192 *Id.*
193 *Id.*
194 *Id.*
195 *Id.*
196 *Id.*
197 *Id.*

On the other hand, when a regime includes laws that strengthen creditor rights more than the debtor's, technologically innovative industries have relatively less leverage and grow disproportionately slower than those with debtor-friendly regimes.[198] As Viral V. Acharya and Krishnamurthy Subramanian demonstrated in their paper, data on ex-ante real investments undertaken by firms in response to bankruptcy and insolvency codes can demonstrate this theory.[199] This is opposed to ex-post efficiency when firms are in financial distress.[200]

For example:

> compared to the counties that did not undergo a creditor rights change, the group of countries that underwent a creditor rights decrease generated 10.7% more patents, 15.4% more citations to these patents, and 9.2% more patenting firms. In contrast, the group of countries that underwent a creditor rights increase generated 9.7% less patents, 13.3% less citations to these patents, and 8.4% less patenting firms than those countries that did not experience a creditor rights change.[201]

According to the data, Viral Acharya and Krishnamurthy Subramanian have hypothesized that innovative industries exhibit greater intensity and a greater volume of patent creation, citation, and growth in countries with weaker creditor (more debtor-friendly) rights in bankruptcy.[202] Therefore, the type of bankruptcy regime can significantly impact and play a role in fostering innovation and growth within a jurisdiction.[203] More broadly put, debtor-friendly regimes promote innovation, and thus encourage better business environments for all in the jurisdiction.

Finally, debtors would be less likely to conduct business in a jurisdiction with more creditor-friendly laws. It should not be hard to imagine that many businesses can be very selective with where they choose to start and conduct their business. This may be in order to avoid a certain jurisdiction's laws, to be subject to other governmental regimes, or for other business reasons. It cannot be ignored that while many bankruptcy or insolvency regimes may not be the entire or even a strong majority reason to establish business in a country, it does play at least a small factor.

Many aware and savvy businesspeople and lawyers will develop a plan when starting a business. This may include where the business should be located or incorporated in order to be subject to the most favorable laws in the off chance that insolvency does occur. Naturally,

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198 *Id.*
199 *Id.*
200 *Id.*
201 *Id.*
202 *Id.*
203 *Id.*

the most debtor-friendly jurisdictions would then receive the more aware and savvy businesses. If not enough business are established in creditor-friendly jurisdictions, the economy is likely to suffer accordingly. Thus, the type of bankruptcy regime can impact the amount of businesses that enter a market.

Furthermore, newer businesses which are more likely to fail may avoid entering jurisdictions with creditor-friendly laws over debtor-friendly laws overall. This would play a factor in reducing the economic prosperity in a jurisdiction too. In any way that less businesses decide to conduct operations in a jurisdiction, this will lead to less prosperity in the area. But again, the type of regime is only one small factor amongst many other considerations that businesses must keep in mind when making such decisions. Therefore, there are numerous benefits of debtor-friendly regimes rather than creditor-friendly regimes.

C. Consequences of Debtor-Friendly Regimes

Still, it should be noted that there are going to be consequences of debtor-friendly regimes as well, like any regime. First, the term “bankruptcy” alone “carries with it a considerable stigma of failure”, especially in German society, “and the fear of financial ruin is very common.”[204] The German culture does not and has not historically looked upon insolvency like many American legislators have in the past. The U.S. does not have the same stigma. Thus, a more debtor-friendly regime is merely something that will take time for the German society to overcome and become normalized to as a more progressive and debtor-friendly regime is adopted.

Second, the market may respond with banks and other creditors having a higher charge off rates.[205] Usually, banks and creditors must anticipate the amount of unpaid funds when preparing their accounting books. When more a higher rate of unpaid debts would be expected, they market will react with higher interest rates. Thus, the economy as a whole in a jurisdiction my see slightly higher interest rates across the board in a debtor-friendly regime. However, the higher number of insolvent firms that do not reemerge from insolvency through the code may also increase the interest rate as well. Having businesses succeed after insolvency may bring that rate down though through providing a more stable economy and financial success in a jurisdiction.

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[204] *See* Maria Gerhardt, *Consumer Bankruptcy Regimes and Credit Default in the US and Europe A Comparative Study CEPS Working Document No. 318/July 2009*, http://aei.pitt.edu/11336/1/1887.pdf (last visited Dec. 29, 2019).
[205] *Id.*

Third, debtor-friendly regimes do not solve the underlying problem that businesses will fail and leave debts unpaid to creditors. Business will naturally fail in any capitalistic economy. However, they do create the most favorable long-term results. Many creditor-friendly regimes find the best outcomes for creditors as soon as the debtor files for protection, rather than find the most efficient outcome for all. Usually, this will result in more liquidations rather than reorganizations. However, the goal of bankruptcy and insolvency should not be to merely liquidate all insolvent businesses. As it was noted in Part I, there are two main purposes of bankruptcy and insolvency codes.

The first was to provide an honest but unfortunate debtor a fresh start. A fresh start will not be completed if all businesses are always liquidated by having their assets collected and sold off to afford creditors some amount of money quickly. This may not be the case in every creditor-friendly regime, but it is still a regime further away from promoting a successful reorganization over time than debtor-friendly regimes.

The second purpose is to provide equal treatment for creditors. While this may be the case for either creditor or debtor-friendly regimes, this concept can be taken a step further if a successful reorganization occurs. In many reorganizations under debtor-friendly regimes, creditors can receive longer term and higher amounts of money back from debtors. If not cash, other assets like stock can be given in the newly reorganized business. Plus, if all creditors are treated fairly, each creditor can receive a fair share of this better, reorganized business for a longer period of time rather than a quick sum of cash from the liquidation of a business. Thus, debtor-friendly regimes promote and better serve the two main purposes of bankruptcy laws.

Thus, despite all of these consequences, creditor-friendly regimes do not nor should not be preferred over debtor-friendly regimes. These are reasons that politicians and lawmakers should resist the lobbying efforts of creditors and implement a debtor-friendly regime. The type of regime utilized by a government impacts various aspects of the economy, in addition to debtors and creditors specifically. From growth and innovation, to excessive liquidations, to economic prosperity, debtor-friendly regimes should be preferred over creditor friendly regimes because they provide more benefits than creditor-friendly regimes.

V. Recommendations for the German Code to Become a Debtor Friendly Regime after Examining the U.S. Code and Comparing Both Types of Regimes

Slowly, some countries have started to adopt the U.S. style restructuring system over time. The limited available information and data demonstrates that this has been associated with favorable outcomes. However, a complete blanket adoption of Chapter 11 styled provisions will not necessarily be desirable in all countries, let alone possible. But still, the adoption of more aspects that allow for a more debtor-friendly regime similar to the U.S. should be encouraged. But before I explain my recommended changes to the bankruptcy regime in Germany, there is a question that first must be answered. Is this possible?

Not all countries can implement a debtor-friendly regime. The implementation of a debtor-friendly code "requires judicial expertise."[206] In addition, creditor-friendly regimes may be desirable in countries where enforcement quality and judicial efficiency are low. This would reduce the incentive for individual creditors to "rush to the exit" and collect debt privately. Plus, if a judges′ capacity to preside over bankruptcy case is limited, the bankruptcy judge should focus on ensuring adequate creditor recovery. As judges′ capabilities increase, the efficiency of more debtor-friendly laws does as well.

As the enforcement quality and judicial efficiency increase, the ability for insolvency regimes to become more debtor-friendly increases. For example, following a Chapter 11-style reform to Brazil's insolvency regime in 2005, firms operating in districts with less congested courts experienced higher access to loans and larger increase in investment and productivity than firms operating in districts with more congested courts. This increases the positive economic impact in the county by allowing firms to contribute to the economy, but also puts less of a strain on the judicial system. Evidence suggests that reforms in a number of European countries introducing some of the features conducive to successful restructuring used in the U.S. have resulted in lower incidence of liquidations, shorter insolvency proceedings, and increased restructuring as a share of total insolvency related procedures and higher recovery rates.

As previously stated, Germany has one of the most competent and capable legal systems in the world. The German Insolvency Code is one of the most robust insolvency laws in the world, albeit less debtor friendly, it is still complex. Thus, the judges who apply the law

[206] Kenneth Ayotte and Hayong Yun, *Matching Bankruptcy Laws to Legal Environments*, JLEO (2009).

in Germany are capable of implementing debtor-friendly laws as well. Therefore, this type of regime implementation is not an issue for contemporary German courts, as its courts' enforcement abilities and efficiently are relatively high.

A. Who Can Utilize

Not everyone can file for insolvency protection at any time. In fact, only debtors in limited situations can filed for insolvency. Thus, the first recommendation that I have is that the German Code by modified to allow for corporations to file for insolvency before they have become insolvent in a similar way to the U.S. regime. This would encourage debtors to file for protection early, before debts become unpayable, and the debtor has a chance to successfully reorganize as soon as it realizes a problem financially.

B. Beginning the Process

Next, the time requirements and the interim insolvency administrator need to be eliminated. The time requirements for when a debtor must file for insolvency add to unnecessary limitations on when a debtor can file for protection. Leaving autonomy to the debtor to decide the best time, usually well in advance of insolvency, to file allows the debtor to control its business. As the debtor is most likely the most knowledgeable in the field, it can make a better reasoned decision on when it needs to file for insolvency. A time requirement to file destroys such autonomy.

In addition, the automatic appointment of an insolvency administrator must also be removed for a similar reason. As it will be discussed below, an automatically appointed administrator or trustee will lack the specific and specialized knowledge the debtor has in operating the business. Thus, it is less likely that a trustee will act in the best interests of the organization as an ongoing business, but rather to maintain value for liquidation purposes. Thus, even a temporary administrator would be detrimental to the debtor as well as a permanent one. Both time requirements for beginning the process and an interim administrator should be removed in favor of no time requirement nor an administrator.

C. The Automatic Stay

The German system does not have the same type of broad automatic stay that is used in the U.S. An automatic stay provision that protects the debtor against actions from creditors such as court proceedings, foreclosures on property, creating liens, perfecting liens, or enforcing a lien against a debtor, and even attempting to repossess collateral should be as broad as possible to allow the debtor to first organize its assets in preparation for reorganization.[207] Therefore , it is also required that a debtor be able to may sue a creditor who violates the automatic stay once it is in place. The German regime should be changed to allow for a broad automatic stay that includes nearly all assets of the debtor. This stay may not include protection of assets such as payments owed for taxes, pensions, etc. It should however include a mechanism similar to the U.S.'s § 362(d) that allows for a lift of the stay with respect to an asset if cause exists, or if there is no need for the asset in the insolvency plan.

D. The Plan for Reorganization

Next, the requiring that unanimous vote by all creditors on a restructuring plan can lead to a delay in the proceedings. Thus, allowing the approval of such a plan by only a majority of creditors (also known as a "cram-down") "can strengthen market selection by promoting the timely restructuring of viable firms that encounter temporary financial difficulties, and deliver higher future within-firm productivity gains."[208]

Evidence seems to demonstrate that "allowing a majority decision on plan approval, rather than a unanimous vote, can improve insolvency outcomes in Europe." For example, the Spanish insolvency system did not have the possibility of a "cramdown" until 2014. The previous system increased the cost and time of insolvency proceedings. Along with other reforms (e.g. the introduction of out-of-court settlements for SMEs and consumers and the introduction of the possibility of a "fresh start"), the allowance of the "cram-down" of a restructuring plan on dissenting creditors has "shortened the process and lowered the share of firms in liquidation."

As the German regime does allow for a majority vote as well in certain scenarios similarly to the U.S., there does not need to be any recommended changes to the Plan of Reorganization.

E. Appointment of an Administrator or Trustee

As previously stated, the automatic appointment of an administrator or trustee removes control from the debtor in the bankruptcy. Administrator or trustee should be tan extraordinary

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[207] Automatic Stay, Investopedia, https://www.investopedia.com/terms/a/automaticstay.asp (last visited Dec. 31, 2019).

[208] Müge Adalet McGowan and Dan Andrews, *Insolvency Regimes and Productivity Growth: A Framework For Analysis*, ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT, http://www.oecd.org/officialdocuments/publicdisplaydocumentpdf/?cote=ECO/WKP(2016)33&docLanguage=En (last visited Dec. 31, 2019).

matter, not the norm. This is because, first, the administrator will be unfamiliar with the business.[209] Also, it will take time for him or her to understand how to make the business profitable compared to the managers.[210] Many administrators may not have the business capacity or knowledge to run the business. Plus, an administrator will cost the estate money that it would rather use to remedy the insolvency or use it to pay off creditors that it owes money.[211]

The German Code should adopt this albeit uniquely America idea that is against the traditions of the German people. However, the exceptions should be that an administrator should only be appointed if: (1) cause such as includes fraud, dishonesty, incompetence, or gross mismanagement, exists; or (2) if it is in the interests of "creditors, any equity security holders, and other interest of the estate." The debtor should also have notice of the possible appointment and the appointment should only occur after the debtor can be heard on the matter.

F. Control of the Debtor's Estate

As we have noted, countries such as Germany have been "wary of adopting the 'debtor-in-possession' model."[212] Allowing incumbent managers to stay in charge of the day-to-day operations of a firm in distress rather than forcing them out during restructuring proceedings can affect productivity. Insolvency regimes that do not provide sufficient cover for incumbent management increase the private incentives of management to hide the true financial state of the firm and gamble on resurrection. This would likely weaken market selection, and by delaying the process, reduce the chance that restructuring is successful in delivering higher future productivity gains. The retention of incumbent management increases the incentives for management to make firm-specific productivity-enhancing investments in the event that new financing is available.

Germany currently is more likely to remove management from the day-to-day operations of the business and instead replace them with an administrator for the insolvency. Because of this, it would be more efficient to allow the debtor's management to remain in place

[209] *How, Why, and When to See the Appointment of a Chapter 11 Trustee*, BERNSTEIN BURKLEY ATTORNEYS AT LAW, https://bernsteinlaw.com/publications-list/how-why-and-when-to-seek-the-appointment-of-a-chapter-11-trustee/ (last visited Dec. 30, 2019). Bernstein Burkley is a well known and respected bankruptcy firm in the U.S. that has expertise in handling Chapter 11 cases.
[210] *Id.*
[211] *Id.*
[212] Alyssa S. Nishimoto, *Shifting Paradigms Within Corporate Bankruptcy Law: The History and Future of Chapter 11 and Its Global Effects on Business Restructurings*, 5 CREIGHTON INT'L & COMP. L.J. 102, 102 (2013).

unless "cause" to remove them arises, similar to the U.S. system. Thus, control should remain with the debtor, rather than an unnecessary administrator.

G. Creditor's Rights and Committees

With respect to creditor's rights and committees, a balance must be struck between the power of the debtor and creditors. Of course, the debtor cannot be given unlimited power in the bankruptcy process. However, the creditors should not be able to control all aspects of the process either.

Currently in both systems, there seems to be an appropriate balance of power with respect to both debtors' and creditors' rights. Creditor's committees also have a fair and equitable amount of power under each code. While this may be the most creditor-friendly aspect shared by both jurisdictions, it is a necessity for the fairness of the entire process. Therefore, I would not recommend any changes to the rights of creditors and committees in either the U.S. or Germany.

H. Recap of Recommendations

The goal is to create a more-debtor-friendly regime through these changes. It should not be expected to occur soon, or even all at once. German lawmakers will need to examine each of these areas: (A) who can utilize, (B) beginning the process, (C) the automatic stay, (D) the plan for reorganization, (E) appointment of an administrator or trustee, (F) control of the debtor's estate, and (G) creditor's rights and committees very carefully to determine what areas can be changed gradually over time.

In the end, the U.S. regime is not perfect, but it demonstrates the current most debtor-friendly bankruptcy regime that has proven success on a large scale. Thus, it should be the model for future changes to the German code, as well as any other jurisdiction that should modify its bankruptcy or insolvency laws, for a more debtor-friendly regime. If possible, other modifications could be made to make the code even more debtor-friendly than the U.S. Bankruptcy Code. However, it remains to be seen how such laws would affect a jurisdiction.

Conclusion

In this thesis, I have demonstrated why bankruptcy and insolvency laws are of vital importance in today's global and trans-national business focused economy, especially in the U.S. and Germany. Not only are Bankruptcy regimes necessary, but they should be debtor-friendly focused like the U.S.'s Bankruptcy Code, but not creditor-friendly like the current German Insolvency Code.

In both countries' bankruptcy and insolvency regimes, there are striking similarities. There are even similar social and economic conditions.[213] However, there are also differences. The current U.S. consumer and corporate bankruptcy laws preserve reorganization or going concern value over the corporation's liquidation value. In the U.S. debtors have the opportunity to choose between Chapter 7 liquidation or Chapter 11 restructuring. Both options are debtor-friendly based on the situation of the debtor. Furthermore, "insolvency regulations [in the U.S.] tend to give priority to creditors' rights, allowing for the recuperation of a greater share of claims, often through stricter rules and longer periods of good conduct for consumers."[214] All of this leads to a more debtor-friendly regime.

On the other hand, insolvencies under the German Insolvency Code are the only judicial proceedings available in Germany. But unlike the U.S. Bankruptcy Code, this regime's aim is not debtor-friendly, but it maximizes the insolvency dividend payable to the creditors. As it has been demonstrated, the German Insolvency Code's "first and foremost aim [is] the best possible satisfaction of the creditors."[215]Thus, the German regime is creditor-friendly. However, as it was noted that the German regime has gone through multiple and recent modifications, further changes to the code may be in store in the near future as well. When those changes do in fact come, the drafters of the new German Insolvency Code and the legislators approving the code should look to the U.S. regime.

The U.S.'s style of a debtor friendly bankruptcy regime is the most economically efficient legal regime, especially for corporate restructurings for economic and innovative reasons, amongst others. Because of the benefits that jurisdictions receive when they enact more debtor-friendly regimes, the German insolvency laws should be revisited, revised, and amended to reflect the U.S. style of bankruptcy and insolvency laws to improve the economic impact within Germany when a company utilizes the German Insolvency Code. Long-held and

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[213] Jason J. Kilborn, *The Innovative German Approach to Consumer Debt Relief: Revolutionary Changes in German Law, and Surprising Lessons for the United States*, 24 NW J. INT'L L. & BUS. 257, 259 (2004).
[214] *See supra* note 204.
[215] *Id.*

strong cultural values may stand in the way of, despite the best intentions of lawmakers.[216] However, in order to provide the best outcome for debtors, the national economy, and all stakeholders, the most debtor-friendly insolvency regime should be the goal of German lawmakers.

[216] *See supra* note 34.

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11 U.S.C. § 1124.

11 U.S.C. § 1128.

Abstract

Konkurs- und Insolvenzrecht sind womöglich das Letzte worüber Privatpersonen und Unternehmen nachdenken wollen. Es handelt sich um ein weltweites Konzept, das viele Rechtsordnungen in unterschiedlichen Formen übernommen haben. Es ist in der Regel mit finanziellen Problemen und Schulden verbunden. Diese Gesetze sind jedoch in modernen Volkswirtschaften sehr wichtig. Die Konkursgesetze in den meisten Rechtsordnungen bezwecken einerseits einem ehrlichen, aber unglücklichen Schuldner einen Neuanfang zu ermöglichen und andererseits die Gleichbehandlung der Gläubiger während des Prozesses zu gewährleisten. Abhängig von der Art des Regimes können sich Konkurs- und Insolvenzgesetze auf die Wirtschaft einer Nationen, die Innovation in der Nation sowie auf das private Leben vieler Menschen auswirken.

In diesem Beitrag werden zwei ähnliche und dennoch unterschiedliche Konkurs- und Insolvenzgesetze analysiert, nämlich das Kapitel 11 (*Chapter 11*) des Insolvenzgesetzes der Vereinigten Staaten sowie das deutsche Insolvenzgesetz. Beide Rechtsordnungen gehören zu den weltweit wichtigsten, am meisten genutzten und umfassendsten Regelungen. Diese Regime scheinen sich zunächst ähnlich zu sein. Sie unterscheiden sich jedoch recht stark, wenn man sich die detaillierten Bestimmungen der beiden Rechtsordnungen genauer ansieht.

Beide Regelungen, auf die sich diese Arbeit konzentriert, beziehen sich eher auf Unternehmensinsolvenzen als auf Einzelpersonen. Zunächst wird in diesem Beitrag der Zweck des Insolvenzrechts im Allgemeinen untersucht. Anschließend können die wichtigen Aspekte des jeweiligen Regelwerks verglichen werden, um die wichtigsten Unterschiede zwischen den beiden Regelwerken zu ermitteln. Einige der ausgewählten Aspekte sind: (a) wer das Regime nutzen kann, (b) die Einleitung des Konkurs- oder Insolvenzverfahrens, (c) die Aussetzung der Schuldeneintreibung und anderer Maßnahmen, (d) der Reorganisationsplan, (e) die Ernennung eines Verwalters oder Treuhänders im Konkurs oder in der Insolvenz, (f) die Kontrolle über die Konkurs- oder Insolvenzmasse des Schuldners und (g) die Rechte und Ausschüsse der Gläubiger. Durch diesen Vergleich wird deutlich, welche schuldner- und gläubigerfreundlichen Aspekte jedes Regime aufweist.

Anhand dieser Informationen kann dann festgestellt werden, warum das US-Regime schuldnerfreundlicher ist als das deutsche Regime. Die Art des Regimes kann nicht nur Auswirkungen auf Schuldner und Gläubiger, sondern auf die Wirtschaft als Ganzes haben. Abschließend kann gesagt werden, dass schuldnerfreundliche Regime aus zahlreichen

Gründen den gläubigerfreundlichen Regimen vorzuziehen sind. Zu diesen Gründen zählen, inter alia, die Auswirkungen von schuldnerfreundlichen Regimen auf die Innovation sowie die Auswirkungen auf die Volkswirtschaft im Allgemeinen.

Diese Arbeit stellt fest, dass das deutsche Regime schuldnerfreundlicher werden sollte. Da gläubigerfreundliche Regime nicht so viele Vorteile wie schuldnerfreundliche Regime enthalten, sollte der deutsche Kodex durch neue, schuldnerfreundliche Regelungen modifiziert werden. Auf diese Art und Weise wären insolvente deutsche Unternehmen und die deutsche Wirtschaft in der Lage von den gleichen Vorteilen profitieren zu profitieren wie in den Vereinigten Staaten und anderen ähnlichen Rechtsordnungen. Daher sollte der deutsche Gesetzgeber sein Insolvenzregime überprüfen und Änderungen vornehmen, um ein schuldnerfreundlicheres Regime zu schaffen, wobei Kapitel 11 des amerikanischen Insolvenzgesetzes als Modell für alle zukünftigen Änderungen dienen sollte.

Abstract

Bankruptcy and insolvency laws are some of the last terms that people and companies want to think about. It is practically a worldwide concept that many jurisdictions have adopted in some type and form. It is usually associated with financial problems and debt. However, these laws are very important in modern economies. Bankruptcy laws in most jurisdictions have the dual purpose of providing for a fresh start to an honest but unfortunate debtor and providing for equal treatment to creditors during the process. Depending on the type of regime, bankruptcy and insolvency laws can affect the economies of nations, innovation in the nation, as well as the personal lives of many people.

This paper analyzes two similar, but different bankruptcy and insolvency codes the United States' Bankruptcy Code's Chapter 11 and Germany's Insolvency Code. Both jurisdictions are among the most important, widely utilized, and comprehensive regimes in the entire world. These regimes seem similar at first. However, they are quite different once one looks more at the detailed provisions of each.

Both regimes aspects that are focused on in this paper will relate to corporate insolvencies rather than individuals. First, this paper will examine the purpose of bankruptcy laws in general. Next, the important aspects of each respective code can be compared in order to determine the major differences between each regime. Some of the important aspects chosen include: (a) who can utilize the regime (b) beginning the process of bankruptcy or insolvency, (c) the stay of debt collection and other actions, (d) the plan for reorganization, (e) appointment of an administrator or trustee in bankruptcy or insolvency, (f) control of the debtor's estate in bankruptcy or insolvency, and (g) creditor's rights and committees. Through this comparison, it can be seen the debtor-friendly and creditor-friendly aspects of each regime.

This information may then be used to determine why the U.S.'s code is more debtor friendly than the German regime. The type of regime can impact not only debtors and creditors, but economies as a whole. Overall, debtor-friendly regimes should be preferred over creditor friendly regimes for numerous reasons. This can include the impact on economies, innovation, and other reasons.

This paper will determine that the German regime should become more debtor-friendly. Because creditor-friendly regimes do not contain as many benefits as debtor-friendly regimes, the German Code should be modified to adopt new, pro-debtor provisions. This way, insolvent German corporations and the German economy can reap the same benefits as those in the United States and other similar jurisdictions. Therefore, the German legislature should examine

its insolvency regime, and implement changes to better reflect a more debtor-friendly regime, using the U.S.'s Chapter 11 as a model for any future amendments it may make.