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LL.M. Graduate Thesis:

GERMANY'S INSOLVENCY ACT: AN INTERNATIONAL APPROACH WITH THE UNCITRAL MODEL LAW ON CROSS-BORDER INSOLVENCY IN MIND

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I. Introduction

Today's international economy is characterized by an accelerating globalization. Large transnational companies are very common in today's picture of globalization: not only big banks, or companies like Daimler Benz and Chrysler are merging these days; Also small companies in new business fields like information technology, or traditional hardware production are interested in new strategy of international marketing. When enterprises look at the global market they find international efforts to harmonize regulations making it quite easy to take part in today's globalization. [1]

Globalization brings not only prosperity and wealth, but also financial difficulties. These financial difficulties may have different causes: a whole branch may be in a crisis; an enterprise may not be well capitalized, or may be poorly organized or badly managed. The debtor goes bankrupt. [2] The courts around the world will face more and more insolvency proceedings involving multinational concerns[3].

This article gives a comprehensive overview of Germany's new insolvency law which reflects changes from a territorial to an universal approach to cross-border insolvency issues. It will compare the results of such changes with some of the main issues of the UNCITRAL Model Law on Cross-Border Insolvency (the Model Law).[4]

[1] Accounting principles (GAAP, ISA) are more and more accepted internationally. Also trade regulations have been developed to encourage the global market (GATT, NAFTA, European Community).
[2] The word "bankruptcy" is derived from the Old Italian "banca" meaning generally, place of business, and the Latin "ruptus" meaning broken, hence one's place of business is broken (See Carl Felsenfeld, Bankruptcy, 2nd Edition, 1 (1997), The Professor Series by EMANUEL LAW OUTLINES, Inc.)
[3] See Jay Westbrook, Developments in Transnational Bankruptcy, 39 ST. LOUIS U. L.J. 745, 745 (1995), "… it appears that hundreds of United States- Mexican and United States- Canadian insolvencies … are pending in the U.S. courts at any given time".
[4] See: Model Law on Cross-Border Insolvency of the United Nations Commission on International Trade Law, Official Records of the General Assembly, Fifty-second Session, Supplement No. 17 (A/52/17, annex I), May 30, 1997.

First, it will be necessary to discuss the changes that reflect Germany's new insolvency law, the "Insolvenzordnung" (the Insolvency Act or InsO).[5] Therefore, this article describes in some detail procedural issues associated with the commencement and resolution of an insolvency case including a new legal tool, the insolvency plan.

This article traces a German shift from territoriality to universality in the treatment of cross-border insolvency cases and shows how the Insolvency Act incorporates universalism into the new statute.

Finally, it will conclude that Germany still needs to enact the UNCITRAL Model Law on Cross-Border Insolvency to implement the means and goals of a coordinated international insolvency law in an increasingly globalized world.[6]

II. The New Insolvency Act (*Insolvenzordnung*)

Germany's Insolvency Act came into effect on January 1, 1999[7], almost five years after its enactment by the Parliament. Until that date there still were divided insolvency laws in former East and West Germanies.

A Legislative and Historical Background

Before the Insolvency Act came into effect, (West) German insolvency law was codified in two statutes. [8] The Bankruptcy Act ("*Konkursordnung"*) of 1898[9]

[5] 1994 *Bundesgesetzblatt* (BGBL) I, 2866.
[6] The terms and phrases used herein collaborate with U.S. American understandings in terms of Title 11 U.S.C., notwithstanding a possible different meaning in Germany. But, some terms like "trustee" would disregard the German understanding of a bankruptcy estate, which is not treated in Germany as a new separate legal entity. Therefore, the term "administrator" reflects the German understanding much better.
[7] Some procedural regulations came into effect on October 19, 1994; See Art. 110 *Einfuehrungsgesetz zur Insolvenzordnung* [Introductory Act to the Insolvency Act], Fn. 26, infra.
[8] And, of course also in the East, until after World War II when Germany became divided.
[9] 1898 RGBL 612, as amended.

regulated liquidation only. The Composition Act ("*Vergleichsordnung*") of 1935[10] applied when either party in interest sought reorganization of the debtor, which included to a certain extent out-of-court arrangements later approved by the bankruptcy court.

After the Wall came down the first free elected East German legislative enacted the Collective Enforcement Act ("*Gesamtvollstreckungsordnung*")[11].

After German reunification on November 3, 1990 (East) German insolvency law had been determined by the special needs of East German enterprises still owned by the government. Therefore, the Treaty on the German Unification[12] took into account these circumstances. The Collective Enforcement Act ("*Gesamtvollstreckungsordnung*") was amended by supplemented regulations to convert a liquidation proceeding of an East German (government owned) enterprise into a reorganization of such enterprise.[13]
In addition, the introduction of the (West) German insolvency law in former East Germany had also been postponed in light of an ongoing effort to reform (West) German insolvency law.[14]

Outdated legal provisions for reorganization of the debtor's business were not efficient.[15] Less than 1% of all bankruptcy proceedings led to reorganization.[16] Approximately three-quarters of all bankruptcy proceedings could not be opened because of a lack of assets.[17] Unsecured creditors with priority in distribution

[10] 1935 RGBL 321, as amended.
[11] 1990 *Gesetzblatt der DDR* (GBL) I 32, 285.
[12] See: *Vertrag zur Herstellung der Deutschen Einheit vom 31. August 1990*, [Treaty Between the Federal Republic of Germany and the German Democratic Republic on the Establishment of German Unity], 1990 BGBL II 885, 921, 1153.
[13] See: *Gesetz ueber die Unterbrechung von Gesamtvollstreckungsverfahren* [Liquidation Proceeding Interruption Act] , 1990 GBL I 45, 782.
[14] See: Klaus Kamlah, The New German Insolvency Act: Insolvenzordnung, 70 Am. Bankr. L.J. 417, 419.
[15] In the West and, after reunification, also in the East part of Germany.
[16] *Verband der Deutschen Inkassounternehmen, Jahresbericht 1998* [German Collection Agency Association, Yearly Report 1998].
[17] See: Jobst Wellensiek, *Die Abwicklung des Verfahrens – Unternehmensinsolvenz und Verbraucherinsolvenz*, 1998, 1, [The winding up of the Proceeding – Business and Consumer Insolvency

realized almost nothing on their proofs of claim.[18] And, even secured creditors realized less than the total amount of their claims (about 80 percent).[19]

On January 1, 1999 a new Insolvency Act came into effect. As far as reorganization is concerned, the new act has roots in Chapter 11 of the American Bankruptcy Code.[20]

There were many reasons to reform the German insolvency law. The major objectives were to overcome the lack of assets and to encourage reorganization efforts including the introduction of only one uniform insolvency case for both, reorganization and liquidation cases. The legislature also intended to promote out-of-court arrangements, to improve creditor rights, and to achieve more equity in distribution. Last but not least, a consumer insolvency proceeding including a discharge for individuals is subject to the new insolvency act.[21]

The Insolvency Act not only erases the division between East and West German insolvency laws, but also inconsistent legal provisions of liquidation and reorganization proceedings. As of January 1, 1999, each case will be balanced as to what is best for the creditors, a liquidation or reorganization of the debtor.[22]

Under the old law, secured creditors were able to get their collateral right away. Under the Insolvency Act, secured creditors cannot take their collateral and walk. They take part in the proceeding to a certain extent. Only the administrator can utilize some of their collateral or interest in property. The administrator can deduct a certain percentage of the realized value.[23] By way of compensation, and provided there is no deficiency in value of their collateral, secured creditors are

I],*(im Rahmen der Seminarreihe Insolvenzverwaltung der Deutschen Anwaltakademie in Zusammenarbeit mit dem Arbeitskreis Betriebswirtschaft-Steuern-Insolvenz Dr. Grannemann & von Fuerstenberg.*
[18] See Wellensiek, Fn 16, supra, at 1.
[19] See *Verband*, Fn. 15, supra.
[20] Title 11 U.S.C.
[21] See Reinhard Bork: *Einfuehrung zur Sonderausgabe der Insolvenzordnung* [Introduction to a Special Edition of the Insolvency Act], C.H. Beck im dtv, 1998, IX.
[22] See Sec. 1 InsO, Fn 5, supra.

able to get some protection (interest) as of the date of the report hearing[24], and on the principal value to ensure that their collateral will not diminish or depreciate in value while being held by the administrator.[25] It means that undersecured creditors will not have any compensation because the administrator is not willing to release the collateral immediately, or there is a delay in realization of such collateral.

The Insolvency Act looks to promote out-of-court reorganizations in several ways:

Section 419 of the German Civil Code ("*Buergerliches Gesetzbuch*")[26] provided in short that any transfer of an asset had no consequences as to debts related to such asset. That meant that if reorganization was sought by transfer of the business of the debtor to another entity, such transfer failed to be successful because of the rule. Article 33 (16) of the Introductory Act to the Insolvency Act[27] has abrogated Section 419 of the German Civil Code. It allows rehabilitation by takeover of shares or assets without certain debts by an insolvency plan.[28] Such takeover must comply with these regulations and is subject to avoidance if not.

Another effort to promote out-of-court arrangements is a more simplified procedure to reduce stockholder or member equity in limited liability companies ("*Gesellschaft mit beschraenkter Haftung, GmbH"*). The German statutory business law regulating the governance of such *GmbH*[29]provides a statutory minimum stockholder or member equity of Twenty-five thousand Euro.[30] To be

[23] Id. Sec. 166 ff (up to nine percent of the realized value, see Sec. 171 InsO).
[24] Described in more detail in part II.A.(d), infra.
[25] See Sec. 169 InsO, Fn 5, supra.
[26] 1896 RGBL 195, as amended.
[27] 1994 BGBL I, 2911.
[28] A plan of Transfer is discussed in part II.D, infra. Tax and labor related debts are still with the asset. Both, Sec. 75 AO ("*Abgabenordnung*"), and Sec. 613 (a) BGB are still in effect. It means that those who take over an insolvent entity are still liable for debts related to tax and labor claims occurred before the insolveny.
[29] *Gesetz betreffend die Gesellschaften mit beschraenkter Haftung* [Act governing Limited Liability Companies], of May 20, 1898, RGBL S. 846, as amended.
[30] Id. Sec. 5 I.

well capitalized stockholders or members often agree to more than the statutory limit. The "more" is registered by filing appropriate certificates.

Under the Introductory Act to the Insolvency Act[31] the stockholders or members of a *GmbH* now can simply reduce their registered stockholder equity up to the statutory minimum, in order to compensate extraordinary losses or depreciation in value of assets.[32] Once a loss or extraordinary depreciation in value occurs to the extent that liabilities exceed the assets of a *GmbH* its agents must call for an extraordinary stockholder or member meeting.[33]Stockholders or member may decide to reduce the registered equity as long as the statutory limit still remains in the company. In doing so, they "cut off" the liability of such company to the stockholders or members themselves. But, all the creditors must agree because reducing the liability to them will increase their pro rata risk. In the case a creditor opposes, such creditor must get paid first, or the company must provide security to such creditor.[34] In addition, "simplified equity reduction" is possible if all the reserves of such *GmbH* are resolved, and new reserves out of it are not used for any payments to the stockholder for at least five years.

The term "simply" refers to two elements. Before the Insolvency Act, it was impossible to reduce stockholder equity unless the debt equity ratio was kept constant. Secondly, there had been a ban to effect such reduction for one year. Now under the Insolvency Act both elements has been abrogated making it "simple" to reduce stockholder equity.

The Insolvency Act provides a discharge for the debtor after seven years of good behavior, [35] or as part of an Insolvency plan.[36] This shall encourage the debtor to file early, hence save more assets for distribution or reorganization.

[31] See Fn. 26, supra.
[32] Id. Article 48 (4).
[33] See Sec. 32 *GmbHG*, Fn 28, supra.
[34] See Sec. 58 a *GmbHG*, Fn 28, supra.
[35] See Sec. 286 ff InsO, Fn 5, supra.
[36] Id. Sec. 227 (1).

The Insolvency Act provides reorganization of the debtors business by an insolvency plan ("*Insolvenzplan"*). As a matter of law only the administrator or the debtor itself can introduce such insolvency plan. But as part of the reorganization effort creditors have more rights to control the fate of the debtor. After a hearing the insolvency court will approve or reject the creditor's decision on the reorganization issue, or the insolvency plan. Of course the insolvency plan can be adjusted if necessary. And, the court can compel creditors in accordance with the "cram down" rule.[37] The insolvency plan is discussed in more detail in part II.D, infra.

After that period of time the discharge will be granted. Any creditor can apply for a denial. If granted the debtor is discharged of all obligations, known or unknown, and occurred before the commencement of the case[38].

Throughout the legislative process and since, the Insolvency Act has been criticized in the literature.[39] One of the disadvantages may be the provision as to the stay. Once the debtor itself files for insolvency, such petition should operate as stay. The insolvency court may order a stay against the collection of claims or perfection of liens, but only if such measures by the creditors are to asses other than real estate property of the debtor.[40] In other words, the court may order a stay against the assessments or seizure of collateral. In addition, the power to avoid most of the preferential transfers of the debtor[41] is limited in time (three month before filing). A preliminary proceeding to find out if the debtor is really insolvent, and if there are enough assets to commence a case can take more than three months. Therefore, the filing may not halt a race among creditors to collect

[37] Id. Sec. 245 (1), (2).
[38] Id. Sec. 301 (1).
[39] A good overview can be found in Klaus Kamlah, The New German Insolvency Act: Insolvenzordnung, 70 Am. Bankr. L.J. 417, 1996.
[40] See Sec. 21 II (3) InsO, Fn. 5, supra.
[41] See part II.C (e), infra.

their claims, notwithstanding some risk that these transfers would be subject to the avoidance power.

B The Preliminary Proceeding

The German insolvency law provides for a preliminary proceeding to decide whether an insolvency case can be commenced.[42] An application must be filed with the insolvency court where the debtor has its general legal venue, or if shown to the insolvency court, where the debtor has its scope of business interest.[43] General legal venue is determined by the debtor's place of residence, or registered business. Scope of business interest means the debtor's place of main business.

The debtor or any single creditor has a right to apply for the commencement of a case.[44] If the applying creditor is a corporate entity, acting agents must prove their right to act on behalf of such entity. There is a statutory presumption that appropriate officers of certain business enterprises like *GmbH* or corporations (*Aktiengesellschaft*) are entitled to act.

There are German provisions imposing a fiduciary duty to file for insolvency within three weeks after the debtor becomes aware of or obtains knowledge of its own insolvency. Among them, Section 64 I of the business law regulating limited liability companies (*GmbHG*)[45], and section 92 II of the business law regulating corporations (*AktG*)[46]. Despite these provisions, debtors often file very late for insolvency.[47]

[42] In contrast: 11 U.S.C. 301, 303: voluntary and involuntary cases are commenced when the petition is filed.
[43] See Sec. 3 InsO, Fn. 5, supra.
[44] Id. Sec. 13 (1).
[45] See Fn. 28, supra.
[46] See *Aktiengesetz vom 6.9.1965* [Business Corporation Law], 1965, BGBL I, 1089, as amended.
[47] One reason might be that filing a debtor-petition in Germany has not only legal consequences. Politics in corporate governance are quite different to other countries like the United States where the influence of the management by the shareholders is less than in Germany. See also: David A. Skeel, Jr., AN EVOLUTIONARY THEORY OF CORPORATE AN LAW AND CORPORATE BANKRUPTCY, 51

An individual will be deemed to have "knowledge" of insolvency if such individual is actually aware of it, or a prudent individual could be expected to discover or otherwise become aware of the insolvency through the exercise of reasonable care or because of his position or skill. A person other than an individual will be deemed to have "knowledge" of the insolvency if an individual who is serving as an agent of such person, such as a director, officer, partner, executor, or trustee, has or had knowledge of the insolvency.

Under certain circumstances, the debtor's agent of such entity is required by law to provide a showing that the debtor would not meet a "balance sheet test" or an "ability to pay test". If these tests are not met, the agent would breach his fiduciary duty not to file for insolvency. In addition, to refrain from filing in such an event of insolvency is subject to criminal punishment. This rule also applies to other business entities, such as limited partnerships.[48] The balance sheet test does not apply to individual debtors (sole proprietorship).

The application must be in writing or placed in the record with the insolvency court clerk.[49] A special power of attorney is required if a counsel makes the application. Any applicant may retract its application as long as no case is commenced.

A debtor must allege his own insolvency or a threat of insolvency. Moreover, the debtor alone may file for insolvency in case of a "threat" of an inability to pay its

Vand.L.Rev 1325, 1336.: "The corporate governance system has an ex post perspective in at least two respects. First, on the corporate governance side, hostile takeovers can be seen as an ex post mechanism for reducing managerial agency costs, since takeover bidders emerge after managers have failed to run the firm efficiently. On the bankruptcy side, Chapter 11 assures that the managers of a firm that encounters financial distress can attempt to reorganize after the fact. Given the striking differences between U.S. and Japanese or German corporate governance, one also would expect Japanese and German bankruptcy to differ from the American approach. And they do. In both Japan and Germany, the managers of a firm that files for bankruptcy lose their jobs immediately."

[48] See Sec. 130 (a) I, *Handelsgesetzbuch (HGB)* [Trade Act], 1897 RGBL 219, as amended.

[49] See InsO Sec. 4, Fn 5, supra; See also: Sec. 246 *Zivilprozessordnung vom 12.9.1950 (ZPO)* [Civil Procedure Code], 1950, BGBL 533, as amended.

debts in the future.[50] This new standard permits the debtor to file at a very early stage in its financial distress. For example, when the debtor knows already in January that he will not be able to pay a long term debt due in December, the debtor can file with the insolvency court.[51] The courts will have to carefully examine such applications to avoid improper use of such regulation. But the "threatening inability test" now exists beside the two traditional tests for insolvency.

In the event that the debtor is a judicial person, such as a *GmbH* or *Aktiengesellschaft,* an individual may not by statutory presumption act on behalf of the debtor alone; additional prima facie evidence of such grounds is required. Such application must comply with the requirements set forth for creditors.[52] It means showing of reliable grounds for the alleged insolvency. Reliable grounds are the inability to pay debts when they come due, or the liabilities exceed the assets of the debtor.

A creditor must allege the debtor's insolvency. The creditor has to show that the debtor is unable to pay debts as they come due, or, in the case of a business other than a sole proprietorship, that the debtor's liabilities exceed its assets. As to the "inability to pay" test, the unpaid debts must be essential debts and there must be a continuing, as opposed to a temporary, inability to pay.[53]

In addition, the creditor's petition must contain prima facie evidence of a matured claim against the debtor, and a description of any efforts that have been undertaken to collect. The *Bundesgerichtshof* held in 1986 that it is necessary for a creditor to show a need to be protected by the commencement of the case. Such need can be shown by providing evidence of circumstances likely to harm

[50] See Sec. 18 (1), (2) InsO, Fn. 5, supra.
[51] In this case the insolvency court may ask the debtor to prove that he has fulfilled his obligation to seek a waiver from the creditor.
[52] See Sec. 15 II InsO, Fn. 5, supra.
[53] Judgment of Nov. 27, 1974, Bundesgerichtshof [BGH], [1975] *WERTPAPIERMITTEILUNGEN, ZEITSCHRIFT FUR WIRTSCHAFT UND BANKRECHT* [WM] 6.

creditors, such as the transfer of assets without reasonable consideration, or not in the ordinary course of business. It is more difficult to provide a need for protection if the claim is secured, or the creditor seeks other ends like payments by installments. But it is certainly enough to show just small amounts of unsecured claims.[54] There is no change in the application of this rule after enactment of the Insolvency Act.

Any individual or legal entity or partnerships, clubs, entities in liquidation, decedents' estates, and joint marital property estates are subject to an insolvency case.[55]

The Federal Republic of Germany, any state of the Federal Republic of Germany, and, if so provided by public law of this state, legal entities determined by such public law[56], are not subject to the Insolvency Act.[57] Theses entities created under public law must be distinguished from other government owned and operated enterprises, which are created under private law by a state, county, city, or town to fulfill the public mandate or local affairs. Such private law entities are subject to the Insolvency Act.

The use of a legally determined public entity may be mandatory to fulfill certain public mandates. But, in general, state and local governmental bodies are free to determine whether a public or private entity will implement the public mandate or local affairs.

The insolvency court will investigate an application sua sponte. Assuming the court finds an application proper, i.e. the debtor is eligible for insolvency relief and the creditor is eligible to apply for such relief, it will notify and hear the

[54] BGH NJWRR 1986, 1188.
[55] See Sec. 11, 12 InsO, Fn. 5, supra.
[56] Legal entities under specific public law are, for example government owned and operated enterprises to fulfill the public mandate or local affairs, similar to municipalities; neither voluntary nor involuntary petitions against such entity are admissible.
[57] See Sec. 12 InsO, Fn. 5, supra.

debtor. If the debtor's whereabouts are known the court may order the debtor to file a special form.[58] In addition, the court may inquire through a special officer and

- interrogate of the debtor including a chance for the debtor to disclose possible crimes;
- obtain the testimony of witnesses and officers of the court, and opinions by experts; and
- inquire special public registers. [59]

To prevent any diminution in the value of the property of the debtor the court may order:

- The seizure, attachment, or confiscation of assets of the debtor;[60]
- The sealing or closing of offices or buildings;[61]
- A stay upon the perfection of liens, the enforcement of judgment, or other acts to collect claims against the property of the debtor;[62]
- The seizure of postal deliveries;
- A general restraint on dispositions by the debtor; and
- A stay against any seizure or foreclosure of collateral.[63].

In addition, the court may appoint an interim administrator.[64] In general, the interim administrator is an individual with special legal and business knowledge, often a lawyer, and sometimes an accountant or tax adviser. In its decision to appoint such interim administrator, the court will provide whether a general restraint on dispositions by the debtor is ordered or not. The legal consequences

[58] Id. Sec. 10 I.
[59] Id. Sec. 20, 97.
[60] Id. Sec. 21 I.
[61] Id. Sec. 22 I (2).
[62] Id. Sec. 21 II (3).
[63] Id. Sec. 21 II (3); As already discussed in part II.A, supra, the insolvency court may order a stay against measures to collect claims (seizure or foreclosure) only if such measures by the creditors are to asses other than real estate property of the debtor.
[64] Id. Sec. 21 I (2).

are different depending on whether a general restraint on dispositions by the debtor is ordered or not.

General restraint ordered

If the court orders a general restraint on dispositions by the debtor, an interim administrator is called a "strong" administrator. Rights of distribution or transfer of property shift to the interim administrator. Any liability or debt incurred by the interim administrator becomes a liability of the estate. For example, while continuing the business of the debtor, labor costs of employees involved in performance of the business are liabilities of the estate. But if the case is not commenced because due to a deficiency in assets despite such continued business, there cannot be a liability of the estate.

The "strong" interim administrator is a fiduciary to the debtor or the estate.[65] He is subject to a business judgment rule in continuing the business. The interim administrator must be aware of all of the subtle hazards that might occur, especially if he does not run such business in the ordinary course. The interim administrator becomes liable to creditors in the event he or she incurs liabilities of the estate and it turns out later that such liabilities are not covered by assets of the estate. In addition, the burden of proof that such deficiency could not be foreseen shifts to the interim administrator.[66]

If the interim administrator wants to shut down the debtor's ongoing business, he needs permission of the court. He or she must apply as soon as such interim administrator acknowledges a deficiency and there is no good chance to recover in continuing the business.[67]

[65] Id. Sec. 61.
[66] Id.
[67] Id. Sec. 22 I (2).

The duty to continue the debtor's business seems to collide with the interim administrator's strict liability for newly incurred debts.[68] A possible solution may be to give the interim administrator enough time to make a decision whether or not to shut down the business. This should be measured according to what a prudent interim administrator would do under similar circumstances.

No general restraint ordered

If the court does not order a general restraint on dispositions to the debtor, the interim administrator cannot incur liabilities of a later estate.[69] The interim administrator's ability to act depends on how much power the court vests in him. Because such interim administrator cannot incur liabilities of the estate, such interim administrator is called the "weak" interim administrator.

The debtor will continue to operate his business. But, the court may order him to ask the interim administrator for permission in certain transactions. Some would argue that in this event, a weak interim administrator should be personally liable like a strong one.[70]

If a weak interim administrator wants the debtor to act in a certain way, he must file a motion with the court. Single competencies or power vested in the capacity of the interim administrator depend on explicit order of the court. Because weak interim administrators have limited liability for post-application obligations, creditors carefully monitor the situation.

German insolvency courts seem to have a bias against ordering a general restraint, but vest powers in the weak interim administrator that are very similar to those that would follow from general restraint.[71]

[68] See Hans-Peter Kirchhof, *Rechtsprobleme bei der vorlaeufigen Insolvenzverwaltung* [Legal insolvency problems of interim administration], ZinsO 7/99, 365, 1999.
[69] See Sec. 55 II InsO, Fn. 5, supra.
[70] See Kirchhof, Fn 67, supra, at 368.
[71] See Kirchhof, Fn 67, supra, at 365: In nearly 90 percent of all cases insolvency courts appoint interim administrators without an order of general restraint.

The interim administrator's obligations and functions are determined by the special character of the preliminary proceeding to commence an insolvency case. In accordance with the court's order, he shall

- take possession, and if appropriate, secure property of the debtor by taking inventory, and if necessary insure and seal it;
- continue the business of the debtor. Such administrator will need business skills in order to fulfill his duty to continue the business. If the interim administrator wants to shut down the business he needs permission of the court. Permission can be obtained by showing in expert opinion to the court that continuation will harm the property of the debtor or a future estate;[72]
- collect receivables of the debtor;
- terminate executory labor contracts; and
- give an expert opinion to the court as to whether the case should be commenced or not.

Such expert opinion includes application of the "inability to pay test", and, if appropriate, the "balance sheet test". If the interim administrator can show sufficient ground to prove the debtor's insolvency, he must submit a first financial statement, i.e. to some extent predict a valuation of the assets and the liabilities of the debtor. Finally, the interim administrator must show probable reasons why the debtor is insolvent, including badges of fraud, crises.

The expert opinion has to conclude whether there are enough assets that will at least cover the costs of the procedure. [73] This conclusion will determine the outcome of the preliminary proceeding. Either the case will be dismissed or commenced.

[72] See Sec. 22 I (2) InsO, Fn. 5, supra.
[73] Id. Sec. 22 I (3).

Prior to enactment of the Insolvency Act, the insolvency court would commence a case only if there were sufficient assets to cover not only the costs of such procedure but also certain kind of debts incurred by the administrator, labor costs occurring six month before the commencement of the case or arising out of executory contracts.[74] The new regulation provides that it is sufficient to show that there are enough assets to cover certain costs of the procedure[75]. It is no longer necessary to show coverage of such other debts because the Insolvency Act repealed these priorities.

The court may dismiss an application to commence an insolvency case if

- There is a lack of assets, and no party in interest wants to advance a payment to cover such costs;[76]
- The application is retracted or rescinded regardless any ground;[77]
- The ground for commencement of the case is not shown, i.e. the "inability to pay test" and a "balance sheet test" fails to give a ground for a commencement; or
- The application is not admissible.[78] An application is not admissible if it is filed against entities not subject to the Insolvency Act.[79]

In the event of a dismissal due to a lack of assets, different legal consequences arise depending on the nature of the debtor. Individuals are listed as "publicly known debtor" in a special public register for five years.[80] Such register is open to the public, and its contents can be retrieved by anyone showing an interest.

[74] See Sec. 59 *Konkursordnung*, Fn 9, supra.
[75] See Sec. 26 (1) InsO, Fn. 5, supra.
[76] Id. Sec. 26 I; Some creditors may have an interest in commencing a case.
[77] Id. Sec 13 II.
[78] Id. Sec. 11.
[79] As discussed in this part, supra.
[80] See Sec. 26 II InsO, Fn. 5, supra.

Legal entities are dissolved and canceled in the commercial register.[81] Partnerships are only canceled if registered.[82]

If the application is not dismissed, the court will commence the insolvency case by appropriate order. The preliminary proceeding is resolved. The court may dismiss the interim administrator, or he will be appointed as administrator in the upcoming insolvency case.

C The Insolvency Case

There are two basic types of insolvency cases, consumer insolvency cases and business insolvency cases.[83] Consumer insolvency includes small business by individuals (sole proprietorship). “Small business” is defined as a business without regular management or keeping book.[84]

Business insolvency cases include the businesses of entities with legal capacity, partnerships and sole proprietorships other than small businesses.

The commencement of a case does not create a new legal entity distinct from the debtor. It remains the debtor’s estate, but the Insolvency Act seems to separately deem the debtor’s estate as a distinct legal entity for some purposes. For example, the fact that an interim administrator can be held liable for certain debts incurred after the application has been filed but before the insolvency case is commenced suggests that a distinct “estate” arises between application and commencement.[85]

[81] See: Sec 141 (a) *Gesetz ueber die Freiwillige Gerichtsbarkeit vom 17.5.1898 (FGG)* [Voluntary Jurisdiction Act], 1898, RGBL, 189, as amended.
[82] See: HGB Sec. 131, Fn. 47, supra.
[83] This is a legal distinction.
[84] See Sec. 304 II InsO, Fn. 5, supra.
[85] See part II.B, supra.

In its commencing order, the court may authorize the debtor to remain in possession provided that the debtor seeks such relief.[86] In the event that a creditor applies for the insolvency case, the debtor's application to remain in possession will not be granted absent the permission of such creditor. The court will consider in its judgment also possible harm to the creditors, for example, if a delay of the proceeding is concerned.

a) The Stay

The commencement of the case operates as a stay[87] against the enforcement of judgments, as well as the creation, perfection, or enforcement of liens against property, until the end of the proceeding, or unless lifted by the bankruptcy court.[88] But there is a substantial difference between the German stay and the "automatic stay" of the U.S. Bankruptcy Code.[89] First, as described in part II.B, supra, there is a preliminary proceeding to commence a case in Germany. The stay does not arise "automatically" as soon as a petition is filed. During the preliminary proceeding, there is only a stay if so provided by the court.[90] This is a statutory gap between any application and the commencement of the case. Second, the German stay is not as broad as the American automatic stay. For example, the Insolvency Act does not provide for a stay against set off of debts owing to the debtor that arose before the commencement of the case, or a stay of the commencement or continuation of a proceeding before the tax trial court.

A legal provision providing an automatic stay as soon as a petition is filed at least by the debtor could have more meaning to the declared legislative end of preventing a shortage of assets. Once the debtor files for insolvency, he knows that there is enough ground for such insolvency proceeding. It makes little sense

[86] See Sec. 270 InsO, Fn. 5, supra.
[87] Id. Sec. 89 I.
[88] InsO Sec. 89 (1), (2).
[89] 11 U.S.C. 362.

to have an interim administrator first investigate the allegation of the debtor that the debtor is insolvent, and than impose a stay against creditor actions. Even if the debtor is not insolvent, a stay would not harm the creditors at large. On the other hand, the absence of a stay creates a need for protection of the creditors. There will be a time consuming and costly proceeding to avoid transactions subject to the avoidance power after the commencement of the case.

This idea encourages a demand for a stronger automatic stay where the debtor files the petition. It is promoted by the legislative intent to improve creditor rights as class. Enabling creditors to realize their claims unless cases estopped by the court contradicts the legislative goals, for example reorganization efforts.

b) The Business goes on

The commencement of the case raises the issue of whether the debtor's business can be reorganized or not. There is only one standardized or uniform case pending for reorganization or liquidation. The Insolvency Act provides the possibility for reorganization of the debtor after filing for insolvency. The new reorganization tool is called an "insolvency plan" (*Insolvenzplan*).[91]

Before enactment of the new German insolvency law, liquidation was the default rule to provide a distribution of the realized assets among creditors. The new law provides a statutory presumption that a business should continue to operate. Already in the preliminary proceeding the interim administrator must seek court permission to shut down the business based upon an allegation that reorganization is impossible, or that the debtor's business has already stopped[92]. The rationale of

[90] But, the Insolvency Act provides for an invalidity of judicial liens if perfected one month before filing of the petition; See InsO Sec. 88, Fn. 5, supra.
[91] See Sec. 217 to 269 InsO, Fn. 5, supra; The insolvency plan is discussed in part II.D, infra.
[92] Id. Sec. 22 I (2) InsO, Fn. 5, supra.

the rule is to enable creditors to determine subsequently whether or not to continue the debtor's business.[93]

Therefore, the business goes on until a decision is reached by the creditors that the debtor's business can be reorganized. The insolvency plan is discussed in part II.D, infra.

c) Executory Contracts

Claims arising out of executory contracts, such as labor or utility contracts and unexpired leases, still have priority in distribution, but only to the extent the administrator chooses to perform.[94] If the administrator does not choose to perform, the other party may have a claim for breach of contract, but such a claim has no priority in distribution. The other party may ask the administrator to vote upon performance. The administrator must choose immediately, otherwise he cannot demand performance from the other party.[95] If the administrator chooses to perform, claims arising out of it are liabilities of the estate, hence, they have priority over other claims.

As to leases, the Insolvency Act invalidates "ipso facto" clauses. Despite agreements to the contrary, a creditor-lessor may not terminate a lease solely on the ground that the debtor-lessee had delayed making a payment before the filing of the petition.[96]

[93] Efforts to reorganize a business prior InsO depended on obtaining the unanimous agreement of the creditors. There was no cram down, but instead a minimum payment of the principal amount required by law (35 percent). Reorganization efforts by the debtor or/and some of the creditors failed very often. In that case the debtor had to file for bankruptcy.
[94] See Sec. 103 II InsO, Fn. 5, supra.
[95] Id.
[96] Id. Sec. 112.

d) Proof of Claims

Unsecured creditors must file their proofs of claim no later than the day determined in the commencing order and published by the court.[97] Insolvency Act provides that such deadline has to be within a period of at least two weeks and at most three months after the commencing order is published.[98] Claims must be filed with the administrator, not the insolvency court.[99]

The commencing order will also conduct a non-public report hearing (*Berichtstermin*) with the insolvency court. At least one week before such hearing, the administrator must submit a list of assets with an assessment of their fair value.[100] If reorganization may be considered, a going concern liquidation valuation analysis also must be submitted. At the same time, the administrator must submit a classified list of creditor's claims, whether secured or unsecured, allowed or contested.[101] Finally, a balance sheet as of the date of the commencement of the case is required.[102]

During the hearing the administrator is obligated to give a detailed report regarding:

- Cause of insolvency and actual situation of the debtor's business;
- Any seizure or attachments on the property, or interest in property including any perfection of liens within one month prior filing of the petition for commencement of an insolvency case;
- Transactions, including preferences, subject to the avoidance power of the administrator;
- Segregation and preferential rights of creditors;

[97] Id. Sec. 28 I.
[98] Id.
[99] Id.
[100] Id. Sec. 151.
[101] Id. Sec. 152 I, II.
[102] Id. Sec 153.

- Pending proceedings involving the debtor; and
- Eligibility, or chances for reorganization and its probable legal consequences for all parties in interest.[103]

At the report hearing, a creditor's committee will be elected. The committee, or if no committee is elected, the creditors, must vote either to shut down or to continue the debtor's business.[104] The creditors or their committee will decide either to liquidate (even after a certain period of continuing business to fulfill another obligation, and to make the pie bigger), or to set time limits within the debtor or the administrator may submit an insolvency plan.[105] There is no statutory time limit within which the administrator, or the debtor itself, must propose an insolvency plan, except that it must be done within a reasonable period of time. The creditors or their committee may apply by motion for the court to set a time limit. After notice and hearing, the court may set a time limit, but the proponent may always get an extension for cause.

All claims are subject to approval during another hearing with the court (*Allgemeiner Pruefungstermin*).[106] Creditors can pursue their claims only under insolvency law,[107] meaning that a creditor cannot pursue its claim outside the insolvency case.

A claim is deemed allowed if neither the administrator, a creditor, nor the debtor objects in the report hearing.[108] Such presumption to allow a claim is final if not orally appealed immediately by such objecting party. Therefore, it is necessary for a party in interest to participate in the claims hearing if such party wants to object against other claims.

[103] Id. Sec. 156.
[104] Id. Sec. 157.
[105] Id. Sec. 218 II.
[106] Id. Sec. 176.
[107] Id. Sec. 87.
[108] Id. Sec. 178 I.

Objections to claims may be litigated in a non-insolvency setting. [109] Such claim is deemed disallowed unless settlement or judgment over the dispute is final. The bases for objections to claims range from the statute of frauds to unconscionability.

The local court, or, in cases where the value in dispute is more than ten thousand DM, the regional court where the insolvency court is located, has exclusive jurisdiction over such subject matter.[110] The court will reconsider contested claims for cause.[111]

g) Distribution

Former Section 59 of the *Konkursordnung,*[112] which had provided a priority in distribution for labor claims and commissions of commercial representatives up to six months before the commencement of the case, for any claim arising out of an retirement plan, and for any claim for social security, has been amended. The Insolvency Act abrogates these priorities. The costs of the procedure and debts incurred by the administrator, including executory contracts, still have priority in distribution as "liabilities of the estate" (*Masseverbindlichkeit*). [113]

h) Discharge

For the first time, the new insolvency law provides a discharge for individuals.[114] This may be good news for entrepreneurs whose destiny is to overtake personal liabilities to get credits for their business. In Germany it is very common to finance business by bank credit rather than equity raised in the public domain. In

[109] Id. Sec. 180 I.
[110] Id.
[111] Id. Sec 178.
[112] See Fn. 9, supra.
[113] See Sec. 53, InsO, Fn. 5, supra.
[114] Id. Sec. 286

addition to voluntary liens, banks usually secure their credits by assignment of all the personal assets and future income of director shareholders or members.

At the final hearing, the court decides whether a debtor's application for discharge will be considered. A debtor can receive a discharge if he did not breach his fiduciary duties. If considered, the debtor is forced to contribute by partial income and excellent behavior, for at least seven years[115]. The debtor, who is in possession of a limited portion of his assets, makes any payment through an agent[116] appointed by the court.[117] Moreover, the debtor will get all of her income paid through the agent. Certain transactions may need to be approved by the agent.[118] During this seven year period, a party in interest may request that the court modify the discharge order.

e) The Avoidance Power of the Administrator

In this part the administrator's power to avoid is discussed in general. The avoidance power is very broad. It ranges from preferential transfers in favor of single creditors to fraudulent transfers of the debtor.

The administrator has power to avoid pre-petition transfers and obligations that occurred

- within three months before or after the filing of the petition if
- such creditor had knowledge of the debtor's inability to pay its debts.[119]

The administrator also has the power to avoid pre-petition transfers regardless of knowledge of the creditor

- within one month before or after the filing of the petition if

[115] Id. Sec. 295; Some reader may think about slavery and the 13th Amendment.
[116] I call them agent because such person has very limited power, not to compare with the administrator.
[117] See Sec. 275 (2) InsO, Fn. 5 supra.
[118] Id. Sec. 277.
[119] Id. Sec. 130 I.

- the creditor had no right to a transfer at all, or no right of the transfer at that time (unmatured), or the creditor had a right against the debtor to perform other than in a kind of payment.[120]

The administrator has the power to avoid pre-petition transfers that occurred

- within the second and third month before filing of the petition if
- the debtor was insolvent, regardless of knowledge of the creditor, or
- the creditor had knowledge that such transaction would disadvantage other creditors.[121]

Individuals are deemed to have knowledge of the other creditor's disadvantage if conclusive circumstances apply. [122] The court will determine as a matter of law what circumstances constitute such conclusion. There is a rebuttable presumption that certain persons had knowledge of the debtor's inability to pay.[123]

The administrator also has the power to avoid any other legal act of the debtor directly disadvantageous to creditors if

- it occurred within three months before filing of the petition at a time the debtor was insolvent, and
- the other party to such action had knowledge that the debtor was insolvent, or
- such action occurred after the filing of the petition, and
- the other party to such action had knowledge of the debtor's insolvency.[124]

Last but not least, the administrator has the power to avoid fraudulent transfers, or any other action done by the debtor, that occurs:

[120] For example: a creditor's claim is directed to a certain performance or action by the debtor, i.e. to do or to refrain from doing something. Instead of doing so, the debtor "pays off" the creditor.
[121] See Sec. 131 I InsO, Fn. 5, supra.
[122] Id. Sec. 131 II.
[123] Id. Sec. 130 III; Such persons may be similar to those who are determined in 11 USC 101 (31) as insider.

- within ten years before or after the filing of the petition, and
- with the intent to disadvantage its creditors, and provided that
- the other party to such action had knowledge of the debtor's fraudulent intent.

There is a rebuttable presumption that the other party had knowledge of the debtor's intention if

- such party had knowledge of a threatening insolvency, or circumstances conclusive of a possibility of insolvency, and
- had knowledge that such action would disadvantage creditors.[125]

In addition, the administrator has the power to avoid any transaction of the debtor

- within four years before filing of the petition,
- done without any valuable consideration,

for example by giving a gift, or if the debtor has given more than usually given in similar occasions.[126]

Finally, the administrator has the power to avoid the perfection of liens securing shareholder credits within ten years before or after the filing of the petition. In the event that the debtor paid off his debts arising out of such credit within one year before or after the filing[127] of the petition, such transaction is also subject of the avoidance power regardless of the intention of the parties. [128]

[124] Id. Sec. 132; For example, any action by a third person that creates claims by others against the debtor, or in the alternative prevents the debtor to enforce his claims against others.
[125] Id. Sec. 133.
[126] Id. Sec. 134.
[127] The reason why there is always a regulation as to "before or after filing of the petition" is that under German insolvency law the case is not commenced by filing such petition. Any petition commences only a preliminary proceeding to determine whether an insolvency case may be commenced or not. The commencement of a case is discussed in Part II.1 of this article.
[128] See Sec. 135 InsO, Fn. 5, supra.

f) Set off

Under Section 94 Of the Insolvency Act, the creditor has the right to set off against counterclaims as long as such creditor has the same right as of the commencement of the case (not the filing of the petition).[129] Therefore, creditors may be interested in getting counterclaims against the debtor as long as the case is not commenced. But, as discussed supra, such a set off may be subject to the administrator's avoidance powers.

The creditor has a right to set off against unmatured or contingent claims after the case is commenced, if such claims become matured or non-contingent.[130]

The following exceptions apply to the right to set off a claim:

1. A creditor first became a debtor of the estate after the commencement of the case.

2. The counterclaim has been transferred to the creditor by another creditor after the commencement of the case.

3. The underlying transaction is subject to the avoidance powers of the administrator.

4. An unsecured creditor without priority in distribution owes something to the estate.[131] This exception would apply in situations likely to diminish assets otherwise needed to cover the costs of the proceeding.

[129] By contrast: Filing a petition in the U.S. prevents actual set-off, 11 U.S.C. 362 (a)(2), and the automatic stay must be lifted to assert further set-off, 11 U.S.C. 362 (d).
[130] See Sec. 95 I InsO, Fn. 5, supra.
[131] Id. Sec. 96.

Therefore, claims occurring after the commencement of the case are likely to invalidate set off.

D The Insolvency Plan

This part will illustrate the reorganization procedure under the Insolvency Act. The liquidation procedure is not further discussed.

Within an approved insolvency plan, section 217 of the Insolvency Act provides that a distribution and utilization of the assets of the debtor can be different from the general legal rule of liquidation. Three different goals may be utilized:

(a) A different distribution following liquidation (Plan of Liquidation);
(b) The transfer of the business as whole by share or assets deal, and realization of the creditor's claims out of a purchase price or future earnings of the business (Plan of Transfer); or
(c) Reorganization of the debtor to regain profitability, and realization of the creditors claims out of the future earnings of the debtor's business (Plan of Reorganization).

Insolvency plans may vary in goals, and therefore may contain combinations. For example, it is possible to run a reorganized business for a certain period of time, then liquidate it at the end.

The Insolvency Act provides that the proposal of an insolvency plan after the last hearing (*Schlusstermin*) is not allowed.[132] If after application of the creditors the administrator is ordered by the court to propose an insolvency plan, the administrator must submit his proposal within a reasonable time period. Only the debtor and the administrator can propose an insolvency plan. The creditors may

[132] Id. Sec. 218 I.

not propose an insolvency plan.[133] But, they have the right to determine the goals of such a plan. [134]

Also, the debtor may file his petition together with a prepackaged plan.[135] Such insolvency plan may be coordinated among certain creditors, but is subject to consideration by the court.

Before the first meeting at the report hearing, the court may appoint the creditors' committee.[136] At this meeting the creditors can approve the members of the creditor's committee appointed by the court, or appoint others to be members of the creditor's committee.[137] In larger insolvency cases, a creditor's committee is more likely to constitute a workable and representative body.

The creditor's committee's powers include:

- Supervision of the administrator in managing the business. The administrator has a broad duty of disclosure regarding anything related to the business;[138]
- Consent to the insolvency plan if such plan is a plan of transfer of the business;[139]
- Approval of new credits necessary to continue the business;[140] and
- Participation in creating a proposal for an insolvency plan, since the creditors have no right to propose their own insolvency plan.[141]

[133] Id.
[134] Id. Sec. 157.
[135] Id.
[136] Id. Sec. 67.
[137] Id. Sec. 68.
[138] Id. Sec. 69.
[139] Id. Sec. 160 II (1).
[140] Id. Sec. 160 II (2).
[141] Id. Sec. 218 III.

a) Structure of the Insolvency Plan

To be eligible for approval, an insolvency plan needs to have a determined structure, formality, and content. The insolvency plan is structured in a description part (*Darstellender Teil*) and a creating part (*Gestaltender Teil*).[142]

The description part must contain: [143]

- Principal goals and settlement structure;
- Classification of the creditors;
- Disclosure of all the facts and data in a complementary liquidation analysis, in order to facilitate a comparison with profit and loss and financial analysis of the reorganized debtor;
- Analysis of the crisis;
- Detailed description and vision of the reorganized debtor;
- Summary of steps to be taken; and
- Summary of effects to the creditors in case of adopting the Insolvency plan.

The creating part must contain: [144]

- Change of the legal position of creditors and the debtor, i.e. how the insolvency plan will impair their rights;
- General regulations regarding an effective date; and
- Nomination of another administrator (who may be the previous administrator) to supervise the realization of the insolvency plan.

[142] Id. Sec. 219.
[143] Id. Sec. 220.
[144] Id. Sec. 221.

b) Classification of Creditors

The insolvency plan divides creditors into different classes depending on their interests and their status as secured or unsecured creditors. Classification of creditors is necessary to determine the voting power, and whether the insolvency plan is accepted or dismissed. Classes may not be selected solely to influence voting results.

Mandatory classifications include:

(a) Secured creditors;
(b) Unsecured creditors other than with subordinated claims;[145]
(c) Unsecured creditors with subordinated claims
(d) Employees, if their claims are deemed to be substantial.

Under section 39 Of the Insolvency Act "subordinated claims" are defined as including:

- Unmatured interest in property otherwise payable under law or agreement as of the commencement of the case;
- Costs of the creditors by participating in the case;
- Fines and penalties;[146]
- Claims to perform other than monetary obligations of the debtor; and
- Credit claims of equity shareholder.

If the insolvency plan provides new credit, such credit is prior in position as to any other new claim arising out in the ordinary course of the debtor's business.[147]

[145] Id. Sec. 39; This is different to the understanding of subordination under 11 U.S.C. 510, which may assume only agreed subordination among creditors. Section 39 InsO is not voluntary subordination.
[146] Regardless of its nature as "compensation for actual pecuniary loss" in terms of 11 U.S.C. 523 (a)(7), or not.
[147] See Sec. 264 I InsO, Fn. 5, supra.

Whether or not claims of employees are deemed to be substantial is not regulated by the Insolvency Act. The insolvency court must determine as a matter of law whether or not such claims are to be deemed substantial. If employee claims are deemed to be substantial, the employees as a class have voting power. There is also social security in insolvency cases called "*Insolvenzausfallgeld*". This social security applies in the event that there are insufficient assets to cover the claims of employees. The court must therefore take into account possible payments out of such social security in determining the substantiality of employees' claims. Such payments may diminish substantiality to almost nothing, hence, employees will have no voting power.

Moreover, unsecured creditors with "small claims" can be classified into a different class. The Insolvency Act provides neither a definition of "small claims" nor a limit in the amount of the claims to be classified as "small claim". Therefore, the insolvency courts may determine as a matter of law what elements are necessary to determine "small claims". Small claim creditors must have similar commercial interests or a reasonable basis for classification.[148]

c) Procedural Steps

The court shall dismiss an insolvency plan if such plan does not comply with any formality provided by the Insolvency Act, although as a practical matter, it would order the proponents to adjust the insolvency plan within a reasonable period of time. If the administrator or the debtor fails to comply with such an order, the plan would be dismissed. Such dismissal is subject to appeal by immediate request for relief (*Sofortige Beschwerde*).[149]

[148] Id. Sec. 222 II.
[149] Id. Sec. 231 III.

If the court does not dismiss the proposed insolvency plan, the proposal will be given to the creditors committee, an employee committee (if one exists), the debtor, and the administrator for review, adjustment, objection, or complaint.[150]

The court will set a time limit of no more than three weeks for review, and determine a date for a hearing to discuss and vote upon the insolvency plan (*Eroerterungs- und Abstimmungstermin*).[151] After the time set for such a review, the insolvency plan, including appendices, statements, objections, and complaints, is available with the court clerk for any party in interest to review.[152]

The insolvency court will hold a hearing to discuss the insolvency plan. The court must determine the voting rights to each class of creditors.[153] After discussing the plan and before voting, creditors and their voting rights must be listed in a special voting list prepared by the court clerk and classified as follows:[154]

- Creditors with the right to vote;
- Creditors without the right to vote because their claims are not impaired by the insolvency plan;[155]
- Creditors without the right to vote because they are not present but properly invited by appropriate notice.[156]

The creditors will either accept or reject the insolvency plan. Assuming proper notice, creditors who abstain from voting are deemed to have abandoned their right to vote.[157] In addition, an insolvency plan is deemed accepted by a class of unsecured creditors with subordinated claims consisting of unmatured interest as of the date of the commencement of the case, and costs of the creditors incurred

[150] Id. Sec. 232.
[151] Id. Sec. 235 I.
[152] Id. Sec. 234.
[153] Id. Sec. 235 I.
[154] Id. Sec. 239.
[155] Id. Sec. 237 II.
[156] See Wellensiek, Fn. 16, supra, at 6.
[157] See Sec. 44 InsO, Fn. 5, supra; This is an interpretation of the rule in section 44 InsO where the rational is to allow a possible, or likely claim against a joint tort-feasor, or guarantor only if such creditor does not file a proof of his claim.

by participating the case. An insolvency plan is also deemed accepted by a class of subordinated unsecured creditors if no such creditor receives more pro rata than any other creditor of the same class.[158] Finally, an insolvency plan is deemed accepted by a class of creditors if none of the creditors of such class vote.[159]

Each class must either accept or reject a plan as a class.[160] An insolvency plan is accepted by a class if that plan is approved by the majority of the voting creditors holding more than one half in value of the allowed claims of the voting creditors.[161]

d) Cram Down and Best Interest Test

The insolvency plan is adopted by the creditors if all classes of creditors have accepted it.[162] If the debtor has also approved the insolvency plan, the insolvency court will then order the confirmation of the plan.[163] The approval by the debtor is deemed to be given if the debtor has not objected in a writing filed with the court, or placed on record with the court clerk.[164]

However, if fewer than all classes of creditors approve the insolvency plan, the so-called "cram down" rule (*Obstruktionsverbot*) may apply. Under section 245 Of the Insolvency Act there is relief from the "all – classes – approval" requirement by providing that the plan may be "crammed down" on certain classes of dissenting claims. The underlying idea of the cram down provision is that opposing creditors have rejected the best that they can get from this debtor and that their continuing opposition is irrational.[165]

[158] Id. Sec. 246 II.
[159] Id. Sec. 246 III.
[160] Id. Sec. 243.
[161] Id. Sec. 244; By contrast, 11 U.S.C. 1126 (c) a plan is approved by creditors holding at least 2/3 in amount, and more than ½ in number of the allowed claims.
[162] Id. Sec. 244 I.
[163] Id. Sec. 248 I
[164] Id. Sec. 247 I.
[165] See Felsenfeld, Fn 1, supra, at 204.

Under the German Insolvency Act, an insolvency plan may be crammed down if the court finds three basic tests satisfied:

(a) Do creditors of an opposing class receive more under the insolvency plan than they would receive without such insolvency plan?[166]
(b) Do creditors of an opposing class participate reasonably in the value of the assets of the debtor?[167] Reasonable participation is provided by The Insolvency Act as follows:
First, no other creditor receives value exceeding the full amount of its claim.[168] Secondly, neither junior or subordinated creditors, nor the debtor, nor equity shareholders receive anything in value before senior unsecured creditors are paid in full.[169] Finally, no creditor in the same position receives more in value pro rata than other creditors in the same position.[170]
(c) Did the majority of the voting classes approve the insolvency plan?[171]

The same cram down rule applies to the debtor because his objection is irrelevant if he receives more in value than he would receive without an insolvency plan.[172]

When the court must apply the absolute priority rule[173] there is uncertainty as to a whether the debtor or its equity shareholders may remain in possession of their rights as equity shareholders or owners by providing new value.[174] This is the so-called new value exception to the absolute priority rule. The Insolvency Act does

[166] See Sec. 245 I (1) InsO, Fn. 5, supra.
[167] Id. Sec. 245 I (2).
[168] Id. Sec. 245 II (1).
[169] Id. Sec. 245 II (2); This is the "absolute priority rule" compared to the fair and equitable test of 11 U.S.C. 1129 (b).
[170] Id. Sec. 245 II (3).
[171] Id. Sec. 245 I (3).
[172] Id. Sec. 247 II.
[173] Id. Sec. 245 II (2).
[174] See Arne Wittig: *Obstruktionsverbot und Cram Down* [The Cram down], ZinsO 7/99, 373, 1999.

not expressly provide for a "new value exception",[175] but also does not explicitly preclude such an exception.

The Insolvency Act also introduces a "best interest of creditors test". Under this "best interest test", every creditor, regardless of its classification, voting power, or position, has an absolute right to object to an insolvency plan if

- such creditor timely (at least at the voting hearing) files a petition in writing, or places such petition on record with the court clerk, and
- such creditor receives less under the insolvency plan than what he would receive in a liquidation of the debtor's business.

The objecting creditor must assert and show at least some prima facie evidence of such a position.[176]

The insolvency court confirms the insolvency plan by appropriate order. Parties in interest may appeal from an order of confirmation by requesting immediate relief.

e) The Effect of the Insolvency Plan

The confirmed insolvency plan binds all parties in interest affected by the plan, regardless of unknown claims and objecting parties.[177] The debtor is discharged from all known claims to the extent such claims are not considered in the insolvency plan.[178] Nevertheless, the insolvency plan does not discharge non-debtors such as guarantors or joint tort feasors.[179]

[175] Id., at 378. Wittig supposes to consider American canons also in German reorganization cases in light of the LaSalle Street decision of the Supreme Court (Bank of America Trust and Savings Association v. 203 North LaSalle Street Partnership, 119 S.Ct. 141, 1999). The new value exception did not apply because the [old] partners were the only class offered upon new value to own the reorganized and discharged debtor.
[176] See Sec. 251 InsO, Fn. 5, supra.
[177] Id. Sec. 254 I.
[178] Id. Sec. 227 I.
[179] Id. Sec. 254 II.

The new insolvency law provides a discharge for individuals. There is a special discharge proceeding (*Restschuldbefreiungsverfahren*).[180] Whether or not a discharge will be granted depends on certain conditions discussed in part I.C (h).

In case an insolvency plan is confirmed, the discharge proceeding does not apply to individuals whose business is reorganized under an insolvency plan, for example partnerships and sole proprietorships. The Insolvency Act provides a different way to get a discharge. These debtors receive a discharge from known claims that are not considered in the insolvency plan.[181] Other than in the special discharge proceeding for individuals, such debtor need not wait for seven years to get a discharge. The insolvency plan may consist of certain other conditions to be fulfilled by the debtor, but once the insolvency plan is finally consummated, the discharge is granted.

The insolvency plan may require supervision and monitoring of the debtor's management to determine compliance with the insolvency plan.[182] In the event that supervision or monitoring of the debtor is required by the insolvency plan, the administrator must

- Control and periodically report to the court and the creditors committee;[183]
- Inform the creditor any violation of the insolvency plan to give them the possibility to apply for review of the case;[184]
- Give approval to transactions as provided the insolvency plan;[185]
- Give reserved approval to a new entity after a plan of transaction;[186] and
- Approve the compliance of new bank credits with the limit set forth in the insolvency plan.[187]

[180] Id. Sec. 286.
[181] Id. Sec. 227.
[182] Id. Sec. 260 I.
[183] Id. Sec. 261.
[184] Id. Sec. 262.
[185] Id. Sec. 263.
[186] Id. Sec. 160.
[187] Id. Sec. 264.

If no further supervision or monitoring is required, the case will be closed. [188] But first, the administrator must pay the costs of proceeding and any undisputed liabilities of the estate incurred by the administrator. Upon demand, the administrator must secure disputed claims arising out of such liabilities of the estate.[189]

The underlying decision of the court to close the insolvency case must be published.[190] The administrator, the creditor's committee, and any other body established in order to comply with the insolvency law in a special case are dismissed.

If the debtor fails to comply with the insolvency plan, its discharge may be lifted, depending upon the grounds for failure.

III. Transnational Insolvency Cases

Sovereign states may agree mutually with other states on a set of rules to govern insolvency issues arising out of cases involving parties in interest of both countries. Germany has entered into a Treaty on Bankruptcy with the Republic of Austria.[191] Part of that Treaty is a general recognition of mutual bankruptcy proceeding.[192] Sovereign states may also agree to implement provisions proposed

[188] Id. Sec. 258 I.
[189] Id. Sec. 258 II.
[190] Id. Sec. 258 III.
[191] *Vertrag vom 25.5.1979 zwischen der BRD und der Republik Oesterreich auf dem Gebiet des Konkurs- und Vergleichs-(Ausgleichs-)rechts* [Treaty of May 25, 1979 between the Federal Republic of Germany and the Republic of Austria on Insolvency and Reorganization Issues], 1985, BGBL II, 410.
[192] The kingdom of Bavaria agreed in 1834 with the Swiss cantons on a mutual bankruptcy recognition. A German court held that even 150 years later the old agreement between the kingdom of Bavaria and the Swiss cantons is still in effect (*Konkursrechtliche Uebereinkunft zwischen dem Koenigreich Bayern und den Schweizer Kantonen vom 11.5./27.6.1834*). This is regardless of section 237 I *Konkursordnung*, which is discussed in more detail in part …, supra, the commencement of a case in Switzerland operates as stay concerning any assets located in Bavaria, and such assets become property of the estate (*OLG Muenchen vom* 11.8.1981 – SU 4070/80, 1982 KTS, 313) The decision was made at a time where German courts still pursued the old territorial approach (It follows that only the Swiss administrator had power over such assets. Since this is a decision only local in effect, no further comments will added.)

by the international community. The United Nations adopted a proposal of its Commission on International Trade Law (UNCITRAL) to provide for a Model Law on Cross-Border Insolvency.[193]

The following part will discuss current German approaches to transnational insolvency in light of the UNCITRAL Model Law on Cross-Border Insolvency (the Model Law). First, the article briefly introduces principles set forth in the Model Law, which may be applied under current German transnational insolvency law.[194] Secondly, the article will discuss in more detail how German law effects certain issues arising out of transnational insolvencies.

A UNCITRAL Model Law on Cross-Border Insolvency: A Short Overview of General Principles

On January 30, 1998, the United Nations General Assembly approved the Model Law on Cross-Border Insolvency that had been adopted by the United Nations Commission on International Trade Law (UNCITRAL).

The Model Law seeks to accomplish the following principles:

(1) A foreign proceeding shall be recognized as a foreign main proceeding if the foreign proceeding is opened in the State where the debtor maintains the center of his main interests.

(2) The recognition of a foreign proceeding is no bar to commencement of a local proceeding.

(3) The court of the enacting State shall recognize only one foreign proceeding as a foreign main proceeding.

[193] See Fn. 4, supra.

(4) A foreign proceeding shall be recognized as a foreign non-main proceeding if the foreign proceeding is opened in a State where the debtor has an establishment.

(5) Upon recognition of a foreign proceeding as a foreign main proceeding, some types of relief automatically come into effect. They will be in effect until modified or terminated by the court.

(6) Upon recognition of a foreign proceeding as a foreign main proceeding, other types of relief may be granted by the court, but will not come into effect automatically.

(7) Upon recognition of a foreign proceeding as a foreign non-main proceeding, relief can only come into effect if it is granted by the court.

(8) The foreign proceeding must be recognized in the enacting State if certain conditions are met. First, such foreign proceeding must be an insolvency proceeding in its nature, i.e. a proceeding providing organized liquidation or reorganization of the debtor's business. Secondly, the foreign court must have jurisdiction over insolvency matters.

(9) When there are two or more proceedings, there shall be cooperation and coordination between the courts s to the application of relief.

(10) If there are surplus proceeds in a local non-main proceeding, they shall be transferred to the main proceeding.

[194] A more detailed overview is shown in an article by Andre J. Berends, The UNCITRAL Model Law on Cross-Border Insolvency: A Comprehensive Overview, 6 Tul. J. Int'l & Comp. L. 309, (1998).

(11) A foreign representative shall have direct access to the judicial authorities of the enacting State.

(12) As soon as a foreign representative has filed an application for recognition of the proceeding in which he is appointed, the court of the enacting State shall grant relief of a provisional nature.

(13) Creditors shall be allowed to file claims in any proceeding. Payments to creditors from multiple proceedings shall be equalized.

Germany has not yet any proposed legislation to implement the UNCITRAL Model Law on Cross-border Insolvency. Nonetheless, German insolvency law already incorporates some of the principles underlying the Model Law. The following part of the article discusses German law regarding cross-border insolvencies, and compares it with the Model Law.

B From Territoriality to Universality

Until 1985, German courts used to rule under a territorial approach that the commencement of a foreign insolvency proceeding had no effect because the commencement of such proceeding was "an act of the state not able to exceed its borders".[195]

In 1985, the *Bundesgerichtshof* (the highest court in the subject matter) abandoned territoriality in favor of a universalist approach to international insolvency proceedings.[196]

[195] See *Reichsgericht*, 21.10.1920, VI 271/20, 1920 RGZ 100; BGH, 4.2.1960, VII ZR 161/57, 1960 NSW 774.
[196] BGH *vom* 11.7.1985 – IX ZR 178/84, 1985 WM, 1004.

a) The *Bundesgerichtshof* decision of July 11, 1985

Facts and procedural history
The plaintiff, the administrator of an insolvent Belgian limited liability company engaged in food processing, claimed payment against two German entities. The first, Defendant 1, was a *GmbH & Co. Kommanditgesellschaft*, similar to a limited partnership in which the general partner itself is a limited liability company (*GmbH*) and the limited partners are individuals. Defendant 2 was the general partner of Defendant 1, the *GmbH*.

Paul was the owner and managing director of the Defendant 2. Paul and his wife, Berta, were the sole stockholder of the plaintiff, the Belgian limited liability company. Until the order for relief, Paul also managed the insolvent company.

In December 1975, Defendant 1 placed a written order to have the plaintiff's beverages produced and delivered. Defendant 1 asserted to have with the bankrupt entity a lease dated July 1975, where Defendant 1 was the lessor and the plaintiff was lessee, over several parts of the machinery to produce and deliver the goods ordered. The lease provided for a minimum amount of 10,000 DM to be paid per year by the plaintiff. In addition, the lease provided that German law would govern and that the parties agreed to submit to German jurisdiction.

In February 1977, Defendant 1 owed the bankrupt plaintiff about 370,000 DM for beverage deliveries. After commencement of the case in Belgium, defendants claimed in a German court to get their property back (machinery etc.). The administrator made counterclaims on his own behalf consisting of payment out of the beverage delivery of the plaintiff.[197]

The German regional court granted judgment to the plaintiff. On appeal, the

[197] There had been several other claims and counterclaims, including claims by Paul and Berta as guarantors to a Swiss firm delivering package material. The claims had been assigned to the defendants.

regional Court of Appeals in Cologne affirmed with minor corrections in the amount. Defendants filed a writ of error with the *Bundesgerichtshof,* the highest German court on the subject matter. They alleged that, under the German code of civil procedure,[198] the administrator had no right of access to German jurisdiction on his own behalf.

Issues

The *Bundesgerichtshof* did not just answer the question as to whether or not the Belgian administrator had on his own behalf a right to claim payment to the estate. The Court also held what law should govern in German courts once a foreign insolvency proceeding is commenced. It gave up its own territorial approach in general with regard to section 237 *Konkursordnung*.[199]

Rules

To illustrate the historical change and the development from territoriality to universality it is necessary to introduce the rules that applied under these circumstances. In a very early decision issued before the enactment of the *Konkursordnung,*[200] the former German supreme court in the subject matter, the *Reichsgericht*, held that foreign bankruptcy proceedings are generally not recognized in Germany.[201]

On May 20, 1898, the *Konkursordnung* came into effect. Section 237 I literally translates as follows:

"Foreclosure of, within the German jurisdiction located, assets of the debtor, whose, outside the German jurisdiction located, assets are subject to a foreign bankruptcy proceedings, is proper".[202]

They are omitted because they do not impact the outcome of the case.
[198] See *Zivilprozessordnung* [Code of Civil Procedure], Fn. 48, supra.
[199] See Fn. 9, supra.
[200] Id.
[201] See the first decision on March 28, 1882, RGZ 6, 400.
[202] This is not an official translation.

After enactment of the *Konkursordnung*, the *Reichsgericht* ruled that commencement of an insolvency case is an act of the state and therefor not recognized in Germany notwithstanding the ambiguous language in of Section 237 I *Konkursordnung*.[203]

In other terms, the court could have read section 237 I *Konkursordnung* like this:

"Even if there is a foreign bankruptcy proceeding over assets of the debtor, who is also in possession of assets in Germany, such proceeding will not bar an otherwise legally admissible foreclosure in Germany."

Or one could read it more extremely like this:

"We don't care about foreign bankruptcy proceedings. Whoever the debtor is, once he owns property or interest in property located in Germany you can foreclose, provided you are eligible under appropriate German provisions."

After the World War II, the *Bundesgerichtshof* continued to interpreted Section 237 I *Konkursordnung* consistent with the territorial approach that had been adopted by the *Reichsgericht*.[204]

Outcome

In its decision of July 11, 1985, the *Bundesgerichtshof* abandoned its previous opinion and held that

1. Assets of the debtor located within the German jurisdiction are subject to a foreign bankruptcy proceeding;
2. The foreign administrator has the right to collect estate assets located in Germany;

[203] RG, JW 1899, 227, Nr. 16.

3. A foreign administrator can claim any right regarding the estate provided it is a lawful claim under the foreign insolvency proceeding and is not against the German ordre public, i.e. the rule will not apply if its local or legal consequences are against the public policies of Germany. Not to recognize such foreign proceeding would contradict the principle of equal treatment of all creditors, and may produce negative international consequences;[205]
4. The act of state doctrine does not apply to bankruptcy proceedings as long as the acting state does not pursue its own political or economic interests. In general, the distraint or seizure of assets by a debtor pursues private rights arising out of civil relationships between the debtor and its creditors. Therefore, such a seizure is in favor of all creditors, including German creditors.
5. Section 237 I *Konkursordnung* is no bar to recognition of a foreign proceeding. The legislative intent back in 1898 was to protect German creditors by allowing them to secure their credits with assets located in Germany. The purpose of the provision is to be measured by its effects on current realities. The non-recognition of a foreign proceeding would encourage debtors to transfer their business activities into foreign jurisdictions, and to keep assets in Germany with the intent to prevent foreign creditors from foreclosure. To provide all the creditors with an equal chance to take part in distribution of all applicable assets of the debtor wherever located also would be in the interest of the German creditors.

The decision reflects a rule under which circumstances a foreign insolvency proceeding in general is recognized in Germany:

- The foreign proceeding is an insolvency proceeding to liquidate the debtor's business or assets;

[204] BGH, WM 1960, 347. Well, exceptions may also apply in this regard over limited issues, but it would certainly break up this article to determine any single nuance in application of the rule in Section 237 I *Konkursordnung* (see Fn. 9, supra).

- The commencing authority has jurisdiction over the subject matter under its own lex fori concursus;
- The commencement is valid under the foreign lex fori concursus;
- The foreign law must claim universality to attach assets located outside of such state; and
- A recognition of such proceeding is not against the public policy in Germany.

b) The Law under The Insolvency Act

After the enactment of the new insolvency law, the same rule applies. A foreign (main) proceeding is recognized in Germany.[206]

Article 102 I of the introductory act of the Insolvency Act reads as follows:

"Assets of the debtor located within the German jurisdiction are subject to a foreign insolvency proceeding, except where the ruling foreign court has no jurisdiction over the subject matter under its own law; and
legal consequences arising out of such proceeding are obviously against the basic rules of public policy in Germany, especially against constitutional rights."

The requirements of a recognition in detail are universality of lex fori concursus, the international jurisdiction of the enacting court, and the consistence with the German ordre public.

[205] Belgium has a statute general recognizing foreign bankruptcy proceedings. But because of the consequent territorial approach Belgium made an exception with Germany.
[206] See Section 102 I Introductory Act to the Insolvency Act, Fn. 26, supra.

C Foreign Main Proceeding

a) Recognition of a Foreign Proceeding

The foreign law must claim universality to be recognized in Germany. As long as such foreign insolvency law claims control over the debtor's legal and equitable (ownership) interests in assets wherever located, this requirement should be fulfilled.[207] If, by contrast, the foreign law only extends to its own territory, there will be no recognition in Germany.[208]

Under section 102 I (1) of the Introductory Act to the Insolvency Act,[209] recognition of the commencement of the case will be denied if a German court finds that the ruling foreign court has no jurisdiction under its own foreign law. Therefore, the test for recognition will be whether or not the foreign law provides in rem and in personum jurisdiction to the enacting foreign court.[210]

In this regard, the Insolvency Act seems to impose a more onerous requirement of recognition of a foreign insolvency proceeding tha the UNCITRAL Model Law on Cross – Border Insolvency. The Model Law would require recognition of a foreign insolvency proceeding whether or not the foreign law asserts an universal approach in transnational insolvency cases. Under the Model Law, a foreign main proceeding shall be recognized if the debtor maintains the center of his business in that country. The Model Law does not impose other substantive requirements for recognition, although it would require a foreign representative to provide certain documents to apply for recognition, such as certified copies of the

[207] The U.S. universality approach can be found in 11 U.S.C. 541 (a).
[208] See Gottwald/Riedel: *WIRKUNGSERSTRECKUNG EINES INLAENDISCHEN INSOLVENZVERFAHRENS IM AUSLAND* [Extent of the domestic effect of a foreign proceeding], 1998 *Internationales Insolvenzrecht, Praxishandbuch Insolvenzrecht,* 13/3, November 1998, at 2.
[209] See Fn. 26, supra.
[210] Section 3 InsO also provides that if the scope of business of the debtor is different from its domicile, or residence (where the debtor's general jurisdiction will be determined) the court has jurisdiction over the insolvency case where the debtor's scope or center of business is located.

underlying decision commencing the case and appointing that individual as representative.

A foreign proceeding and its legal consequences must accord with the German ordre public. Legal consequences contrary to essential civil or constitutional rights are not enforceable.[211] This standard for recognition of foreign judgments is consistent with the UNCITRAL Model Law,[212] as well as Article 26 of the proposed European Regulation on cross-border insolvency.[213] The Model Law provides a public policy exception. A court may refuse to take any action if such action would be contrary to the public policy of the enacting State.[214]

This requirement is narrowly construed under German law. Despite a different regulation in Germany, the *Bundesgerichtshof* found no violation in a Swedish legal provision giving the estate legal capacity.[215] As discussed in part II.C, supra, the commencement of a case in Germany does not create a new legal entity. In another decision, the *Bundesgerichtshof* held that a Norwegian legal provision granting a minimum quota of 25 percent of the principal amount for creditors to be crammed down in reorganization cases does not violate "ordre public".[216] By contrast, the former *Vergleichsordnung*[217] had required 35 percent to be recognized by the bankruptcy court.

Section 102 I of the Introductory Act[218] does not require a mutual recognition of insolvency proceedings. Thus, Germany will recognize a foreign insolvency proceeding regardless of whether the enacting State recognizes the German insolvency proceeding, so long as the foreign insolvency proceeding complies with the other requirements of that section.

[211] See Sec. 102 I (2) EGInsO, Fn. 26, supra.
[212] See Article 15 to 24 of the Model Law, Fn. 4, supra.
[213] See European Union Regulation on Insolvency Proceedings, opened for signature Nov. 23, 1995, 17 ZIP 976, 35 I.L.M. 1223 (1996).
[214] See Model Law Article 6, Fn. 4, supra.
[215] 1997 NJW 658.
[216] 1997 NJW 527.
[217] See Fn. 10, supra.

The Model Law permits a recognition proceeding.[219] Some foreign jurisdictions require a special proceeding for recognition of a foreign insolvency proceeding to give them legal effect. Switzerland, for example, provides an extra decision by the appropriate court to recognize the case as to be commenced.[220] In Germany, no such special proceeding exists.

As a general rule, Germany's recognition of a foreign insolvency proceeding also entails recognition of its substantive and formal legal effects or consequences.[221] The recognition includes foreign requirements relating to: the commencement of an insolvency proceeding, the powers of the foreign administrator, and the distribution of the assets of the debtor or the estate. The recognition is not limited to the legal consequences of the commencement of the case, but also includes the results after closing such case.[222]

There are exceptions to the general rule of recognition. Such exceptions are governed by certain legal effects concerning single legal relationships. This is not necessarily a German approach. Almost every jurisdiction where universality is claimed has exceptions from a general recognition. They are the reason for all the efforts taken to harmonize international insolvency laws once an international issue arises.[223]

The following decisions summarize the German approach in solving such issues.

[218] See Fn. 26, supra.
[219] See Model Law Article 11, Fn 4, supra.
[220] See: Article 166 International Privacy Law Act of Switzerland.
[221] See Ebenroth: *Muenchner Kommentar zum BGB* [Munich Commentary to the BGB], , EGBGB Art. 10, Rndnr. 357.
[222] See Gottwald/Riedel, Fn. 207, supra, at 5.
[223] For example, the UNCITRAL Model Law, Fn. 4, supra, or the European Regulation, Fn. 212, supra; See also "Cross-Border Insolvency Concordat", adopted by the Council of the Section on Business Law of the International Bar Association, in Paris, France, on September 17, 1995, and adopted by the Council of the International Bar Association, Madrid, Spain, May 31, 1996.

b) The Power of the Foreign Administrator to Represent

As long as the German assets are not bound in a secondary insolvency proceeding in Germany, the foreign administrator has the power to represent the estate of the debtor. The administrator may, for example, sell, buy, and abandon property of the estate, or lease, or rent property from others. He has the right to sue and be sued, to collect and/or forfeit property[224], to press claims of creditors against the objection of the debtor, to assert objections against claims of the creditor's[225], and to perfect judicial liens in the land Register.[226]

In general, this is in compliance with the Model Law. The Model provides that a foreign representative is entitled to apply directly to a court of the enacting State.[227] The article is limited to expressing the principle of direct access by the foreign representative from having to meet formal requirements such as a license or consular actions.[228]

c) Stay Upon Commencement of an Insolvency Case

Under German law, the commencement of a foreign insolvency proceeding operates as an automatic stay if so provided under the foreign insolvency law. If so, any act to enforce a judgment against the debtor or its property, to obtain possession of property of the debtor, or to create, perfect or enforce any liens against the property is invalid.[229] In addition, the perfection of any involuntary

[224] LG Krefeld, 1992 NJW-RR 1535.
[225] See: Hess/Kropshofer: *Kommentar zur Konkursordnung* [Commentary of the Bankruptcy Code], Sec. 237 Rndnr. 16.
[226] OLG Zweibruecken, 1990 NJW 648.
[227] See Model Law, Article 9, Fn. 4, supra.
[228] See: Guide to Enactment of the UNCITRAL Model Law on Cross-Border Insolvency, U.N.C.I.TRA.L. Comm., 30th Sess., U.N. Doc. A/52/17, paras. 176-178, 1997.
[229] See Sec. 89 I InsO, Fn. 5, supra.

lien against the property of the debtor within one month before filing the petition, or after that date, is invalid and is subject to avoidance.[230]

The commencement of a foreign insolvency case operates as stay upon any civil action[231] in Germany.[232] In reaching this conclusion, the *Bundesgerichtshof* reversed its own prior decision[233] and held that the lex fori concursus should apply. But the court did not determine the legal effects of such stay,[234] for example, the requirements for commencement or continuation of a proceeding.

The application of the rule upon commencement of a foreign proceeding is a major shift toward universality. The *Bundesgerichtshof* decided in 1985 that the commencement of a foreign proceeding did not prevent any creditor (even a foreign creditor) from foreclosing against assets of the debtor located in Germany.[235]

This rule complies with the Model Law. The Model Law provides that upon recognition of a foreign proceeding as a main proceeding, the commencement or continuation of individual actions or individual proceedings concerning the debtor's assets, rights, obligations or liabilities is stayed.[236]

[230] Id. Sec. 88. Anyway, the legal provision of a stay in Germany upon commencement of an insolvency case is not limited to Section 88 or 89 InsO. There are more statutory provisions effecting single relationships in case of insolvency. Most important: Section 240 ZPO (Civil Procedure Law), which operates as a general stay as to pending civil actions, or the commencement of new actions; exceptions apply.
[231] BGH, 1988 NJW 3096.
[232] BGH, 1995 BGHZ 256; BGH, 1997 RIW 508.
[233] BGH, 1988 NJW 3096.
[234] See Gottwald/Riedel, supra, Fn. 207, at 8; Also Article 15 European Regulation provides that legal consequences arising out of a stay are determined by the law of the jurisdiction where such proceeding is pending, Fn. 212, supra.
[235] See Fn. 195, supra; Sec. 237 I *Konkursordnung*, Fn. 9, supra.
[236] See Model Law, Fn. 4, supra, article 20 I (a).

d) Avoidance Power of the Administrator and Set Off

Under Article 102 II Introductory Act to the Insolvency Act[237], the foreign administrator can avoid transactions of the debtor only if such transaction may also be avoided, or are invalid for another reason, under German law, such as the German insolvency law or statute of frauds.[238] The foreign administrator therefor has the same avoidance powers that a German administrator would have in the same position and situation, provided such transfer would also have been avoidable under that foreign law.

As a general rule, transactions made within a certain period of time before the filing of the petition are subject to the administrator's avoidance power if such transaction disadvantages the creditors.[239] Under German insolvency law, as of the commencement of the case, the debtor's assets and also the debtor's future income are subject to insolvency regulations. Therefore, the foreign administrator may invalidate not only the debtor's transfers of property or interest in property incurred as of the commencement of the case, but also dispositions of the debtor's future income.[240]

The Model Law provides for other types of relief that are not automatically in effect but may be granted by the court.[241] In its application of the rule that a foreign administrator has the same avoidance power than its domestic administrators, the German law is in compliance with the Model Law.

German courts hold that foreign law (lex fori concursus) determines whether a claim of the creditor can be set off against counterclaims of the debtor.[242] If the claim of the debtor or the estate and the counterclaim are governed by the laws of

[237] See Fn. 26, supra.
[238] A similar regulation can be found in Article 13 European Regulation, Fn.212, supra.
[239] The avoidance power of the administrator is discussed in detail in Part II.C.(e).
[240] See Sec. 81 II InsO, Fn. 5, supra.
[241] See Model Law Article 19, Fn. 4, supra.

two different states, and if set off is allowed by the law governing the claim of the estate against the creditor, than the insolvency proceeding does not affect the right of set off.[243] Legal consequences arising out of a set off are determined by the law of the jurisdiction the claim occurs.[244] Set off under the German Insolvency Act is discussed in part II.C.(f).

Claims in a foreign currency may be set off as long as they are freely convertible in both places, where the claim and the counterclaim occur regardless who owns the claim or counterclaims, the creditor or the debtor. The value of the convertible claim is determined as of the day and the place the set off declaration is received.[245]

The Model does not expressly provide for a set-off. The working group on insolvency law of the UNCITRAL reported to the General Assembly of the United Nations of its Session on January 6, 2000, that there are many different views concerning that issue: On the one hand, set-off should be recognized as a general principle despite the fact that set-off is not always permitted under national law; On the other hand, permitting set-off would be an exception to the equitable treatment of creditors.[246]

e) Executory Contracts

Under the German insolvency law, executory contracts (labor contracts, leases, etc.) are not governed by lex fori concursus. The applicable contract law determines any legal consequences arising out of such contracts.[247]

[242] BGH, 1985 NJW 2897.
[243] See Manfred Balz: The European Convention on Insolvency Proceedings, 70 Am. Bankr. L.J. 485, 510.
[244] See Gottwald/Riedel, Fn. 207, supra, at 8; The same regulation applies under Article 4 (2)(d) European Regulation, Fn. 212, supra.
[245] See Sec. 95 II InsO, Fn. 5, supra.
[246] See: UNCITRAL, Report of the working group on insolvency law on the work of its twenty-second session, U.N. Doc. A/CN.9/469 (2000), par. 54.
[247] See Geimer, IZPR, 2. Auflage, Rdnr. 3545, as to Leases; see also Article 10 European Regulation, Fn. 212, supra.

As discussed in part II.C (c) supra, claims arising out of executory contracts, such as labor or utility contracts and unexpired leases, still have priority in distribution, but only to the extent the administrator chooses to perform.[248] If the administrator does not choose to perform, the other party may have a claim for breach of contract. In general, such a claim is unsecured. By contrast, if the administrator chooses to perform, claims arising out of it are liabilities of the estate and they have priority over other claims. [249]

The Model Law does not provide for a specific regulation how to treat contracts. Under the Model Law, the court must be satisfied in granting relief that the interests of the creditors and "other interested persons" are protected.[250] The UNCITRAL working group on insolvency law reported to the General Assembly of the United Nations that there is a widely expressed view among the representatives of the nations that the power to continue or terminate contracts is essential to both liquidation and rehabilitation proceedings. The choice between continuation and termination of a particular contract would be dependent upon which course of action is most profitable for the creditors.[251]

As discussed in part II.B and C, supra, the German interim administrator in a preliminary proceeding and the administrator after the commencement of the case may be liable if they make a wrong decision in their choice to terminate or continue an executory contract. The rationale of this rule is to provide the creditors with a maximum satisfaction of their claims. In other words, the course of action of the administrator shall be most profitable to the creditors. It shows that the German Insolvency Act complies with the widely expressed views and opinions of the participating nations.

[248] See Sec. 103 II InsO, Fn. 5, supra.
[249] Id.
[250] See article 22 I of the Model Law, Fn. 4, supra.

f) Secured Claims

German courts do not apply lex fori concursus as to claims of foreclosing secured credit, such as liens or chattel mortgages. The legal consequences are too different between jurisdictions. Commentators disagree as to what law should govern such secured claims given to foreign creditors by the foreign debtor concerning assets located in Germany.[252]

For example, consider an Italian debtor who grants a chattel mortgage on his movable assets located in Germany and becomes later insolvent. If lex fori concursus would apply, the Italian administrator could avoid such mortgage because the Italian insolvency law does not recognize credit securing tools like a chattel mortgage. The legal effect would be that, despite such chattel mortgage given on any chattel located in Germany, which is legal and accepted in Germany, an Italian administrator could retrieve or collect all the assets to the estate. This is reason enough to deny recognition of a foreign law governing secured credit.[253]

The Model Law does not provide for a specific regulation of treatment of secured creditors, but courts should be satisfied that the interests of the creditors and other interested persons are adequately protected.[254] The UNCITRAL working group on insolvency law reported that different considerations as to the effect of the commencement of the case apply depending on the type of the proceeding: liquidation or rehabilitation. For further consideration, it would be necessary to include secured creditors in any stay on rights of enforcement of their claims.[255]

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[251] See: UNCITRAL, Report of the working group on insolvency law on the work of its twenty-second session, U.N. Doc. A/CN.9/469 (2000), par. 52.
[252] See Pruetting: *Aktuelle Entwicklung des Internationalen Insolvenzrechts* [Actual Developments of International Insolvency Law], 1996 ZIP 1277.
[253] See Gottwald/Riedel, Fn. 207, supra, at 8; Also the European Regulation in Article 5 provides that security rights on tangible or intangible personal, or real property, located outside of the jurisdiction where a case is commenced are not interfered.
[254] See Model Law, article 22 (1), Fn. 4, supra.
[255] See: UNCITRAL, Report of the working group on insolvency law on the work of its twenty-second session, U.N. Doc. A/CN.9/469 (2000), par. 57.

The new German insolvency law provides a stay of enforcement of judgments, as well as the creation, perfection, or enforcement of liens against property, until the end of the proceeding, or unless lifted by the bankruptcy court.[256] In addition, any perfection of a lien against property of the debtor within one month before filing the petition becomes invalid as soon as the case is commenced.[257] As discussed in part II.A, the legislative intent was to provide more equitable treatment of the creditors and a chance of reorganization of the debtor. This approach is in compliance with the intent of the UNCITRAL Model Law as reported.

g) Reorganization Plans and Discharge

German jurisdiction recognizes foreign reorganization plans, including a cram down.[258] The applicable foreign reorganization plan must comply with such foreign law.

As already discussed in part II.C.(h), the new German Insolvency Act introduced new regulations on dischargeability. An individual may be granted a discharge provided the debtor act in good faith. The *Bundesgerichtshof* has found that a foreign discharge applies against the assets of the debtor located in Germany.[259] A lower German court has held that a foreign discharge will be enforced in Germany only if the German creditors were able to participate in the foreign insolvency proceeding in which the discharge was granted. [260] The *Bundesgerichtshof* has not disturbed the lower court's ruling.[261]

[256] InsO Sec. 89 (1), (2).
[257] Id. Sec. 88.
[258] BGH, 1997 NJW 526; LG Aachen, 1987 NJW-RR 503.
[259] BGH, 1993 NJW 2312.
[260] OLG Frankfurt/Main, 1996 InVo 39.
[261] See Gottwald/Riedel, Fn. 207, supra, at 11.

The Model Law does not expressly provide for such a relief, but German courts can grant any additional relief that may be available to them under German law.[262] The cram down as well as a discharge are discussed in part II.D(d) and (e). The Insolvency Act provides that an insolvency plan may "cram down" on certain classes of dissenting creditors.[263] In addition, the debtor is discharged from all known claims to the extent such claims are not considered in a confirmed insolvency plan.[264] Therefore both, the cram down and the discharge are relief that may be granted after recognition of a foreign proceeding.

In this case, the same applies as to secured creditors and parties of executory contracts. It means that the German Insolvency Act is in compliance with the opinions and views of the UNCITRAL working group because there is a preference as to rehabilitation of debtors in appropriate cases. Within a rehabilitation proceeding, a discharge should be recognized and foreign creditors should have an equal opportunity to participate in such cases.[265]

h) Secondary Proceeding

Under German law, if an insolvency case is commenced in Germany (a secondary proceeding) after the commencement of a foreign main proceeding, such foreign main proceeding will not be recognized as to assets of the debtor located in Germany.[266] But the German secondary proceeding is limited to assets located in Germany.[267] The requirements for commencing a secondary proceeding in Germany are the same as in regular insolvency cases. That means that in a preliminary proceeding will be determined whether or not there are enough assets

[262] See Model Law Article 21.1(g), Fn. 4, supra.
[263] See InsO Sec. 245 I, Fn. 5, supra.
[264] Id. Sec. 227 I.
[265] See: UNCITRAL, Report of the working group on insolvency law on the work of its twenty-second session, U.N. Doc. A/CN.9/469 (2000), paras. 59, 61.
[266] See Gottwald/Riedel, Fn. 207, supra, at 3.
[267] See Sec. 102 III EGInsO, Fn. 26.

to cover the costs of a proceeding.[268] If the commencement of a foreign proceeding against the debtor can be alleged, no further evidence, such as proof of an inability to pay debts or balance sheet tests, is necessary. The allegation must accompany prima facie evidence, such as an officially translated commencing order of the foreign court. But, the German insolvency court may require more evidence depending on the circumstances. For example, if the German insolvency court has doubts about the legal capacity or the existence of a debtor, certified copies may be required. The German insolvency court where the assets are located has jurisdiction over the case. But, as discussed supra, the court will only commence secondary proceeding if there are sufficient assets to cover the cost of such proceeding.[269]

The Model Law provides that the recognition of a foreign proceeding does not affect the right to request the commencement of a proceeding in the enacting State.[270] There are no further requirements as to the quality or nature of the debtor's assets similar to the European Regulation's requirement that the debtor has an establishment in the enacting State.[271] To commence a secondary proceeding in Germany, it does not matter whether the assets are in connection with "economic activities carried out with human means and goods" or not. Assuming the debtor does not "carry out economic activities with human means and goods", but has other assets eligible to cover the cost of an insolvency proceeding, such case will be commenced. Thus, the German rule that a secondary proceeding can be commenced in Germany so long as the there are assets in Germany is consistent with the Model Law.[272]

[268] The requirements to commence a case are discussed in detail in part II.B, supra.
[269] See Sec. 26 I InsO, Fn. 5, supra.
[270] See Article 20.4 Model Law, Fn. 4, supra.
[271] The old law required to commence a secondary proceeding that the debtor owns, or runs by lease a certain kind of business, or a business branch in Germany. See former *Konkursordnung*, Sec. 238 II, Fn. 9, supra.

D German Main Proceeding

The new German insolvency law claims universality as to all assets of the debtor. Section 35 of the Insolvency Act translates as follows:

"All assets of the debtor as of the commencement of the case, or acquired thereafter, and wherever located, are subject to the insolvency proceeding."

The Insolvency Act claims universality even as to assets of the debtor located in a foreign jurisdiction.[273] It makes this claim regardless of whether and to what extent a foreign jurisdiction recognizes such German approach.

Moreover, the claim that the German insolvency proceeding has universal effect as to all assets of the debtor, wherever located, also implies the claim that the legal consequences arising out of a German insolvency case should be recognized by the foreign jurisdiction.

a) Claim to Operate as Stay

As discussed in Part II.C (a) of this article, the commencement of case in Germany operates as a stay. The problem is that there is time-consuming preliminary proceeding to decide whether the debtor is insolvent or not and whether there are enough assets to cover the costs of such a proceeding.

There is a distinction between the function of such stay during the preliminary proceeding and after the case is commenced. In the preliminary proceeding, the court may order a stay upon the perfection of liens, the enforcement of judgment,

[272] By contrast, Article 3 II of the European Regulation provides that the debtor must have an establishment to commence a secondary proceeding. The regulation defines "establishment" very broadly as any "place of operations where the debtor carries out a non-transitory economic activity with human means and goods".
[273] BGH, 1983 ZIP 761.

or other acts to collect claims against the property of the debtor.[274] If there is no such order, the interim administrator appointed by the court to act in a preliminary proceeding must generally file a petition with the insolvency court to prevent acts by third persons (foreign creditors) directed to impact the debtor's assets abroad.[275]

Once the case is commenced, such stay operates automatically[276] to the extent of any assets of the debtor wherever located, in Germany or in a foreign jurisdiction.[277]

Assuming a foreign jurisdiction does not recognize the German provision as to a stay, and a creditor subject to the German jurisdiction successfully realizes his claim by foreclosing assets abroad, everything earned must be surrendered to the administrator.[278] Therefore, the German administrator may collect from such creditor any amount received.

If, after the commencement of the case, a creditor subject to the German jurisdiction successfully perfects a judicial lien against property of the debtor or the estate located outside the German jurisdiction, such perfection is void. Such creditor cannot now claim to be a secured creditor.[279]

These hypothetical situations illustrate the need for implementation of international rules of mutual recognition. Assuming the foreign country has implemented the Model Law, a German administrator could apply directly to a court of that state for recognition of the German proceeding,[280] and at the same time ask for relief because such relief is urgently needed to protect the assets of

[274] See Sec. 21 II (3) InsO, Fn. 5, supra.
[275] See Part II.B, supra.
[276] See Sec. 89 InsO, Fn. 5, supra.
[277] Id. Sec. 35.
[278] BGH, 1983 NJW 2147.
[279] See Gottwald/Riedel, Fn 207, at 2.
[280] See Model Law Article 9, Fn. 4, supra.

the debtor or the interests of the creditors.[281] A stay of execution against the debtor's assets would be appropriate relief.

b) Claim to have Power to Avoid Foreign Transactions

Whether and to what extent a German administrator may avoid a transaction in a foreign jurisdiction is controversial in the literature.

The *Bundesgerichtshof* held that it is permissible for a foreign representative to rely on German avoidance law as long as application of German avoidance law does not interfere with foreign interests.[282] The court had to decide whether to apply foreign avoidance law in a case the underlying transaction was subject to that foreign jurisdiction. But, since no foreign creditors were involved or foreign interests contravened, the *Bundesgerichtshof* applied the German provisions.

The Model Law provides that, upon recognition of a foreign proceeding that is a main proceeding, the right to transfer, encumber, or otherwise dispose of any assets of the debtor is suspended.[283] In the event that the foreign proceeding is not a main rpoceeding, the same rule applies, but the foreign court must be satisfied that, under the law of the enacting State, such relief relates to assets that should be administered in the foreign non-main proceeding.[284] Neither provision relates to a period of time prior to the application. Therefore, the power to avoid may depend on the following requirements: First, the power to avoid must be available under the law of the enacting State;[285] Secondly, the applying administrator must show that the avoidance of a special transfer is necessary to protect the interests of all of the creditors;[286] And third, the court in the enacting State must be satisfied that the

[281] Id. Article 19.1(a).
[282] BGH, 1993 IPRax 87.
[283] See Article 20.1 (c) Model Law, Fn. 4, supra.
[284] Id. Article 21.3.
[285] Id. Article 21.1 (g).
[286] Id. Article 21.1.

power to avoid the transfer relates to assets that should be administered in the foreign proceeding.[287]

c) Claim to Accept German Legal Consequences

Recognition of a German main proceeding by foreign jurisdictions is the most important pre-requisite to discuss legal consequences arising out of such insolvency case with effect in a foreign jurisdiction.[288] This goes to every possible legal consequence like the effect of a stay, or the power of an administrator to avoid.

Domestic regulations about recognition of a foreign main proceeding vary from jurisdiction to jurisdiction. On the one hand, foreign insolvency cases are without further special procedures recognized (for example: Belgium). [289] Others require a special recognition procedure (for example: Italy).[290] Finally, countries with a strict territorial approach will not at all recognize such foreign insolvency proceeding.

In most countries the commencement of a foreign main proceeding will be no bar to the commencement of a secondary proceeding. In such a case, the German main proceeding will not extend its legal effects to the assets subject to a secondary proceeding. The same rule applies if a secondary proceeding is commenced in Germany.[291]

[287] Id. Article 21.3.
[288] See Gottwald/Riedel, Fn. 207, supra, at 2.
[289] Id., at 3.
[290] Id.
[291] Id.

IV. Conclusion

The German Insolvency Act meets the need of a modern insolvency law. It provides fair and equitable treatment for all creditors, enables the reorganization the debtor's business where appropriate, and gives the debtor a chance for a fresh start. Creditor's interests find fair and equitable treatment with the provisions of the new Insolvency Act that abrogate most priorities and that enable creditors to vote on an insolvency plan. Reorganization of viable businesses is now encouraged under the new Insolvency Act, which permits implementation of an insolvency plan. The provisions about the discharge for individuals in a special proceeding or under an insolvency plan give the debtor a chance to start a new financial life without the fear of oppression.

Transnational insolvency issues are likely to appear increasingly in today's world of international mergers and acquisitions. These issues should be solved by a set of internationally recognized rules and standards. The UNCITRAL Model Law on Cross-Border Insolvency provides minimum standards of mutual recognition of foreign insolvency proceedings, applications of foreign representatives, and cooperation among insolvency courts. On the other hand, the Model Law provides in article six a public policy exception that is sufficient to abstain from application of rules manifestly contrary to the policy of the enacting State.

Germany's universal approach in solving transnational insolvency cases does not conflict with the Model Law. But, German law does not fully implement all of the provisions of the Model Law. For example, provisions governing a recognition procedure for applying foreign representatives and authorizing a German administrator to act in a foreign State are missing. In addition, rules for cooperation and direct communication between courts would bring more legal certainty. Such missing rules may lead to an unequal treatment of, and acts detrimental to, creditors inside and outside of the German jurisdiction. Therefore,

Germany should enact regulations to fully implement the UNCITRAL Model Law on Cross-Border Insolvency.[292] In accordance with the objectives of the Model Law, an implementation will bring greater legal certainty for trade and investment, facilitate the rescue of financially troubled businesses, and thereby protect such investments and preserve employment. [293]

[292] The United States will probably be one of the first States enacting the UNCITRAL Model Law on Cross-border Insolvencies into domestic law. An appropriate bill (see 106th CONGRESS, 1st Session H.R. 833) to implement the Model Law as chapter 15 in title 11 U.S.C. is discussed, and in most part already agreed on.

[293] Of course, once the European Regulation of insolvency proceedings becomes effective, it will bring general relief to member States. But Germany has very strong trade relations and transnational business with countries that are not member of the European Union.