Insolvency Darwinism - Forum Shopping Activities from Germany to England as an Example of a Driver of Insolvency Law Perfection

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PhD

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Thesis Submission Statement

I, Heike Luecke confirm that the work presented in this thesis is my own. Where information has been derived from other sources, I confirm that this has been indicated in the thesis.

Signed:

Heike Luecke

Abstract

The practice of German companies to indulge in forum shopping in England to achieve beneficial treatment under English insolvency proceedings has encouraged the German Government to make significant changes to German insolvency laws by introducing new legislation in the form of the *Law for the Further Facilitation of the Rehabilitation of Companies* ("Gesetz zur weiteren Erleichterung der Sanierung von Unternehmen" "ESUG"[1]). The Act states that the impetus for the reform was the move of German companies to England which started a general discussion of "Germany, as a restructuring jurisdiction" ("Sanierungsstandort Deutschland"). Such forum shopping activities increased the awareness of the perceived weaknesses of the German system.

This research looks at forum shopping from a Darwinian perspective. Germany and England as Member States of the European Union[2] compete with each other as movement of capital to another Member State has a negative effect on the country's economy. A reputation as a "bad restructuring jurisdiction" has an impact on the choice of business location and could act as a disincentive to company incorporations in Germany. Freedom of establishment allows companies to choose a regime which fulfils their needs, the Member States have to be motivated to attract companies and be willing to adapt to changes to keep up with business demands. In particular it should be borne in mind that forum shopping is not a one-dimensional activity and in itself constitutes an element of investment. The quality of a country's legal restructuring framework has an impact on a company's choice of business location in the first place and its willingness to invest and hence to attract debt financing.

Taking the example of Germany and England, it is argued that forum shopping activities foster the development, improvement, reform and revision of existing laws. This thesis argues that Insolvency Darwinism results in a global

[1] Gesetz zur weiteren Erleichterung der Sanierung von Unternehmen (ESUG) – BGBl I 2011, 2583.
[2] Hereafter "EU"

alignment and convergence of insolvency systems so that the jurisdictions within the EU imitate each other with their rescue-friendliness. This competition for the "best insolvency regime" results in a more perfect insolvency landscape. The alignment with more rescue-friendly insolvency regimes is preferred to avoid unwanted forum shopping activities, whereas a "fettered Darwinian approach" of partially imitating another system will fail to deliver the desired result.

This thesis critically examines whether Germany has achieved its aim of establishing a "culture of second chance" in changing the Insolvency Code ("Insolvenzordnung")[3] introduced by the ESUG. Chapter one serves to explain why forum shopping functions as a driver of insolvency law perfection, using a "Darwinian approach" and Darwin's core thesis of "natural selection" to explain the competition of jurisdictions in insolvency law. Chapters two and three give an overview of the developments of the rescue culture in Germany and England. Chapters four to eight compare and contrast the different key areas in Germany and England, examining the situation in Germany before and after the introduction of the ESUG. Specific focus is put on the question of whether the changes introduced by the ESUG were driven by forum shopping activities and whether these changes led in fact to a *more "perfect"*[4] insolvency regime, in the sense as examined in chapter one. Chapter nine is dedicated to the conclusion.

[3] Hereafter "InsO"
[4] Author's emphasis, see definition in introduction 0.5.2.

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Table of Contents

Contents

List of Abbreviations

BAK	Bundesarbeitskreis Insolvenzgerichte ("Federal Working Group Insolvency Courts")
BGH	Bundesgerichtshof ("German Federal Supreme Court")
BT-Drs.	Bundestagsdrucksache (printed matter of the German parliament)
BRAO	Bundesrechtsanwaltsordnung ("Lawyers Professional Standards")
BR-Drs.	Bundesratsdrucksache (printed matter of the Federal Council)
COMI	Centre of Main Interest
CVA	Company Voluntary Arrangement
DAV	Deutscher Anwaltsverein ("German Lawyer Association")
DES	Debt-to-equity swap
DIP	Debtor-in-possession
DNV	Deutscher Notarverein ("German Association of Notaries")
DRB	Deutscher Richterbund ("German Association of Judges")
EA	Enterprise Act
ESUG	Gesetz zur weiteren Erleichterung der Sanierung von Unternehmen ("Law for the Further Facilitation of the Rehabilitation of Companies")
EU	European Union
GG	Grundgesetz ("German Constitution")
IA	Insolvency Act
InsO	Insolvenzordnung ("Insolvency Code")
IOH	Insolvency Office Holder
IP	Insolvency Practitioner
KO	Konkursordnung ("German Bankruptcy Act 1877")
MoMIG	Gesetz zur Modernisierung des GmbH-Rechts und zur Bekaempfung von Missbraeuchen ("Act for the Modernisation of Limited Liability Company Law and Prevention of its Misuse")
OFT	Office of Fair Trading
RPB	Recognised Professional Body
SchvG	Gesetz zur Neuregelung der Rechtsverhaeltnisse bei Schuldverschreibungen aus Gesamtemissionen und zur verbesserten Durchsetzbarkeit von Anspruechen von Anlegern aus Falschberatung "Schuldverschreibungsgesetz" ("Bond Act")

SoA	Schemes of Arrangement
TFEU	Treaty on the Functioning of the EU
VglO	Vergleichsordnung ("Rules of Conciliation 1934")
VID	Vereinigung Insolvenzverwalter Deutschlands ("Association of Insolvency Practitioners in Germany")

List of Figures

Introduction

"Improvement of restructuring opportunities of companies is an essential feature of an insolvency culture"-

"Verbesserung der Sanierungschancen von Unternehmen als Wesensmerkmal einer Insolvenzkultur"[5]

0.1. Aim of the Research

The aim of this research is to critically examine whether Germany has in fact established a culture of second chance with the introduction of the changes by the ESUG. [6] It is argued that forum shopping activities promote the development and improvement of present laws and that forum shopping fosters perfection[7] within the existing insolvency regime. The movement of German companies to England intensified the need for changes and the German Government had to react with reforms to stop the perception of Germany being a 'bad restructuring jurisdiction'. A "Darwinian approach" is chosen, using an analogy for jurisdictions inside the EU to living creatures, competing with each other for the "best insolvency regime" to attract capital and avoid a movement of capital to other Member States causing a negative impact on the country's economy.

0.2. Idea for the Research

0.2.1. Starting Point

Rescuing companies in financial distress as an alternative to company winding up is not a new model, however, due to the complexity and increasingly high numbers of insolvencies in previous years, methods to rescue companies

[5] Heinz Vallender, 'Insolvenzkultur gestern, heute und morgen' (2010) NZI 2010,838, 839.
[6] Sabine Leutheusser-Schnarrenberger 'Begruessungsansprache der Bundesjustizministerin beim Siebten Deutschen Insolvenzrechtstag' (Berlin 17. March 2010) 1, < http://www.schuldnerhilfe-direkt.de/wp-content/uploads/2011/02/Schnarrenberger.pdf.
[7] "Perfection" is a loaded term which is discussed in the introduction 0.5.2.

have become an ongoing topic necessitating adaption to the changes of time and different policy objectives. The aim is to foster the existing rescue regimes, develop them further to compete within a globalised world, where parties are able to forum shop in their favourite jurisdictions. The challenge is to find a balance between the interests of creditors and debtors alike, stimulating entrepreneurship and risk- taking and at the same time supply expertise and service for companies facing financial difficulties.[8]

The historical saying "Great Britain rules the waves"[9] describes aptly a recent development in Germany.[10] German companies fleeing from Germany to England and Wales[11] to benefit from the apparently more flexible restructuring tools. This is seen as one form of so-called "forum shopping".[12] Furthermore the English Schemes of Arrangement[13] proceeding is used for restructurings by German companies even without them having their centre of main interest (COMI)[14] in England.[15]

0.2.2. Reforms in Germany/ ESUG

These cases of migration to England resulted in continuous discussion within the profession concerned about legal disadvantages for the "Insolvency place Germany" ("Sanierungstandort Deutschland") in comparison to other jurisdictions, and especially England.[16] This led to the initiation of a fundamental reform of insolvency law in Germany in 2009. The result of these reforms was, *inter alia,* the changes to the InsO introduced by the ESUG.[17] The Government decided against a completely new Act and imbedded the

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[8] R3, 'The Value of the Insolvency Industry, A study into the economic significance of the insolvency, recovery and turnaround profession' (2008), 2 <https://www.r3.org.uk/media/documents/policy/policy_papers/insolvency_industry/R3_Value_of_Industry_FINAL_VERSION_01May2013.pdf>

[9] Originally: "Rule Britannia, Britannia rule the waves".

[10] Heinz Vallender 'Gefahren für den Insolvenzstandort Deutschland' (2007) NZI 135, 135.

[11] Hereafter "England"

[12] Recital 4 of the Council Regulation on Insolvency Proceedings defines forum shopping as the occurrence that debtors "transfer assets or judicial proceedings from one Member State to another, seeking to obtain a more favourable legal position" :Council Regulation (EC) no 1346/2000 of 29 May 2000 on insolvency proceedings, [2000] OJ L160/ , hereafter "EIR"

[13] Hereafter SoA

[14] Hereafter "COMI"

[15] Examples are La Seda Barcelona; Tele Columbus Group; Rodenstock GmbH; Metrovacesa and Galleria Media, see Rutstein, M. Roll up! Roll up! Schemes round-up (2011) 4 CRI 125; forum shopping occurs as well in other area of law, for example in family law, finding the "best" jurisdiction with regard to divorce laws.

[16] Heinrich Meyer, Jan-Moritz Degener, 'Debt-to-equity-swap nach dem RegE-ESUG' (2011) BB 846, 846.

[17] More details to the reform process see chapter 2.3.10.

changes into the existing InsO instead. Some key words are used in connection with this fundamental reform: the establishment of a new restructuring/insolvency culture ("Etablierung einer neuen Sanierungs-/ Insolvenzkultur"); paradigm shift ("Paradigmenwechsel") and insolvency as a chance for a "fresh start" (Insolvenz als Chance fuer einen "fresh start").[18] Paulus speaks of the attempt to optimise the restructuring mentality.[19] The ESUG is aimed at improving the framework for a timely restructuring of companies threatened by insolvency[20] by generally fostering the notion of restructuring ("Sanierungsgedanke") and making insolvency procedures more transparent and predictable for the parties involved.[21]

0.3. Original Contribution to Knowledge - Novelty

The original contribution to knowledge of this thesis is the observation of Insolvency Darwinism resulting in a global alignment and convergence of insolvency systems so that the jurisdictions inside the EU imitate each other in their rescue-friendly provisions. The overarching policy aim of rescue makes the alignment with increased rescue-friendliness a more "perfect" insolvency regime. Therefore a race to rescue is seen as a race to the top and not to the bottom as uniformity goes toward more rescue-friendly regimes. The question of forum shopping activities as drivers of insolvency law perfection is of importance as its affirmation would lead to recognition that competition for the "best insolvency regime" results in a more perfect insolvency landscape. Becoming aware of this fact would help the German policy makers to accept and understand that an alignment with more rescue-friendly insolvency regimes is the true path to avoid unwanted forum shopping cases. This thesis argues that half-hearted and culturally fettered attempts towards convergence for more rescue-friendliness can only result in a fettered Darwinian approach,

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[18] Christoph Schulte-Kaubruegger, 'Das ESUG in der Praxis' – Erste Erfahrungen' (2012) 3; <http://www.insolvenzverein.de/archiv/12/ESUG.pdf>3 <http://www.insolvenzverein.de/archiv/12/ESUG.pdf>

[19] Christoph G. Paulus 'Berufsklaeger als Sanierungshemmnis' (2012), 1556, 1556.

[20] Ibid

[21] Sabine Leutheusser-Schnarrenberger 'Begruessungsansprache der Bundesjustizministerin beim Neunten Deutschen Insolvenzrechtstag' (Berlin 22. March 2012) <http://www.bmj.de/SharedDocs/Archiv/DE/Reden/DE/2012/20120322_9_Insolvenzrechtstag.html> (last visited 19.09.2015).

making it very likely that further adaptations will be needed to eliminate forum shopping activities.

0.4. How does the Thesis fit into the Existing Literature - and Further Novel Elements

This thesis examines all relevant changes introduced by the ESUG, coming in addition to the already existing comparative literature. There is no holistic post-ESUG comparative work that has been undertaken. The methodology applied in considering the changes from the perspective of being driven by forum shopping activities leading to a more "perfect" insolvency regime, looked at from a Darwinian perspective represents a novel approach.

A number of articles which critically examine the changes introduced by the ESUG have been published, most of them in the German language from a German perspective. They are individually defective for the reasons now examined. This thesis fills the gaps and takes the existing literature forward.

One such example of a comparative approach is Bork's textbook *Rescuing Companies in England and Germany*[22], which offers a comprehensive comparison of German and English company restructuring laws. Although written with a holistic approach, the book does not focus on the changes introduced by the ESUG and serves to give a general overview of restructuring procedures available in Germany and England instead. This thesis, on the other hand, compares and contrasts different aspects of restructuring laws in the two countries, taking a different approach in making the changes to the InsO the focal point of comparison. It supplements Bork's work as it includes the new laws. It takes Bork's book forward in shifting the focus to the new insolvency landscape.

The overriding aim is not just to generally compare the rescue culture in both countries, but to argue that the changes introduced by the ESUG were driven

[22] Reinhard Bork *Rescuing Companies in England and Germany* (Oxford University 2012); see as well Heike Luecke, 'Publication Review – Rescuing Companies in England and Wales' (2013) Insolv. Int. 93.

by forum shopping activities, consequently leading to a more perfect insolvency landscape in Germany.

Camek's thesis *Das Schutzschirmverfahren nach paragraph 270b InsO und seine Funktionalitaet im internationalen Rechtsvergleich*[23] compares the protective umbrella proceeding with restructuring proceedings in England, France and Italy with the aim of evaluating its competitiveness. Whereas Camek's work puts its focus on the protective umbrella proceeding as one partial aspect of the ESUG, this thesis presents a more holistic overview on the various changes of the ESUG. Camek does not go beyond a description of aspects of the individual restructuring procedures in the aforementioned countries, also staying mainly descriptive in the rather restricted comparative part of his work. Concerning the comparison of the English and German systems, it is most striking that there is an effort to compare the protective umbrella proceeding with actual pre-insolvency proceedings such as the Company Voluntary Arrangement (CVA)[24] and the SoA. This thesis argues in chapter eight that a comparison of the requirements for these proceedings can only give a distorted image as the protective umbrella proceeding as preparatory in nature cannot be compared to the CVA or the SoA as stand-alone pre-insolvency proceedings. Neither does Camek methodologically explain as to what extent the procedures are comparable at all, realising, for example, that a moratorium is not possible in a protective umbrella proceeding due to its solely preliminary nature.[25]

Another work comparing an important aspect of the ESUG with English law is Wolf's thesis *Promoting an Effective Rescue Culture with Debt-to-Equity Swaps?*[26] in which she analyses whether the amendments in regard to the debt-to-equity swaps[27] introduced by the ESUG are now paving the way for a more effective rescue culture in Germany by comparing specific aspects

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[23] Fabian Camek, *Das Schutzschirmverfahren nach paragraph 270b InsO und seine Funktionalitaet im internationalen Rechtsvergleich* (PL Academic Research, Schriften zum Verfahrens Recht, Band 48 Peter Lang Verlag Frankfurt am Main 2014)48.
[24] Hereafter: "CVA"
[25] Camek (n 23) 178.
[26] Annika Wolf, *Promoting an Effective Rescue Culture with Debt-to-Equity Swaps? - A comparative study of restructuring public companies in Germany and England* (Nomos, Schriften zur Restrukturierung Baden – Baden 2015).
[27] Hereafter "DES"

pertaining to Germany and England.[28] This thesis comes to supplement Wolf's work by, firstly, providing a more holistic overview in comparing and contrasting all main changes introduced by the ESUG and, secondly, taking a different approach with the use of forum shopping activities as a starting point to analyse whether the changes have in fact led to a more perfect insolvency regime in Germany.

A similar work in the German language is the thesis published by Hagemann *Debt Equity swaps nach englischem und deutschem Recht unter besonderer Beruecksichtigung des ESUG*.[29] The objective of Hagemann's thesis is to analyse the effectiveness of provisions with regard to DESs, newly introduced by the ESUG.[30] Hagemann's work focuses on one particular change, whereas this thesis acts complementarily in considering the totality of changes and their policy foundations. In contrast to Hagemann's "classical" comparison, this thesis takes a different approach, looking at the changes from a Darwinian perspective. Therefore in the wider context, Hagemann's work is ultimately deficient.

Forum shopping activities considered as the starting point of the thesis are indeed the topic for a whole variety of literature published. In this context, Ringe's *Forum Shopping under the EU Insolvency Regulation*[31] is of note. The argument of forum shopping having a positive effect for companies and creditors alike rather than distorting domestic markets, serves as the first building block for this thesis. The argument is progressed further by the results of this research, not only finding forum shopping in itself a positive phenomenon, but considering the positive results of forum shopping as a race to the top. Ringe simply concentrates on the impact of forum shopping on the EU internal market, whereas this thesis goes further by looking at the broader implications for national jurisdictions and the reaction most likely called for.

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[28] Wolf (n 26).
[29] Sebastian Hagemann, *Debt Equity Swaps nach englischem und deutschem Recht unter besonderer Beruecksichtigung des ESUG* (Schriften zum Insolvenzrecht, Nomos, Band 52 Baden – Baden 2014).
[30] In the following: "DES"
[31] Wolf-Georg Ringe, 'Forum Shopping under the EU Regulation' (2008) Oxford Legal Studies Research Paper No 33/2008 <http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1209822> ,see as well: Wolf-Georg Ringe *Forum Shopping under the EU Regulation in: Current Issues in European Financial and Insolvency Law* (2008) Studies of the Oxford Institute of European and Comparative Law.

The implications on national jurisdictions and their policy as influenced by competitor jurisdictions is critically examined.

Eidenmueller's article *Abuse of Law in European Insolvency Law*[32] attracts the same critique. Eidenmueller examines the concept of abuse of law with respect to the freedom of establishment and the Council Regulation on Insolvency Proceedings[33] by way of forum shopping activities. Similarly to Ringe's article, the article is considered the initial approach for this research topic as it looks exclusively at the issue of forum shopping in respect of consequences for the freedom of establishment and the EIR. This research, on the other hand, uses these arguments as a basis on which to build the findings of forum shopping resulting in a race to the top, a race to rescue at a national level inside the EU.

The articles are complemented by Armour's work *Who Should Make Corporate Law? EC Legislation versus Regulatory Competition*[34], in which he argues that regulatory competition caused by a diversity of different corporate governance models amongst EU Member States would lead to specialisation rather than alignment. Regulatory competition would encourage the legislator to enhance national laws, valuing the overall interests more highly than those of individual parties. This thesis differs to Armour's article, arguing that regulatory competition at EU level will lead to convergence and alignment of insolvency laws, to be regarded a race to the top.[35] This represents a novel approach and perspective. This alignment is most clearly demonstrated by the German jurisdiction imitating English rescuing provisions, albeit in a fettered manner as this thesis demonstrates.

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[32] Horst Eidenmueller, 'Abuse of Law in the Context of European Insolvency Law' (2009) European Company and Financial Law Review 1-28.

[33] EIR (n 12) recast of the EIR, coming into force in 2017: "(4) It is necessary for the proper functioning of the internal market to avoid incentives for the parties to transfer assets or judicial proceedings from one Member State to another, seeking to obtain a more favourable legal position to the detriment of the general body of creditors (forum shopping)."

[34] John Armour, 'Who Should Make Corporate Law? EC Legislation versus Regulatory Competition' (2005) ECGI Working Paper Series in Law, Working Paper No. 54/2005 <http://papers.ssrn.com/sol3/papers.cfm?abstract_id=860444)>.

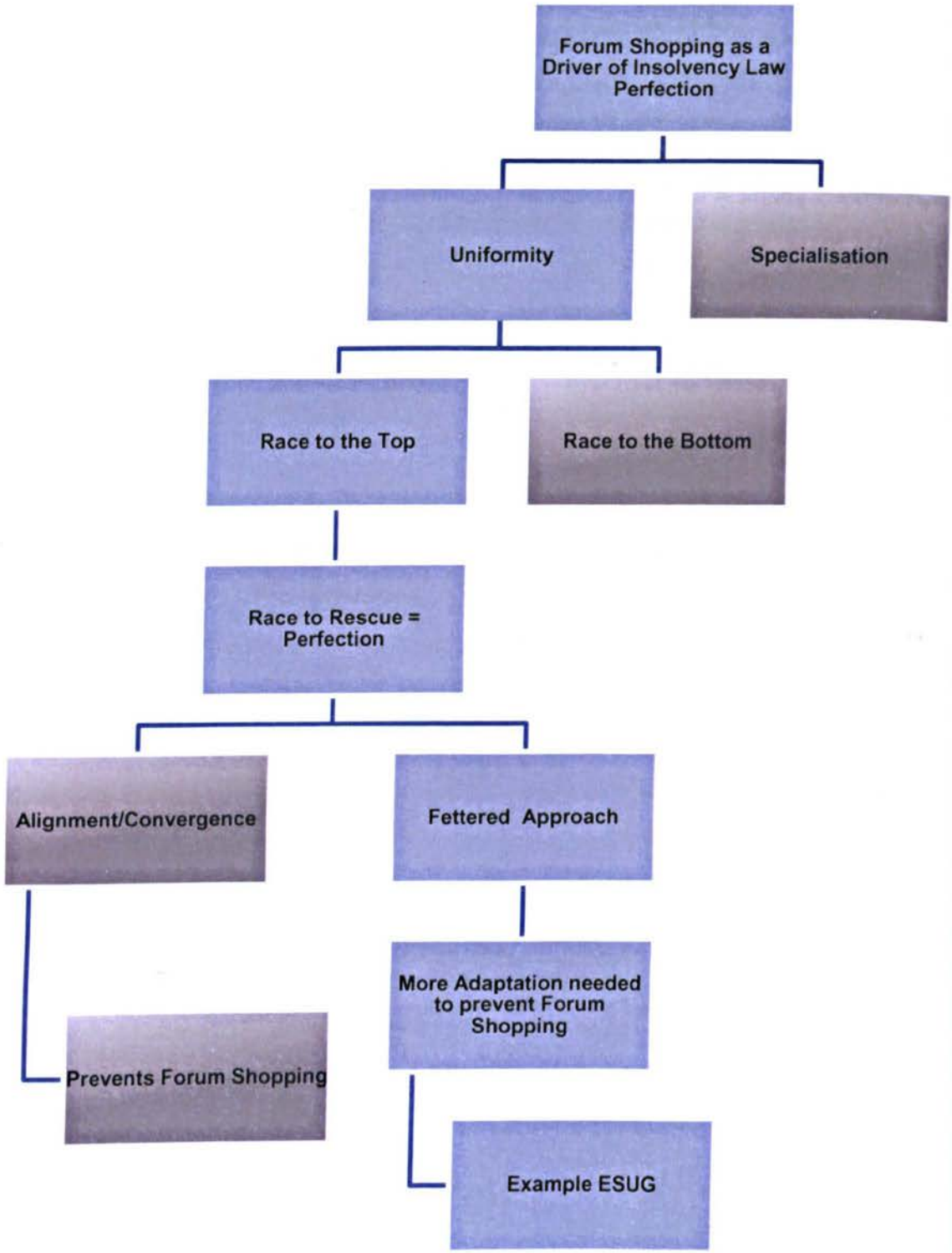
[35] See introduction 0.5.3.

Supplementary to Armour's article, Crawford's *Forum Shopping and the Global Benefits of Soliciting Insolvency*[36] also analyses whether forum shopping results in either a race to the top or a race to the bottom. Crawford argues that under the non-homogeneity of the European market, unlike the US market, forum shopping would not lead to a race to the bottom, as it encourages specialisation. This thesis differs to Crawford's article by arguing that a different approach towards defining "race to the bottom" and "race to the top" is appropriate, a race to the top being defined as a race to more uniformity, leading to a race to more rescue-friendly provisions.

[36] Keith Crawford, 'Forum Shopping and the Global Benefit of Soliciting Insolvency' (2010) <http://www.ntu.ac.uk/PSS/Nottingham%20Law%20School/Publications/99913.pdf> (last visited 15.05.2015).

0.5. Forum Shopping as a Driver of Insolvency Law Perfection

Figure one: Forum Shopping – Stages to Perfection



The core thesis of this research argues that forum shopping can be regarded as a driver of insolvency law perfection. As shown in figure one step two, forum shopping activities result in more uniform insolvency laws amongst the Member States of the EU and not a specialisation of the law. As figure one step three shows uniformity is not seen as a race to the bottom, but a race to the top as the race goes towards more rescue-friendly regimes and not towards highest liquidation returns. The main policy aim of modern policy makers is to establish a rescue culture, therefore a race to rescue is seen as a race to the top, a race to perfection as highlighted in step four of figure one. Step five of figure one shows that if this alignment and convergence is performed courageously it will prevent forum shopping. However, if this alignment and convergence is executed in a fettered way, more adaptation is needed in the future to prevent forum shopping activities as demonstrated by the ESUG example.

Two issues need to be defined to aid analysis. First, the question of why forum shopping is driving insolvency reforms and, secondly, what is meant by insolvency law perfection. The above steps are examined with this treatment in mind.

0.5.1. Forum Shopping as a Driver

It is hypothesised that forum shopping is an unwanted phenomenon for the deserted country due to its negative impact on the economy. The desire to stop unwanted forum shopping generally encourages the deserted jurisdiction to reassess their position in the insolvency sphere and fosters the readiness to amend the system in order to be able to withstand international competition.

Forum shopping cases should under no circumstances be dismissed as isolated or exceptional cases, bearing in mind that roughly 95% of all non-performing loans[37] in Germany rest in the hands of hedge-funds as creditors.[38]

[37] Definition by the IMF: A non-performing loan is a loan "for which it is probable that contractual payments will not be made." https://www.imf.org/external/pubs/ft/bop/2005/05-29.pdf (last visited 14.09.2015).
[38] Roman Paulus, 'Die auslaendische Sanierung ueber einen Debt-Equity-Swap als Angriff auf das deutsche Insolvenzrecht?' (2008) Deutsche Zeitschrift für Wirtschaftsrecht 6, 7.

As these creditors are mainly foreign investors preferring to rely on and refer back to their own tried and tested legal system, it would appear likely that they would want to get away from the more or less unfavourable German insolvency law.[39]

Adopting the paradigms of the benefitting jurisdiction is one way likely to achieve higher competitiveness. Adaptation, not necessarily meaning just copying foreign laws, requires looking at general principles and ideas in the context of one's own country's policy framework and background.[40] Facing "regulatory competition" makes it possible to boost the desired evolution of national laws.[41] Competition is able to "stimulate innovation"[42] which "may lead to a great release of energy and creativity."[43] McCormack speaks of "seeds of ingenuity", which could be used for reproduction if they are seen as valuable.[44] Armour, on the other hand, argues "innovation" and "mutual learning".[45] Facing "regulatory competition"[46] enables boosting the valuable evolution of national laws.[47]

0.5.2. Insolvency Law Perfection

How can "insolvency law perfection" be interpreted? The word "perfection" originates from the Middle English meaning "completeness", also tracing back to the old Latin-based expressions of "perfectio" and "perficere", both meaning "to complete."[48] Perfection can therefore best be defined as "the state or quality of being perfect" or "the action or progress of improving something until it is faultless".[49] "To perfection" can be defined as "to a state that could not be better". Another definition takes perfection as "an instance of excellence "[50] or

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[39] Roman Paulus, 'Die auslaendische Sanierung ueber einen Debt-Equity-Swap als Angriff auf das deutsche Insolvenzrecht?' (2008) Deutsche Zeitschrift für Wirtschaftsrecht 6, 7
[40] See Methodology 0.7.
[41] Armour (n 34) 11.
[42] Armour (n 34) 11.
[43] Gerald McCormack, 'Jurisdictional Competition and Forum Shopping in Insolvency Proceedings' (2009) Cambridge Law Journal 169, 179.
[44] Ibid
[45] Armour (n 34) 11.
[46] Ibid
[47] Ibid
[48] Oxford Dictionary "perfection"; http://www.oxforddictionaries.com/definition/english/perfection (last visited 31.08.2015)
[49] Ibid
[50] http://www.thefreedictionary.com/perfection.

"the highest degree of proficiency, skill, or excellence"[51] or "the highest or most nearly perfect degree of quality or trait."[52] It could be argued that "Perfectionism is black and white with no grey area".[53]

All these definitions are useful, of course, but they will need to be aligned when practically applied to insolvency law and this particular research. Any law will hardly reach a state of perfection in the sense of being considered complete or faultless for all situations and cases. Neither can there ever be a solution equally satisfactory for all parties involved. We need laws to be flexible and adaptable to continuing changes especially when looking at insolvency law involving different variables, such as parties with separate rights or debtors of different industries facing different challenges in an insolvency scenario in the light of an ever changing economic environment.

It is not argued that there is such a thing as the "perfect insolvency law paradigm for all countries"; comparing and contrasting, however, helps to achieve finding some of the best qualities of insolvency law paradigms, particularly under the competitive circumstances relevant to EU Member States. Perfection in a broader sense implies that law makers pursue the optimal paradigm for the given situation, bearing in mind the different environments together with social and historical developments. This in return requires an attitude of being adaptable to changes brought about by the relentlessly moving legal environment; adaptability and willingness to change are fundamental to functioning insolvency law regimes.

The fact that stakeholders with a variety of different interests are involved, makes it obvious that "perfecting" the situation for one participant could bring the opposite for other participants. Enhancing the rights of the debtor, for example, might easily be detrimental for creditors. It is therefore important to exactly define the overall viewpoint with regard to perfection.

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[51] http://dictionary.reference.com/browse/perfection.
[52] Ibid
[53] http://www.excelatlife.com/print/excellence.htm.

0.5.3. Rescue-Friendliness as the Primary Objective

It is argued that the overarching aim of modern insolvency law is to increase the chances for restructuring, in other words, the fostering of a rescue culture.[54] Improvement of restructuring opportunities is an essential feature of a modern insolvency system.[55] The paramount policy drivers both in the US and England for the last 40 years with the emphasis on rescue caused regimes to be more rescue-friendly in looking towards saving companies and businesses as their so called primary objectives.[56] Cork put great stress on the wider implications of a company's failure, stating that "the effects of insolvency are not limited to the private interest of the insolvent and his creditors, but that other interests of society or other groups in society are vitally affected by the insolvency and its outcome, ..."[57] Rescuing a company is not only beneficial for the debtor, but for example for the employees, suppliers and often as well for a whole community, making a race to rescue, the way to a more "perfect" insolvency regime. The convergence and alignment towards more rescue-friendly regimes is therefore to be regarded as a positive outcome of forum shopping activities. Sustainability and not the quick return in the form of high liquidation return rates for the creditors make up the key for a well-functioning and modern insolvency law. Selfish interests of individuals in an insolvency procedure as a collective proceeding should be ruled out in favour of creating a flexible framework to facilitate a "perfect" restructuring with an outcome beneficial for the majority of the stakeholders.

This means that historically jurisdictions as Germany, who were less rescue-friendly have been pushed in policy terms to align their systems with more rescue-friendly regimes. This is important for this thesis because it shows how Insolvency Darwinism leads to a global convergence of insolvency systems so

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[54] This may not be what some jurisdictions select, but as this thesis demonstrates this has been a trend in Europe and the US for over 40 years. See for example Bruce G Carruthers; Terence C. Halliday, *Rescuing Businesses-The Making of Corporate Bankruptcy Law in England and the United States* (Oxford University Press 1998).
[55] Vallender, 'Insolvenzkultur' (n 5), 839, 839.
[56] See on the development of a rescue culture in other countries: Paul Omar, 'Four Models for Rescue: Convergence or divergence in European Insolvency Laws?-Part 1' (2007) I.C.C.L.R 127,127,128; Catherine Bridge 'Insolvency a second chance – why modern insolvency laws seek to promote business rescue' (2013) 04 EBRD Law in transition 28.
[57] Insolvency Law and Practice, 'Report of the Review Committee' (Cmnd 8558 HMSO London 1982) ("Cork Report"), 55.

that the major jurisdictions imitate each other in their rescue-friendliness. Whether or not that is appropriate in terms of policy outcomes is discussed in chapter two and three.

0.5.4. Rescue-Friendliness

So what can be understood by the terms rescue-friendliness or rescue culture? Rescue culture is the "philosophy of reorganising companies so as to restore them to profitable trading and enable them to avoid liquidation";[58] "seeking to preserve viable businesses;[59] in other words being rescue-friendly in their provisions. Rescue can be seen as "a major intervention necessary to avert eventual failure of the company".[60] Hunter states that: "It is a multi-aspect concept, having both a positive and protective role, and a corrective and a punitive role. On one level, it manifests itself by policies, legislative and judicial, directed to the more benevolent treatment of insolvent persons, whether they be individuals or corporations, and at the same time to a more draconian treatment of true economic delinquents. On another level, it consists in the adoption of a general rule for the construction of statutes, which is deliberately inclined towards the giving of a positive, and socially profitable, meaning, rather than a negative and socially destructive meaning, to statutes of socio-economic import. Of such statutes, insolvency legislation may justly be regarded as the paramount example."[61]

0.5.5. Rescue-Friendliness equals Debtor-Friendliness?

Can rescue-friendliness be considered tantamount to debtor-friendliness? In a debtor-friendly regime, the management is not replaced, but it remains in place as "debtor in possession", at the same time offering a stay in the enforcement of creditor rights.[62] The "cram down"-nature[63] of a proceeding could be seen as another quality of a debtor-friendly regime. Features of a

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[58] Roy M. Goode, *Principles of Corporate Insolvency Law* (fourth edition, Sweet & Maxwell London 2005)), 383.
[59] Powdrill v. Watson [1995] 2 A.C. 394, HL, per Lord Browne-Wilkinson at 442A.
[60] Alice, Belcher, *Corporate Rescue* (Sweet & Maxwell London 1997) 12; it is further discussed whether the aim is rescuing the company or rescuing the business, for this purpose rescue is meant in both ways, see Terminology.
[61] Muir Hunter, 'The Nature and Functions of a Rescue Culture' (1999) Journal of Business Law 491, 497.
[62] ibid
[63] See Terminology 0.7.

creditor-friendly regime are the replacement of management by a court-appointed trustee or IOH, not providing an automatic stay[64] or the availability of remedies for the creditors during the course of the proceedings or strong security.[65] A creditor-friendly regime could be a system offering the highest liquidation returns.[66]

There is a tendency of rescue-friendliness at least in part being similar to debtor-friendliness as both focus on restructuring a company and not liquidating it. Debtor-friendly rules encourage debtors to file for insolvency at an early stage, helping to promote restructurings. Rescue-friendliness on the other hand would not automatically imply that creditor-friendly regulations tend to stifle efforts to rescue a business. Creditor-friendly rules, for example in the form of participation rights, serve to encourage creditors to support rescues. Rescue-friendly rules are balancing the rights and obligations of all involved parties. Effective rescue-friendly rules will offer an amount of flexibility to build a solid framework allowing all parties to find a mutually satisfactory solution, rather than being rules-orientated and only focussing on debtor-friendliness. This can be demonstrated by the fact that companies are not moving to France which is known to be debtor-friendly[67], but instead to England, where national insolvency laws seemingly offer a flexible framework including a variety of restructuring tools. This is supported by the purpose of rehabilitation procedures given by the IMF, which is that "The overall economic objective of rehabilitation procedures is to enable a financially distressed enterprise to become a competitive and productive participant in the economy, thereby benefiting not only the stakeholders of the enterprise (owners, creditors, and employees) but also the economy more generally."[68] The IMF highlights that a balance has to be found between incentives for the debtor and the creditor for providing a long-term competitiveness and hence a successful

[64] Sefa Franken, 'Creditor-and debtor-oriented corporate bankruptcy regimes revisited' (2004) European Business Organization Law Review 645, 650.
[65] Ibid
[66] Franken (n 64) 650.
[67] Sergei Davydenko, Julian A. Franks, 'Do Bankruptcy Codes Matter? A Study of Defaults in France, Germany and the UK' (2006) <http://papers.ssrn.com/sol3/papers.cfm?abstract_id=647861>
[68] International Monetary Fund 1999, 'Orderly & Effective Insolvency Procedures' International Monetary Fund 1999, 'Orderly & Effective Insolvency Procedures', 4. Rehabilitation Procedures,<http://www.imf.org/external/pubs/ft/orderly/> (last visited 17.09.2015).

restructuring framework.[69] In other words rescue-friendliness does not only focus on merely debtor-friendly rules, as incentives for the creditors as participants in the proceedings is as important for a successful restructuring as incentivising the debtor to file for insolvency at an early stage.

0.5.6. The Way to Rescue - a Work in Progress

With all this in mind it can still not be argued that England already has the "perfect" insolvency regime; the emergence of a "rescue culture" remains a work in progress.[70] Forum shopping cases however, demonstrate that England seems to offer certain rescue-friendly attributes not equally found in Germany and other jurisdictions. This as yet "imperfect" state of the English regime and other regimes inside the EU could end in a reciprocity in the wider sense that European jurisdictions are developed to become mutual drivers for a more symmetrical and homogenous rescue-friendly insolvency regime, in the long run resulting in a uniform "best" insolvency law with regulations fully adapted to enable sensible rescues. The alignment and convergence driven by various Member States in copying other jurisdictions to become the best in order to survive international competition will therefore result in a race to the top, a race to perfection. The race to perfection must therefore be considered a race to uniformity and harmonisation of insolvency systems. Potentially idealistic, the natural consequence is that in essence, non-rescue- friendly regulations and other hindrances are lost for that in a similar way that Darwinism explains why humans no longer have a tail. Given time, superfluous regulations will decline to make room for necessary and state-of-the-art fundamentals.

In the context of cross-border insolvencies it is argued that the lack of harmonisation and alignment of the Member States' legal systems has a negative effect on the coordination of insolvency systems and therefore

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[69] I International Monetary Fund 1999, 'Orderly & Effective
Insolvency Procedures' International Monetary Fund 1999, 'Orderly & Effective
Insolvency Procedures', 4. Rehabilitation Procedures,<http://www.imf.org/external/pubs/ft/orderly/> (last visited 17.09.2015).

[70] Ian F. Flechter, 'Spreading the gospel: the mission of insolvency law, and the insolvency practitioner, in the early 21st century' (2014), 523, 526.

uniformity and alignment of insolvency regulations is promoted and developed on an international level.[71] International harmonisation of insolvency laws facilitates a functioning and effective marketplace.[72] Harmonisation at EU level is aimed at facilitating restructurings, which is underlined by the new Commission Recommendation to a new approach to business failure and insolvency.[73]

This underlines the Darwinian approach taken in this thesis that the race to perfection is a race to rescue, Member States with less rescue-friendly provisions are encouraged to change their regimes facilitating restructurings.

0.6. Chapter Outlines

Part A of this thesis introduces the "Darwinian approach" and gives an overview of the development of the rescue culture in England and Germany.

0.6.1. Insolvency Darwinism

Chapter one explain why and how Darwin's core theory can be applied to insolvency law regimes by looking at different jurisdictions in competition to each other, much like genes in areas of biology contesting for supremacy. In order to be able to survive the competition among EU Member States, jurisdictions have to adapt to changes in the economic environment. The success of a system can more easily be judged by forum shopping due to directly noticeable consequences and the need to react accordingly. It is argued that forum shopping is a positive occurrence, strengthening rescue culture, under which debtors and creditors alike are able to choose the "best" regime for their requirements. Rescue is more and more becoming the

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[71] Flechter Spreading the gospel (n 70) 530, 531;Jennifer L L Grant, 'Path Dependant Obstacles to Cross-Border Insolvency: A Social Darwinian Perspective' (2015) 3 Nottingham Insolvency and Business Law e- Journal 7, 102,103, see as well Paul J Omar 'Jurisdictional Criteria and Paradigms in International Insolvency Texts' (2012) 12(1) I L J 7.

[72] Grant (n 71) 102.

[73] See Commission Recommendation C2014 1500; 'Recommendation to a new approach to business failure and insolvency'(1); http://ec.europa.eu/justice/civil/files/c_2014_1500_en.pdf (last visited 15.09.2015): "The objective of this Recommendation is to ensure that viable enterprises in financial difficulties, wherever they are located in the Union, have access to national insolvency frameworks which enable them to restructure at an early stage with a view to preventing insolvency, and therefore maximise the total value to creditors, employees, owners and the economy as a whole. The Recommendation also aims at giving honest bankrupt entrepreneurs a second chance across the Union."

predominant aim of modern insolvency law. The convergence of laws driven by migration activities results in a race to the top, shown up by the progressive alignment of the German system with more rescue-friendly regimes such as England, supporting rescue culture in an altogether positive development towards a modern insolvency arena.

0.6.2. Germany – "Rescue Neanderthals"[74]

Chapter two gives a brief overview of the situation pre InsO, arguing that to adapt existing laws had become a necessity in view of the malfunctioning KO and VglO in order to stimulate an improved application of insolvency laws.

Following the negative experience with two separate proceedings, the InsO introduced a single, homogenous insolvency procedure, now with one single main aim of the collaborative realisation of given assets for the creditors.[75] The InsO paved the way for a more rescue-friendly insolvency landscape culminating in a better functioning insolvency regime in Germany. Nevertheless, the InsO was still regarded as a "permanent building site"[76] as several imperfections and flaws had found their way into the system. The German legislator adjusted the regulations haphazardly, only to find out that a piecemeal approach to essential reforms did not bring the desired result. Recognising this, together with the financial crisis and the growing competition among EU-Member States, as well as mounting criticism about the flaw-stricken German insolvency regime, finally led to far-reaching fundamental reforms, with the ESUG as one result.

0.6.3. England's Flexibility

Chapter three examines the development of insolvency law in England, which is of fundamental interest to establish whether changes introduced by the

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[74] Manfred Balz 'Market Conformity of Insolvency Proceedings: Policy Issues of the German Insolvency Law' (1997) 23 Brook. J. Int'l L. 167, 167.

[75] Section 1 InsO: "The insolvency proceedings shall serve the purpose of collective satisfaction of a debtor's creditors by liquidation of the debtor's assets and by distribution of the proceeds, or by reaching an arrangement in an insolvency plan, particularly in order to maintain the enterprise. Honest debtors shall be given the opportunity to achieve discharge of residual debt."

[76] Wilhelm Uhlenbruck, '5 Jahre InsO-Kein Grund zum Feiern' (2004) ZIP 1.

ESUG were indeed a result of forum shopping activities. Due to the nature of this thesis, the issues discussed in the chapter convey a wider angle of vision. Whereas in chapter two it was possible to concentrate on the changes in German law, the parallels in English law to these changes are harder to identify. With this in mind, the chapter aims to give a critical overview of the insolvency landscape and, more specifically, the rescue culture in England, leaving it to the analytical chapters in Part B to determine the precise comparable laws. The fact is that England reacted to changes in the economic environment by adapting relevant laws, crossing interim valleys of negative experience, but staying aware of the necessity for future change.

0.6.4. Drivers of Insolvency Law Perfection

Part B brings the changes implemented by the ESUG into focus with the various individual topics of the chapters arising from the different identified key areas. The situation in Germany pre- and post-ESUG is compared to the current situation in England. Whether or not relevant changes were in fact being driven by forum shopping activities, resulting in an improved insolvency regime in Germany, in line with objectives set by the legislator to achieve a culture of second chance, amounting to a paradigm shift.

0.6.5. Missed Opportunity

The examination laid out in chapter four is focused on the influence of creditors during an ongoing proceeding, in particular the influence on appointing the IOH and the blocking potential during the course of ongoing proceedings. It is argued that the ESUG shows only a few changes for an increasing participation of creditors and therefore in the outcome not really reflecting the policy aim of the ESUG to effectively promote a better participation of creditors. As to this well-meant intention, the legislator ended up with an inconsequential solution, missing the opportunity for a radical change by not using the reforms as a fresh start. Introducing a compulsory creditors' committee for certain cases as one of the main changes could, of course, be considered an improvement; the amendments, however, fell clearly short of leading to more

influence for creditors as the influence via the preliminary creditors' committee is the exception rather than the norm. In this context, it could even be argued that burdens such as the requirement for a list of all creditors and the burdensome procedure of appointing a preliminary creditors' committee together with the existing thresholds set, leads to procedural delays and in consequence to a less perfect outcome than already achieved even before the changes were implemented. The reduction of blocking potentials for dissenting creditors, however, must be regarded a right step towards a more perfect regime. However, the German legislator should have abolished potential remedies after an approved plan, in other words they should have created a cram-down like procedure.

0.6.6. Cautious conservatism

Chapter five critically examines the so-called self-administration ("Eigenverwaltung")[77] amended by the ESUG with the focus on the stand-alone self-administration procedure laid down in section 270 a InsO. The second variation, the so-called "protective umbrella proceeding", is discussed separately in chapter eight. Although the modifications made can be looked upon as a positive step towards a better adapted insolvency landscape, it must be concluded that the overall burdens still existing contradict a Darwinian interpretation, especially as the modifications are a compromise for the unwillingness to implement a separate pre-insolvency proceeding as discussed in chapter eight. This merely desultory effort is likely to need further adjustments in future, to meet the requirements set by the insolvency arena. The legislative aim to motivate an early filing is partly accomplished by the latest version of self-administration as well as the newly introduced protective umbrella procedure. Nonetheless, Germany's cautious conservatism is still holding back from a more enterprising approach to introduce a pre-insolvency proceeding in order to encourage an even earlier filing with the aid of such procedures.[78]

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[77] See Terminology 0.7.
[78] More details see chapter 8.

0.6.7. Mere Clarification

The focal point of analysis in chapter six concerns the definition of independence for the IOH. It is concluded that changes made in regulating the IOH's independence will not produce significant progress towards a forward-looking insolvency regime in Germany. Summarising, the changes implemented hardly spread much light on the definition of "independence" in comparison with the situation pre-ESUG. Not allowing the originator of an insolvency plan to subsequently continue as IOH in accordance with original plans must be considered the biggest flaw in this respect.

0.6.8. DES - Insolvency Solution

One of the most substantial deficiencies in the pre-ESUG insolvency landscape was the non-functioning DES regime, which led to amendments as analysed in chapter seven. The legislator reduced the obstacles for a smoother proceeding especially by opening the possibility of reducing shareholder rights, which can be seen as a major improvement. In imitating certain features of the English equivalent, however, the German approach turned out to be again only half-hearted, still leaving elements of uncertainty as to the possibility of potential claims by dissenting creditors or the lack of clarity concerning the valuation of a claim and maintaining the necessity of creditors having to consent to a DES. Also the risk of dissenting creditors abusing their bargaining power should have been ruled out, as this was seen as a major flaw leading to uncertainty in practical applications. Another shortcoming concerns the lack of a holistic approach towards effecting a DES. The inclusion of the DES in the insolvency plan proceeding excludes an out-of-court DES to benefit from the positive modifications. The DES regime in England is still better equipped to offer flexible tools for more tailored and specific need focussed solutions. Obviously, Germany yet again held on to traditions instead of breaking with some for a more modern and sophisticated outcome.

0.6.9. "A nicer Form of Failure"[79]

Chapter eight sets out to examine the newly introduced protective umbrella proceeding ("Schutzschirmverfahren"). [80] Challenges for a comparative analysis become evident in this chapter as it argues that the protective umbrella proceeding cannot be compared to pre-insolvency proceedings such as the CVA or the SoA because of its solely preparatory nature lacking the status of a stand-alone feature. It is argued that the procedure offers the possibility for an earlier, faster and less contentious restructuring compared to the situation pre- ESUG. Remaining hurdles and continuing lack of clarity would indicate, however, that this adaptation had not been carried out in the best Darwinian sense, thus making further adjustments likely. The protective umbrella proceeding is not considered to be a replacement for a pre-insolvency procedure and it is suggested that there is a lacuna in the German insolvency arena. The overarching aim to develop a new "Restructuring culture"; a "Shift in paradigm" and a "Culture of second chance" will not be achieved if Germany adheres to its conservative approach. There will have to be a change in the mentality of the legislator before a shift in paradigm can take place. It will take more courage to break with old traditions, adapting to economic realities and as a consequence being able to offer a "commercially supportive legal environment".[81]

0.7. Methodology

Comparing and contrasting the changes implemented by the ESUG, involves a comparative approach within this thesis.

The comparison of different jurisdictions faces several pitfalls. On the other hand, however, the necessity to compare phenomena seems to influence all

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[79] Dana Heide, Schoener Scheitern Handelsblatt vom 09.08.2013 http://www.handelsblatt.com/unternehmen/mittelstand/insolvenzrecht-schoener-scheitern/v_detail_tab_comments/8606460.html http://www.handelsblatt.com/unternehmen/mittelstand/insolvenzrecht-schoener-scheitern/v_detail_tab_comments/8606460.html (last visited 17.09.2015).

[80] New section 270b InsO, although know under "Schutzschirmverfahren", the heading of section 270 b InsO is "preparation of a restructuring" ("Vorbereitung einer Sanierung").

[81] Ian F Flechter, 'Comment to "The protective umbrella procedure, a new German restructuring tool" by Professor Dr Reinhard Bork' (2012) Insolvency Intelligence 24, 25.

forms of decision-making and could be seen as paramount to the development of intelligence.[82] Sacco argues that most legal changes develop through borrowing and that changes led by innovations are rare.[83] Germany was influenced by a spate of companies moving to England in order to benefit from English insolvency procedures and realised that England apparently employs better tools in national law to restructure insolvent companies. Realising that the insolvency regime contained specific weaknesses encouraged the German legislator to close those gaps in order to impede the migration of companies to England. The best way, of course, was to look at the reasons and studying the given laws behind the new phenomenon and to possibly adapt or imitate those responsible for the appeal of a foreign jurisdiction. This necessitated comparative work as Germany was not acting in a legal vacuum.

All scholars should be painfully aware of dangers in comparative work, but to shy away from these difficulties and to not engage in that different activity is to not fully critique, explain and examine the influencing factors that led to the German reforms. We operate in a globalised environment; it is not possible to be parochial in our understanding of policy drivers and reforms: this would fail to appreciate the pressures on stakeholders using insolvency laws or the policy makers who must respond to a given need. In this instance that need has led to alignment, harmonisation and uniformity almost to the extent that we can say an unofficial global harmonisation towards rescue- friendly rescue regimes is taking place.

There is no single established methodology for comparative legal analysis. "[A] comparative approach to law becomes an attempt . . . to formulate the pre-suppositions, the preoccupations, and the frames of action characteristic of one sort of legal sensibility in terms of those characteristic of another."[84] This phrase serves to indicate the challenges of a legal comparison. It could be argued that legal comparison is based on the method of forming and testing a

[82] Vernon V. Palmer, 'From Lerotholi to Lando: Some Examples of Comparative Law Methodology' 53 Am. J. Comp. L. (2005) 261, 262.
[83] Rodolfo Sacco, 'Legal Formants: A dynamic Approach to Comparative Law (Instalment I of II)' (1991) 39Am J Comp L 1
[84] Clifford Geertz, in Palmer (n 82).

hypothesis.[85] Zweigert and Kotz suggest that the basic methodology is that of functionality.[86] "[Functionality] rests in what every comparatist learns... that the legal system of every society faces essentially the same problems, and solves these problems by quite different means, though very often with similar results."[87]

Both England and Germany feel the challenge of companies facing financial difficulties and companies being insolvent. As EU-members, both countries are confronted with competition, knowing that reforms do not happen in a legal vacuum. The aim of this research is not to compare the restructuring regimes of England and Germany in total, but to examine distinct aspects of a different regime possibly being the trigger responsible for the changes implemented by the ESUG. The purpose therefore is not to reason which of the two jurisdictions has the best restructuring regime, but to establish whether the movement of German companies to England is causally related to the defects of the German regime and whether this in turn led to a more perfect insolvency regime in the Darwinian sense.

There are various pitfalls in taking a comparative approach. The research includes translation work, as large parts of the literature used is in German. Legal terminology is fraught with linguistic traps and that any form of translation bears the risk of missing conceptual differences from language to language.[88] Translation work was done with great care trying to avoid transmitting errors and, where necessary, explain linguistic subtleties with a special regard to key insolvency terminology. For a clear understanding, key German concepts, terms or individual words have been set in parentheses.

"Law is part of the different cultures of lawmakers".[89] Member States of the EU face direct competition with regard to insolvency law due to forum shopping

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[85] Peter De Cruz, *Comparative law in a Changing World* (third edition, Routledge-Cavendish Abingdon 2008), 236.
[86] Konrad Zweigert, Koetz, Hein, *An Introduction to Comparative Law* (Tony Weir translated, third edition, Oxford University Press 1998), 268-274, see as well de Cruz (n 85). 236-238.
[87] Ibid, de Cruz (n 85) 237.
[88] De Cruz (n 85) 220.
[89] Catharine MacMillan, *Mistakes in Contract Law* Hart Publishing, Oxford, 2010, p.305; if one model works in one country it does not automatically imply that it works in a different setting.

possibilities, it could be argued that different socio-legal aspects do not matter as companies being able to forum shop are indifferent towards reasons for different approaches.

This thesis shows how the German legislator could stop unwanted forum shopping, the intention is not to suggest specific changes, but to raise the awareness that in a globalised world, despite certain historically explainable differences and path-dependencies, these differences have to be overcome in order to achieve greater alignment and hence survive the competition in the Darwinian sense.

The German legislator pursued the aim of establishing a culture of second chance.[90] However, holding back for historical and cultural reasons seems contradictory. Path-dependence can be used to explain differences, but not as an excuse for half-hearted attempts to reach a certain aim.

Looking at social, historical and cultural reasons for the German legislator's approach will be part of future research. The theory of path-dependence helps to understand the influence on the approaches of the development of rules and regulations of jurisdictions.[91] It is of interest and relevance to look at historical and cultural differences if one's intention is to find out the reasons for the different approaches towards law making.

It is discussed in the corresponding literature whether a legal transplant is at all possible, as it could be argued that law is not able to move from one society to another without changing its content.[92] The working of a system in one country does not automatically imply its working also under a different setting.[93] "Simply put, the idea of a legal transplant is a situation where a rule is lifted from system and 'transplanted' into another. However, although there are many examples of such transplantations, the movement of rules from one system to another is usually a complex process which may involve more than

[90] See chapter 2.1.1 and Part B introduction.
[91] See in more detail for cross-border insolvencies: Grant (n 71) 104.
[92] MacMillan (n 89) 305.
[93] Ibid

the actual rules themselves. For example, Alan Watson has long argued that what got transferred was as much a system as a mass of rules".[94]

The purpose of this thesis is not to transplant parts of the English restructuring regime into the German system. The intent is rather to be able to answer whether the changes introduced by the ESUG were indeed driven by forum shopping activities to England and whether these changes led to a more perfect insolvency regime in Germany. The intention is not to propose that certain rules should be adopted completely, but to broaden the horizon in looking for efficient procedures, elements and the fundamental idea behind these positive features, and use these for the original system, always keeping in mind the different settings involved.[95] In other words, to go and look for general principles in order to apply them to different situations.[96]

0.8. Terminology

This thesis contains some terms of art that are well known but it also contains other portmanteaux terms that are loaded with a baggage wider than the term itself. These terms are defined here for clarity and subsequent use. They are also revisited in the pertinent chapters.

Forum Shopping

Forum shopping is defined in two ways. The "classical" form of forum shopping is defined in the EIR as: the phenomenon by which debtors "transfer assets or judicial proceedings from one Member State to another, seeking to obtain a *more favourable*[97] legal position."[98] Or it can be defined as "...identifying the optimal jurisdiction for a certain transaction, in the context of insolvency certainly for the purpose of the restructuring or insolvency of a given company, and taking measures so that the law of that jurisdiction is applied."[99]

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[94] Geoffrey Samuel, *An Introduction to Comparative Law Theory and Method* (Hart Publishing Oxford, 2014), 115.
[95] MacMillan (n 89) 307.
[96] Ibid 305
[97] Author's emphasis.
[98] EIR (n 12).
[99] Ringe (n 31) 3.

A new way of forum shopping without the necessity of a change of COMI is the possibility to use other restructuring tools, such as the English SoA thereby benefitting from another Member States' judicial proceedings.[100]

Insolvency Darwinism

The thesis uses the term "Insolvency Darwinism" in the following sense: jurisdictions within the EU, responsible for the development of insolvency laws undergo, by analogy to living organisms, a process similar to the evolutionary process. Similar to living creatures they have to keep track with the changes in the economic environment and adapt to these changes in order to survive the competition amongst EU jurisdictions.[101]

Insolvency Law Perfection

"Insolvency Law Perfection" is defined in this thesis in the sense of jurisdictions offering a legal framework which enables stakeholders to find the best possible solution for the majority of the parties involved, preventing abuse and offering protection for the stakeholders.[102]

"Cram-down" nature of a proceeding

A "cram-down" is the effect that a restructuring plan can be confirmed although stakeholders have objections. In other words if the proceeding is confirmed it binds all creditors and shareholders.

[100] Section 895 Companies Act 2006; see more chapter 3.3.6.
[101] A more in depths definition see chapter 1.5.
[102] More in depth definition see introduction 0.5.3.

Stakeholders

There are several parties who have an interest or concern in an insolvency proceeding. These stakeholders are the debtor in form of the company, the creditors, employees and society as a whole.

Creditors

Creditors in general could be defined as "all persons having pecuniary claims against the company notwithstanding that they are often difficult to quantify and irrespectively of whether such claims are actual, contingent, unliquidated, or prospective."[103] There are various different creditors involved in insolvency proceedings. Differentiations have to be made between preferential, secured and unsecured creditors and pre-and post-restructuring creditors.[104]

Creditors' Autonomy

In Germany, insolvency proceedings are governed by the principle of creditors' autonomy ("Glaubigerautonomie").[105] Courts only have a supervising and mediating role in making sure that processes run smoothly and to encourage the necessary understanding amongst the parties involved.[106] This principle should be understood in the sense that creditors are given the opportunity to participate in the proceedings, but not having the power to organise the procedure itself.

Insolvency Office Holder

The EIR offers a definition for the IOH, referring to "any person or body whose function is to administer or liquidate assets of which the debtor has been

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[103] *Re T&N and others* (No.4) [2007] Bus LR 1411.
[104] There are various forms of creditors, these are defined in chapter 4.4.2.1 and 4.4.1.
[105] See more details, chapter 4.2.2.
[106] Volker Beissenhirtz, 'Creditors' rights in German Insolvency Proceedings – How Effective are the Procedural Rules?' (2006) Int. C. R. 316, 320.

divested or to supervise the administration of his affairs."[107] In England, titles like liquidator, administrator, trustee and nominee fall within this definition whereas in Germany there is the "Insolvenzverwalter" or "Sachwalter".[108]

Rescue culture

As noted above,[109] rescue culture is the "philosophy of reorganizing companies so as to restore them to profitable trading and enable them to avoid liquidation";[110] "seeking to preserve viable businesses.[111] Rescue can be seen as "a major intervention necessary to avert eventual failure of the company".[112] It could be argued that rescue is focussed on restructuring the company as a going concern or the restructuring of the business. For the purpose of this thesis restructuring is meant in the broader sense, both restructuring of the company and the business.

Self-administration/ Debtor-in-possession

Self-administration ("Eigenverwaltung") is the expression used in Germany where the debtor remains in possession, instead of involving an IOH. In the UK and the US this form of procedure is better known as a debtor-in-possession[113] procedure. Self-administration and debtor-in-possession are used interchangeable in this thesis.[114]

Preliminary proceedings

Preliminary insolvency proceedings are defined as preparatory proceedings before the actual formal proceeding starts. In Germany there is always a preliminary insolvency proceeding ("vorlaeufiges Insolvenzverfahren" or

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[107] (EC) No 1346/200, Article 2 (b); see as well Jan Adriaanse, Iris Wuisman, Bernhard Santen, 'European Principles and Best Practices for Insolvency IOHs' (Universiteit Leiden 2014) 15.
[108] Ibid 1
[109] See Terminology 0.7.
[110] Goode (n 58) 383.
[111] *Powdrill v. Watson* [1995] 2 A.C. 394, HL, per Lord Browne-Wilkinson at 442A.
[112] Belcher (n 60) 12; it is further discussed whether the aim is rescuing the company or rescuing the business, for this purpose rescue is meant in both ways, see Terminology 0.7.
[113] In the following "DIP"
[114] For more detailed definition see chapter 5.

"Eroeffnungsverfahren"), a period of a maximum of three months used to examine whether the preconditions for the commencement of insolvency proceedings are met.[115]

Insolvency Proceedings

Insolvency Proceedings are defined in article 1 (1) EIR as proceedings which are based on the traditional concept of insolvency, requiring a negative balance sheet or the lack of liquidity of the debtor in consequence being unable to pay his creditors.[116]

Pre-Insolvency Proceedings

Pre-Insolvency Proceedings could be defined as consisting "in initiating quasi-collective proceedings under the supervision of a court or an administrative authority for the purpose of enhancing corporate restructuring efforts to prevent the commencement of insolvency proceedings."[117]

Transferred Restructuring

"Transferred restructuring" ("uebertragende Sanierung") is used as a term of art in Germany for restructuring the business by transferring parts or all assets to a new legal entity.[118]

Debtor

The subject matter of this thesis refers solely to insolvent companies, leaving out any dealing with private insolvency. The insolvent company is the debtor.

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[115] For more detailed definition see chapter 2.3.3.
[116] Art 1 (1) EIR (n 12) Burkhard Hess, Paul Oberhammer, Thomas Pfeiffer 'External Evaluation of Regulation No. 1346/2000/EC on Insolvency Proceedings', JUST/2011/JCIC/PR/0045/A4 ("Vienna-Heidelberg Report");10,11;http://ec.europa.eu/justice/civil/files/evaluation_insolvency_en.pdf (last visited 25.09.2015).
[117] Vienna-Heidelberg Report (n 116), 11.
[118] More detailed definition see chapter 2.3.7.

The interests of companies as legal persons are represented by the shareholders and company management.[119]

Armed with these terms and with an "Insolvency Darwinism" perfection in mind it can now be moved forward to an examination of this key element of this thesis.

[119] Bork Rescuing Companies (n 22) 27.

Part A

Chapter One

Insolvency Darwinism

"It is not the strongest of the species that survives, nor the most intelligent that survives. It is the one that is the most adaptable to change."

Charles Darwin[120]

1.1. Introduction

This chapter demonstrates that Darwin's core thesis, known as "natural selection" can be applied to the competition amongst the Member States of the EU with regard to their insolvency law regimes. A definition of forum shopping is presented and Darwin's core thesis is explained and other areas of the usage of Darwinism are highlighted. "Insolvency Darwinism" is explained before analysing the phenomenon of "forum shopping" and its application to the research question. This chapter explains why forum shopping results in a race to the top towards a more "perfect" insolvency regime.

1.2. Definition of Forum Shopping

Recital 4 of the EIR defines forum shopping as the process in which debtors "transfer assets or judicial proceedings from one Member State to another, seeking to obtain a *more favourable*[121] legal position."[122]

Looking more closely into the meaning of a "more favourable position" makes the competition between Member States of the EU become apparent. To find out which position is more favourable, a comparison of the different legal systems is necessary. It could be argued that the effect of forum shopping

[120] Charles Darwin, *On the Origin of Species* (sixth edition, Wordsworth Editions Limited Ware 1872).
[121] Author's emphasis.
[122] EIR (n 12) recital 4.

generates the aspiration of a "weaker" jurisdiction to obtain a better position compared to its competitors.

The main aim of the EIR is to provide a framework for the efficient and effective regulation of cross-border insolvency proceedings.[123] It provides the Member States with a framework, regulating how to deal with concurrent insolvency proceedings and their interrelation.[124] The EIR differentiates between "main" and "secondary" proceedings.[125] Main proceedings as primary proceedings can only be opened in one Member State[126] called the COMI.[127] There is an automatic recognition of the main proceedings in all other Member States. Once one Member State has opened insolvency proceedings, any other Member State can only open secondary proceedings.[128] The laws of the Member State in which proceedings have been opened serve to govern the proceedings.[129] Change of COMI from one Member State to another under the EIR is one possible way to forum shop.[130] Successful examples of German companies moving their COMI to England are *Schefenacker* and *Deutsche Nickel*[131]; an unsuccessful case in this context is *Brochier.*[132]

Ringe defines forum shopping as "...identifying the optimal jurisdiction for a certain transaction, in the context of insolvency certainly for the purpose of the restructuring or insolvency of a given company, and taking measures so that the law of that jurisdiction is applied."[133]

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[123] EIR (n 12) recital 2.
[124] David Wright and Sam Fenwick, *Bankruptcy tourism – what it is, how it works and how creditors can fight back* (2012) I I L R, 45, 45.
[125] EIR (n 12) chapter II, III
[126] Whereas a multiple set of secondary proceedings in different Member States is possible, see EIR (n xxxx) Article 27
[127] Article 3.1 EU Insolvency Regulation: "The courts of the Member States within the territory of which the centre of a debtor's main interests is situated should have jurisdiction to open insolvency proceedings. In the case of a company or legal person, the place of the registered office shall be presumed to be the centre of its main interests in the absence of proof to the contrary." and article 3.2: "Where the centre of a debtor's main interest is situated within the territory of a Member State, the courts of another Member State shall have jurisdiction to open insolvency proceedings against that debtor only if he possesses an establishment within the territory of that other Member State. The effects of these proceedings shall be restricted to the assets of the debtor situated in the latter Member State."
[128] EIR (n 12) chapter II, article 16.
[129] Wright and Fenwick (n 124) 47.
[130] EIR (n 12).
[131] See appendix one
[132] See appendix one
[133] Ringe (n 31) 3.

A new way of forum shopping without the necessity of a change of COMI is the possibility to use other restructuring tools, such as the English SoA,[134] thereby benefitting from other Member State's judicial proceedings. Examples of companies who used the English SoA are *La Seda Barcelona; Tele Columbus Group; Rodenstock GmbH;*[135] *Metrovacesa and Galleria Media*[136] and just recently *Van Gansewinkel*[137]. In the case of the SoA under English law, an English court is able to sanction a SoA for "any company liable to be wound up",[138] therefore also including overseas companies.[139]

1.3. The Darwinian Approach

Forum shopping in fact offers a good basis for a "Darwinian approach" to viewing insolvency law reform and policy. Darwin's core thesis is now outlined, and it is examined why it can be applied to the insolvency regimes of different jurisdictions, in this case more precisely those of Member States of the EU, using the example of English and German companies, both being involved in forum shopping activities.

Darwinism can be defined as a "theory of biological evolution developed by Charles Darwin and others, stating that all species of organisms arise and develop through the natural selection of small, inherited variations that increase the individual's ability to compete, survive, and reproduce."[140] "Core Darwinism, is the minimal theory that evolution is guided in adaptively non-random directions by the non-random survival of small random hereditary changes."[141] It is the part of evolutionary change that is adaptive that Darwin so neatly explained."[142]

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[134] Section 895 Companies Act 2006.
[135] See appendix one
[136] See more Rutstein (n 15) 125; Jennifer Payne, 'Cross-border schemes of arrangement and forum shopping' (2013) E.B.O.L.R. 563; list of cases see Christian Pilkington *Schemes of Arrangement in Corporate Restructuring* (Sweet & Maxwell London 2013), 2, 3.
[137] *Re Van Gansewinkel Groep B.V and others* [2015] EWHC 2151 (Ch), [2015] All ER (D) 241 (Jul)
[138] Section 895 (2) (b) Companies Act 2006
[139] Lynda Elms, 'Re Rodenstock: sanctioning SoA of solvent overseas companies' (2011) 4 CRI 114, 114, more see chapter 3.3.6.
[140] The American Heritage Dictionary of the English Language (Fourth Edition, Houghton Mifflin Company Boston 2000).
[141] Richard Dawkins *Devils Chaplain* (Houghton Mifflin Boston 2003), chapter 2.2 Darwin Triumphant 95.
[142] Ibid

1.3.1. Natural Selection

Taking Darwin as an analogy puts a focus on the "core of Darwin's theory", the "natural selection"[143] also referred to as "the survival of the fittest."[144] According to this theory, an individual species with a marginally favourable modification from the normal form will survive the struggle of life due to these differences in consequence inherited by its offspring with the result that the favoured will obtain supremacy and the less favoured vanish with the deviation taking root.[145] In Darwin's words: "This preservation of favourable variations, and the rejection of injurious variations, I call Natural Selection."[146]

These modifications result from the fact that those species adapt better to their environment compared to their rivals. Bearing in mind that "Nature is not cruel, only pitilessly indifferent. This is the one of the hardest lessons for humans to learn. We cannot admit that things might be neither good nor evil, neither cruel nor kind, but simply callous-indifferent to all suffering, lacking all purpose."[147] As Jones phrases it "To him [Darwin], evolution had no commonwealth; self-interest is what matters. He was right. There is no charity in Nature"[148]

1.3.2. Adaptation

To obtain these differences and survive the struggle for life, all species have to adapt to the given environmental conditions. The environment can be seen as a filter with regard to who will survive and who not.[149] In the "Origin of

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[143] Darwin (n 120) 72; Mayr summarises Darwin's theory in five different theories: "1.Evolution as such. This is the theory that the world is not constant or recently created nor perpetually cycling, but rather is steadily changing, and that organisms are transformed in time. 2. Common descent. This is the theory that every group of organisms descended from a common ancestor, and that all groups of organisms, including animals, plants, and microorganisms, ultimately go back to a single origin of life on earth. 3. Multiplication of species. This theory explains the origin of the enormous organic diversity. It postulates that species multiply, either by splitting into daughter species or by "budding", that is, by the establishment of geographically isolated founder populations that evolve into new species. 4. Gradualism. According to this theory, evolutionary change takes place through the gradual change of populations and not by the sudden (saltation) production of new individuals that represent a new type. 5. Natural selection. According to this theory, evolutionary change comes about through the abundant production of genetic variation in every generation. The relatively few individuals who survive, owing to a particularly well-adapted combination of inheritable characters, give rise to the next generation." See Erwin Mayr, One Long Argument: Charles Darwin and the Genesis of Modern Evolutionary Thought (Harvard University Press Cambridge Massachusetts 1991).

[144] Darwin (n 120) 72.

[145] Ibid

[146] Ibid 92.

[147] Richard Dawkins, *River out of Eden: A Darwinian View of Life* (Basic books New York 1995) 112.

[148] Steve Jones, *Almost like a Whale* (Black Swan edition, London 2001)195.

[149] Eric A. Marks, *Business Darwinism- Evolve or Dissolve* ((John Wiley & Sons Inc New Jersey 2002) 52.

Species"[150] Darwin uses the *example of a country undergoing physical changes,*[151] which automatically would lead to changes of some of the inhabitants; the ones who do not undergo these changes would probably die out.[152] The adaptation is necessary as all living organisms battle against uncompromising forces.[153]

Darwin argues that we have a place for natural selection only if changes in the condition of life occur, this in turn would lead to more variability of the species.[154] Though variability not necessarily in an extreme form; already slight changes could result in an advantage and more modest changes would increase these advantages over other living organisms.[155] Dawkins uses the example of children being only slightly different form their parents, but "they could be as different as a hippo is from a human."[156] "Evolution consists of step-by-step trajectories through the genetic space, not large leaps. Evolution, in other words, is *gradualistic.*"[157]

Jones uses an illustrative example of a new island where natural selection and adaptation is an ongoing process: "On the new island, natural selection had been at work, daily and hourly scrutinising, throughout the world, every variation, even the slightest; rejecting that which is bad, preserving, and adding up all that is good; ....., at the improvement of each organic being in relation to its organic and inorganic condition of life."[158] The rapid spread of bacteria via a very good mechanism of adaptation is a classic example of what natural selection is capable of.[159] "Adaptation is a constant progress as the condition of life never stays exactly the same. No country can be named in which all the native inhabitants are now perfectly adapted to each other .....; that none of them could anyhow be improved..."[160] Marks defines this adaptation as the

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[150] Darwin (n 120).
[151] Author's emphasis, as explained later in analogy physical changes, changes of the insolvency regime.
[152] Darwin (n 120) 64.
[153] Jones (n 148) 73.
[154] Darwin (n 120) 64, 65.
[155] Ibid
[156] Dawkins River out of Eden (n 147) 98.
[157] Ibid; author's emphasis
[158] Jones (n 148) 95, 96.
[159] Ibid 117.
[160] Darwin (n 120) 64, 65.

ability to survive "shifts in environmental conditions".[161] Jones uses the example of the eye, the voice and the brain, which always had the same job, but developed gradually. He calls this development "the mountaineer's dilemma".[162] "Few peaks are straight slogs upwards to the summit. Instead, a climber has to lose some of his hard-won gains by crossing a valley before he can reach the next high point. "[163]

1.3.3. Competition

Natural selection causes competition. Using the example of plants, Darwin states that "...if we wished in imagination to give the plant the power of increasing number, we should have to give it some advantages over its competitors..."

All eco-systems have barriers in a certain form "allowing or restricting immigration and emigration".[164] In a country with certain barriers, where other living organisms do not have free access, competition might be less prevailing. Darwin uses the example of an island and a country with a barrier, meaning that others could not freely enter. "We should then have places in the economy of nature which would assuredly be better filled up, if some of the original habitants were in some manner modified; for, had the area been open to immigration, these same places would have been seized by intruders. In such a case, every slight modification, which in the course of the ages chanced to arise, and which in any way favoured the individuals of any of the species, by better adapting them to their altered conditions, would tend to be preserved; and natural selection would thus have free scope for the work of improvement."[165]

Summarising, the most important feature to survive competition is the adaptability to changing environmental conditions.

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[161] Marks (n 149) 53.
[162] Jones (n 148) 95, 96.
[163] Jones (n 148) 95, 96.
[164] Ibid
[165] Ibid 64.

1.4. Darwin applied

Applying "Darwinism" to other fields is not novel. There are several examples of the theory of evolution being applied to other areas than biology. Darwin's theory had an influence on psychology, physics, politics and economics (also called "Social Darwinism"), eugenics, theology, philosophy, linguistics and literature and in the business world ("Business Darwinism").

It would go beyond the scope of this thesis to discuss all approaches in detail. Nevertheless, a brief synopsis may serve to give an idea of the great variety of how the thesis has been variously deployed. For example, Spencer as the father of "Social Darwinism" applied Darwin's theory to society and argued that people in society undergo the same laws as living organisms.[166] Social Darwinism was especially used to defend racism and political conservatism.[167] It was Spencer who coined the expression "survival of the fittest", only later used by Darwin in the "Origin of the Species."[168] The theory was used to justify differences between nations and races,[169] especially the "alternative Social Darwinism", presented by Bagehot[170] argued that superior cultures were more disciplined and organised in contrast to the classical view of Social Darwinism which argued for competition of individuals.[171]

Darwin's theory is also fruitful for psychology as it could be used as a structure for analysing human behaviour.[172] Tinbergen developed a questionnaire on this basis, asking questions about a trait to help understanding how a trait is able to add to the survival or reproduction of any organism.[173] Evolutionary psychology is not used to explain a behaviour with a "gene", but allowing development by adapting to modified conditions.[174]

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[166] http://creation.com/herbert-spencer (last visited 19.09.2015).
[167] http://darwin200.christs.cam.ac.uk/pages/index.php?page_id=e4.
[168] Darwin (n 120) 72
[169] Although clearly against the Darwinian Theory as this argues that we human are all one species, with a common ancestor (s. http://darwin200.christs.cam.ac.uk/pages/index.php?page_id=e4).
[170] Walter Bagehot, *Physics and Politics or, Thoughts on the Application of the Principles of "Natural Selection" and "Inheritance" to Political Society* (D. Appleton and Company New York 1873).
[171] http://darwin200.christs.cam.ac.uk/pages/index.php?page_id=e4.
[172] Ibid
[173] Ibid
[174] Ibid

Even in astrophysics, Darwin's theory is used when examining *universes*[175] showing them to be gradually different, arguing that these variations could explain why certain universes would be in a better position to propagate.[176]

Darwin, himself a gifted philosopher, influenced many philosophers. He introduced the so-called "population thinking", emphasising individual variation rather than the previously prevailing "dominant thinking" of looking at species as fixed "types".[177] In this context, evolutionary philosophers reflect on whether "evolution is progressive".[178] Darwin does not argue that one animal ranks above another. He argues that evolution permits a progression in adaptability: "The inhabitants of each successive period in the world's history have beaten their predecessors in the race for life, and are, in so far, higher in the scale of nature".[179] Dawkins argues that evolution is progressive in the sense that it results in an increased versatility "to fill an environment".[180]

An interesting and important analogy for this research is made by applying Darwin's theory to businesses. Jones concluded that "Like any business, life must diversify its manufactures; or fail. Evolution-like capitalism-must run to stay in the same place. If the young overtake their parents, the parents have no choice but to find another trade, or die. That brutal fact launched the Industrial Revolution and drives the economies of today. Commerce depends, like life itself, on a constant input in energy."[181] The main idea of "Business Darwinism" is that companies need to be able to adapt to growing changes enabling them to survive the competition. Marks argues that "Companies that do not perform according to the fitness metrics of revenue, profit, cash flow and market share will not survive, and they surely will not be able to replicate or transition themselves across a generation of change."[182] Related to the topic "Business Darwinism" is the so- called "Digital Darwinism" which tries to explain the phenomenon of e-commerce, arguing that companies active in this

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[175] Author's emphasis, universe in analogy to the Member States of the EU.
[176] http://darwin200.christs.cam.ac.uk/pages/index.php?page_id=e4.
[177] http://darwin200.christs.cam.ac.uk/pages/index.php?page_id=e4.
[178] http://darwin200.christs.cam.ac.uk/pages/index.php?page_id=e4.
[179] Ibid
[180] Ibid
[181] Jones (n 148) 128.
[182] Marks (n 149) Introduction, XV.

area need to be creative, agile, fast and *extremely adaptable*[183] to survive the fierce competition.[184]

1.5. Insolvency Darwinism

It is argued in this thesis that Darwin's core theory can be applied to insolvency law regimes in looking at different jurisdictions competing with each other.

Grant uses a social Darwinian approach to explain path-dependence in cross-border insolvencies. She argues that "There is a certain Darwinian effect here, [path dependency demonstrating how history influences the process of legal change] as essentially the success of an outcome in the past will lead to similar choices in the future, theoretically common to differential reproductive success in evolutionary theory."[185] However, looking at the Darwinian Theory explained above,[186] approaches influenced by path dependency explain how historical events influence legal changes, whereas Darwin's theory is based on the reverse explanation, that changes in the environment necessitate changes in order to survive competition. It seems that path dependency and a Darwinian approach are two different ways to explain changes. Either legal changes are effected by adaptation to the environment or inspired by historical events.

The Cork Committee pointed out the importance of the flexibility to adapt to changes under the "Aims of good insolvency law"; stating that "To devise a framework of law for the governing of insolvency matters which commands universal respect and observance, and yet is *sufficiently flexible to adapt to, and deal with, the rapidly changing conditions of our modern world.*"[187] Furthermore the Cork Committee states that its proposals "are no more than a natural extension and clarification of past developments, a further chapter in the long *evolutionary process*[188] of insolvency law."[189]

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[183] Author's emphasis.
[184] Evan I. Schwartz, *Digital Darwinism; 7 Breakthrough Business Strategies for Surviving in the cutthroat web-economy* (Broadway Book New York 1999).
[185] Grant (n 71) 106.
[186] See chapter 1.3.
[187] Cork Report (n 57) 55; author's emphasis
[188] Author's emphasis
[189] Cork Report (n 57) 35.

The central core of this thesis is to see jurisdictions, responsible for the development of insolvency law regimes in the EU, as creatures undergoing a process similar to the evolutionary process of living organisms. Like living organisms, jurisdictions have to pursue changes in the economic and insolvency landscape and adapt to these changes to be able to survive the competition amongst jurisdictions. As it would go beyond the scope of this research to compare all jurisdictions of the EU, focus is put on the comparison of two major countries, England and Germany.

One could argue that jurisdictions would not easily disappear in the Darwinian extinction sense. Within the system of the EU it is, however, conceivable over a longer period that a majority of companies would choose the COMI in another Member State if their home country refused to improve the existing insolvency regime at all and thus not adapt to a changing economic environment. Looking into insolvency law regimes of differing jurisdictions, companies could even decide at the outset where to incorporate within the EU. Companies could therefore avoid a country with only a "weak" insolvency system by registering in a Member State offering more favourable conditions for the case of insolvency.[190]

Under the term "Survival of the fittest" the Member State best adapted to the prevailing economic environment will most likely be the jurisdiction to attract most companies looking for a change of jurisdiction in order to benefit from a better insolvency law regime. Like nature the economic environment is indifferent, jurisdictions have to adapt to this pitiless environment; there is no charity.[191] The economic environment is changing, which is an ongoing process and jurisdictions need to adapt to these changing environments. It is therefore important that existing legal insolvency framework allow for a certain flexibility, avoiding the need of going through a legislative reform process even for slight changes in the economic environment.

[190] Due to the possibility of free movement:Article 45 of the Treaty on the Functioning of the EU.
[191] Jones (n 148) 195.

Do we really have competition amongst jurisdictions in the sense that a jurisdiction is at all interested in attracting foreign insolvent companies?[192] Should jurisdictions not be elated if insolvent companies change the COMI? The first question can be answered positively as the insolvency industry contributes to the economic welfare of a country. A study into the economic importance of insolvency and turnaround industries carried out by R3[193] revealed the enormous significance that this particular law sector has on the prosperity of a country.[194]

Having explained why Darwin can be applied to the case of jurisdictions the phenomena of forum shopping is now analysed in more detail, expanding the introduction definition, with this Darwinian approach in mind.

1.6. Rationale behind Forum Shopping

1.6.1. Corporate Insolvency

What is the driving motivation and rationale behind forum shopping on the part of debtors? The definition itself points to their main motive in "seeking to obtain a more favourable legal position".[195] Different legal systems of Member States offer various incentives for forum shopping. These could be of a procedural nature, such as benefits through quicker, slower or more cost-effective procedures or of a more substantive nature, such as the granting of punitive damages, zero capital requirement, more favourable limitation periods and so forth.[196]

Looking at some prominent cases[197] reveals the motive for *Deutsche Nickel* moving their COMI to England to better overcome legal hurdles in realising a

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[192] One example is the "Delaware effect", see chapter 1.6.5.
[193] R3 is the UK Association of Business Recovery Professionals
[194] R3, The Value of the Insolvency Industry (n 8); the UK insolvency industry was responsible for rescuing around 5,851 businesses in 2009; Helped to save nearly 2 million jobs (1,951,743) in companies going through insolvency in 2009; Provided assistance to businesses with a combined turnover of around £363 billion in 2009; Made a direct contribution of around £562 million to national GDP, in addition to an indirect contribution of approximately £177 million in 2008; Employed around 10,000 people across the UK in 2009. The insolvency industry "plays a vital role in maintaining a business environment in which creditors are willing to lend entrepreneurship is encouraged and the economy can flourish" - Centre for Economics and Business Research.
[195] EIR (n 12) recital 4.
[196] Philipp M. Reuss, *Forum Shopping in der Insolvenz- Studien zum auslaendischen und internationalen Privatrecht* (Mohr Siebeck Tuebingen 2011) 8, 9.
[197] See appendix one

debt-to-equity swap[198]. Restructuring in Germany seemed impossible because of this legal obstacle, whereas English insolvency law opened the possibility to restructure the company in form of the CVA in the sense that it was more "perfect" for the given objective.[199] *Schefenacker's* motivation was similar. Following several unsuccessful attempts in Germany, the company believed that a more promising restructuring could be achieved under English law.[200] *Schefenacker* used the CVA procedure as well and was successfully restructured.[201]

1.6.2. Personal Bankruptcy

It is not only companies making use of moving the COMI to another Member State. "Bankruptcy tourism" by private individuals is observed as well.[202] The general motive behind the search for a "better legal position" is comparable to that of companies. This "better position" for the human debtor with regard to personal bankruptcy is attributed to the fact that discharge periods can vary immensely from country to country: from one year in England[203] to up to six years in Germany.[204] This, of course, encourages individuals to migrate to a country where they can discharged earlier.

Whereas early relief from debt seems to be the main motive for private individuals; motives of companies are clearly more diverse. The overall main motive of a company to migrate elsewhere is the prospect of more successful restructuring options, likely to be beneficial for the other parties involved as well. The reason for an individual facing financial difficulties can normally be explained by just having spent more money than was received or by the loss

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[198] More details to the situation pre and post ESUG see chapter 7.
[199] More details see appendix one
[200] Annerose Tashiro, Volker Beissenhirtz, 'German Companies heading towards England for their Rescue' (2007) Int.C. R. 171, 174.
[201] See appendix one
[202] On this issue see further: John Tribe, *Bankruptcy tourism in the European Union – myth or reality?* (2016) King's Law Journal, ISSN (print) 0961-5758 (In Press) Flechter I F, 'Living in interesting times – reflections on the EC Regulation on insolvency proceedings: Part 2' (2005) Insolv. Int. 18 (5), 68-77. Cases: *Irish Bank Resolution Corp Ltd v. Quinn* [2012] NICh [2012] BCC 608; *Skjevesland v Geveran Trading Company Ltd* [2003] BPIR 924; *Shierson v. Vlieland-Boddy* [2005] EWCA Civ. 974; *Stojevic v. Official Receiver* [2007] BPIR 141, [2006] EWCH 3447 (Ch); *Re Staubitz-Schreiber* [2006] ECR 1-701, [2006] BPIR 510, [2006] BCC 639; *Official Receiver v. Eichler* [2007] BPIR 1636; *Re Eichler No. 2, Steinhard v. Eichler* [2011] BPIR 1293.
[203] Section 279 Insolvency Act 1986
[204] Since the 01.07.2014 there is the possibility to reduce this discharge period to three years, see section 300 InsO. Another example of an alignment with a more rescue-friendly provision in England; see more details: Heinz Vallender, Hildegard Allemand, Stephen Baister, Pawel Kuglarz, Hans Mathijsen, Barry O'Neill, Eugene Collins and Stathis Potamitis 'A minimum standard for debt discharge in Europe?' (2013) Ins Int 97

of money for certain reasons. Reasons for financial difficulties in a company can be much more diverse and consequently making the way out of this situation far more complex. The solution is often not only financial restructuring, as in the case of individuals, but also involving operative restructuring, working on improvement of operational and strategic capabilities.

1.6.3. Forum Shopping in a Globalised Economy

Globalisation fosters phenomena like forum shopping, as an interchange of different views, cultures and ideas broadens the horizon for Governments to compare and contrast with other jurisdictions. It strengthens the awareness for weaknesses in their own system. Forum shopping must be regarded as a never-ending phenomenon. It is an ongoing process, reminding legislators to constantly be aware of changes and to reflect on improving existing law to offer flexibility and be adaptable for alteration. Modifications do not need to be drastic ones; often merely marginal adaptation results in an advantage over another jurisdiction. A law reform process can be compared with the picture that Jones uses of natural selection taking place on a new island: the committees involved look at existing law aiming to maintain the good parts and concentrate on improving weaker sections, bearing in mind "conditions of life", namely the economic environment.[205] Adaptation is a constant process and jurisdictions have to internalise the idea that changes will be endless and adjust to this concept. It encourages the willingness to change. Without this adaptability and willingness to change, a jurisdiction would not survive the insolvency law competition in the long run.

Law always needs to be flexible and adaptable to changes; insolvency law firmly connected to the economic environment in particular needs to be flexible to adapt to the needs of the market. The willingness of a jurisdiction to change to fulfil these needs represents a basic requirement for a well-functioning insolvency law. Ignoring changes would automatically lead to a non- or "ill"-functioning insolvency regime.

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[205] See chapter 1.3.2.

Forum shopping in its modern form of looking at other jurisdictions to bring law to perfection, arises not only in the area of insolvency law, but also in other fields of law.[206] Law is becoming a product and, like other products, bound to face international competition.[207]

The necessity to compare phenomena seems to have an impact on all forms of decision- making and could be seen as paramount to the development of intelligence.[208] Sacco argues that most legal changes come about through borrowing and that really innovative amendments are rare.[209] Without forum shopping, law would develop more slowly; with less improvement and less perfection. Even if laws cannot be transplanted from one jurisdiction to another, it is still beneficial to compare and contrast to other systems and laws, getting ideas which stimulate thinking outside given confinements.

It would be a mistake to think that different jurisdictions have not influenced each other before, but forum shopping seems to be more prevalent currently. It is a new phenomenon, more apparent than just the fact of one jurisdiction being influenced by another. It is direct competition and in a sense happening more involuntarily. Whereas general influence takes place on a voluntary basis, forum shopping puts pressure on governments to change,[210] in some cases probably provoking changes, which would normally not have been carried out. Forum shopping indirectly encourages adaptability to change; jurisdictions without the necessary willingness to change will disappear in the long run. There are different level of barriers with regard to the competition amongst different countries; the special feature however with regard to the Member States of the EU is that the barriers are lower and the competition more prevalent.[211]

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[206] Horst Eidenmueller, Tilmann Frobenius, Wolfram Prusko, 'Regulierungswettbewerb im Unternehmensinsolvenzrecht: Ergebnisse einer empirischen Untersuchung' (2010) NZI 545, 545.
[207] Ibid
[208] Palmer (n 82) 262.
[209] Sacco (n 83).
[210] One example is the third step of the insolvency reforms in Germany: since the 01.07.2014 it is possible to reduce the discharge period to 3 years, see above footnote 204.
[211] See chapter 1.3.3.

1.6.4. Forum Shopping – a Positive or Negative Phenomenon?

This brings up the question whether forum shopping of companies can be seen as negative or positive. At first glance and considering the discussion above, forum shopping, from a debtor's perspective, is clearly seen as a positive phenomenon. With certain restrictions, debtors have the possibility to pick out an advantageous jurisdiction within the EU. Taking the complexity of insolvency proceedings from the viewpoint of all parties involved, however, forum shopping will not always prove advantageous, as discussed in the following passages.

There is much controversial discussion on whether to regard forum shopping as having a positive or negative impact on the internal market. On one hand, Knof and Mock speak about a "forum shopping malus",[212] while others consider forum shopping essential.[213] This is the result of the complex tangle of interests involved, where a fair balance has to be found. In the following paragraphs, the reasons for such negative and positive attitudes are explored.

Recital 4 of the EIR argues on the hypothesis that forum shopping is seeking to gain a more competitive regime represents a negative phenomenon for the abandoned jurisdiction.[214] How does the overall approach of the EU coincide with the aim of discouraging forum shopping in general as clearly stated in Recital 4? How is Recital 4 reconcilable with the EU principle of freedom of establishment?[215]

The principle of freedom of establishment is part of the general concept of Title IV, Part three of the Treaty on the Functioning of the EU (TFEU), the free movement of persons, services and capital.[216] The discussion of freedom of establishment of companies was started with the *Centros* case,[217] where it was decided that a company is free to choose a company law regime by act

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[212] Reuss (n 196) 10.
[213] Ibid
[214] EIR (n 12).
[215] See articles 43 and 48 EU Treaty.
[216] Ibid
[217] Case C-212/97 *Centros v Erhvervs- og Selskabsstyreisen* [1999] ECR I-01459.

of registration in the chosen Member State.[218] In other words, a company is able by registration to conduct business activities in other Member States without the necessity of material connection.[219] This was also confirmed in the cases *Ueberseering*[220] and *Cartesio*[221] which clearly state that companies generally have free choice of company law regime. National courts, however, consider cases of abuse and fraud, when assessing the scope of freedom of establishment.[222] The issue is therefore decided for company law, but is this also valid for the choice of insolvency law regimes? Is this freedom of choice with regard to company law regimes applicable to the insolvency forum as well? The argument of insolvency law being fully independent of company law raises questions about any case involving the freedom of establishment. However, as insolvency law is concerned with companies facing financial difficulties, it cannot be seen totally separate from company law.[223]

1.6.4.1. Application to Insolvency Law

Reasons for restriction are found by looking at the general aims of the EIR. The preamble of the EIR highlights the "proper functioning of the internal market"[224] as one essential criterion for having an "area of freedom, security and justice"; in other words "the efficient and effective administration of cross-border insolvencies."[225] Another essential criterion can be found in Recital 4, namely the prevention of forum shopping.[226]

These two aims possibly conflict with each other as it might sometimes be necessary to change the COMI for an efficient and effective administration of a cross-border insolvency.[227] Following Eidenmueller's argument, efficient and effective administration has to be seen as the paramount aim of the Regulation

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[218] I Case C-212/97 *Centros v Erhvervs- og Selskabsstyreisen* [1999] ECR I-01459; see as well Paul J Omar, 'Centros, Ueberseering and beyond a European Recipe for Corporate Migration Part 2 (2005) ICCLR 18.
[219] Eidenmueller, Frobenius (n 206) 12.
[220] Case C- 208/00 *Überseering v Nordic Construction Company Baumanagement GmbH* (NCC) [2002] ECR I-09919
[221] Case C 210/06 *Cartesio Oktató és Szolgáltató bt* [2006]
[222] Case C-212/97 *Centros v Erhvervs- og Selskabsstyreisen* [1999] ECR I-01459; Case C- 208/00 *Überseering v Nordic Construction Company Baumanagement GmbH (NCC)* [2002] ECR I-09919; Case C-167/01 *Kamer van Koophandel en Fabrieken voor Amsterdam v Inspire Art Ltd.* [2003] ECR I-10155.
[223] Armour (n 34) 39.
[224] EIR (n 12) recital 2.
[225] Eidenmueller, Frobenius (n 206) 14; EIR (n 12) recitals 2,8,16,19 and 20.
[226] Ibid 14
[227] Ibid 14 /15

and preventing forum shopping should only be reserved for cases where its effect is obviously negative and abusive.[228]

Insolvency law should be treated differently from company law. Eidenmueller admits that company and insolvency law issues might become blurred and he argues that the freedom of establishment would generally protect a COMI shift, with certain restrictions justified to protect workers and creditors.[229] There is an area of conflict between freedom of movement and the granting of protection, more precisely between autonomy on behalf of debtors and protection for creditors.[230]

1.6.4.2. Necessity of Creditor Protection?

Why would creditors need protection? One main aim of an insolvency procedure is the orderly distribution of the debtor's assets allowing the highest possible settlement of the creditor's claims.[231] For such an orderly procedure it is important for the involved parties to anticipate the appropriate court.[232] This could become problematic with the debtor's possibility of forum shopping and thereby changing the seat of court for legal proceedings. Uncertainty about jurisdiction in international cases, possibly encouraging a "race to the courthouse", should be prevented, as any emphasis on just securing the best possible forum might lead to pushing a company into insolvency too quickly.[233] However, it could be argued that early insolvency facilitates the procedure.[234]

Knowledge about respective insolvency regimes is valuable for creditors for the assessment of risks in their interaction with debtors.[235] Forum shopping makes this prediction difficult and could therefore lead to restrictive lending in the first place or to higher interest rates to cover any non- assessable risk of default.[236] Furthermore, the potentially missing proximity to the court could

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[228] Eidenmueller, Frobenius (n 206) 14.
[229] Ibid, 12
[230] Reuss (n 196) 59.
[231] Ibid, 62
[232] Ibid, 66
[233] Ibid, 67
[234] Horst Eidenmueller, 'Wettbewerb der Insolvenzrechte' (2006) ZGR 467.
[235] Reuss (n 196) 67.
[236] Ibid 68

interfere with the maximisation of assets, as enforcement abroad is cost-intensive and would worsen the insolvent's estate ("Insolvenzmasse").[237]

However, forum shopping does not need to be avoided for the proper functioning of the internal market. It should be borne in mind that one fundamental idea behind the internal market is to draw benefit from differences between the jurisdictions of Member States.[238] As the cases of *Schefenacker* and *Deutsche Nickel* demonstrate, both companies, without the possibility to forum shop in England, would have most likely gone into liquidation in Germany.[239]

It could be challenged as well whether creditors really need protection. There is ground for argument that creditors can never rely on assuming jurisdictions as they always face the risk of a company changing its COMI and this will not necessarily take place only on the brink of insolvency.[240] It is the creditor's responsibility to protect himself against these risks, and a restriction via regulation is therefore not necessary.[241] There are different ways of a reconciliation of interests for creditors without the need to prohibit forum shopping. One way is the possibility of a reconciliation through an act of volition ("volenti non fit injuria");[242] in other words through the consent of the creditors. Creditors agreeing to forum shopping do not need protection. The successful migration of *Schefenacker* and *Deutsche Nickel* would not have been possible without the consent of the creditors involved. In the *Schefenacker* case it was actually the creditors who initiated the migration.[243] Migration is almost impossible for a company without the creditors' approval. One example is the safeguard in the German Transformation Act,[244] which provides a creditor protection regime in the form of a security deposit they could claim if the change of the legal form would impair the settlement of the claim.[245] In practice, the assets of a company are pledged to creditors and this

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[237] Reuss (n 196) 69
[238] Ringe (n 31) 29; Armour (n 34) 11.
[239] It could be argued differently see Tashiro, Beissenhirtz (n 200) 174.
[240] Ringe (n 31) 18.
[241] Ibid 18
[242] Reuss (n 196) 12.; "to a willing person injury is not done".
[243] Ringe (n 31) 19.
[244] See above used for the migration of Schefenacker and Deutsche Nickel
[245] Ringe (n 31) 20.

would lead to a necessity for a consent, certainly covering the majority of all cases.[246] Eidenmueller argues against the "volenti non fit injuria", as this would not take all of the creditors' interests into account, namely those of workers and minority creditors who would need protection by regulations such as under Recital 4.[247]

Looking at the case of *Deutsche Nickel* for example, the argument of it not giving adequate protection does not apply as employees benefitted from the company migrating as well as their employment was secured in all three locations, Schwerte, Halsbruecke and Freiberg, which would not necessarily have been the case if the company had been liquidated under German law.[248] In all insolvency cases, not only in those of migration, different interests have to be balanced. It is wishful thinking to believe that all interests involved can always be satisfied, but this holds true not only in cases of forum shopping.

A company moving its COMI from one Member State to another is clearly covered by the freedom of establishment.[249] It is not unusual that a company's move is motivated by a more appealing regulatory environment.[250] Restructuring tools in other jurisdictions could offer more efficient and attractive procedures in fostering company rescue,[251] possibly leading to a better outcome for all parties involved.

1.6.4.3. Forum Shopping - Outcome in General Positive

Forum shopping should be regarded positively, especially from the perspective of the debtor, being able to choose more suitable procedural or substantive law.[252] It could be argued that certain courts are handling cases more efficiently with the positive effects of cost and time saving.[253] Another reason not be underestimated is the fact that the parties involved will choose a forum which is familiar to them, be it for language purposes or previous

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[246] Ringe (n 31) 20.
[247] Eidenmueller Abuse of Law in the Context of European Insolvency Law (n 32) 14.
[248] Hans-Peter Doehmen, Former CEO of the VDN group in a conversation with the author on the phone in 2013.
[249] Eidenmueller Abuse of Law in the Context of European Insolvency Law (n 32) 11.
[250] Ibid
[251] Eidenmueller Abuse of Law in the Context of European Insolvency Law (n 32) 6.
[252] Gerard McCormack, 'Time to revise the Insolvency Regulation' (2011) IILR 121, 128.
[253] Ibid 128

experience; according to the principle "better the devil you know than the devil you don't".[254]

The cases discussed above underline the positive effect of forum shopping; shifting the COMI resulted in restructuring the companies, which would have been impossible otherwise. The companies would have most likely ended in liquidation, with a worse outcome for all parties involved. Moreover, the successful rescue of these companies brought a positive effect also for the creditors in question.

"The appropriate task is to devise measures that reduce the possibility or effects of harmful forum shopping while accentuating the advantages."[255] It could be argued, that the ultimate question lies in the motive behind the COMI shift, "whether a COMI shift is driven by considerations of efficiency (no abuse of law) or considerations of claiming value, for example distributive concerns (abuse of law)."[256] So far there are no cases reported of companies successfully abusing the possibility of forum shopping. Abusive cases however, have been reported amongst individuals changing their COMI.[257]

The case of *Brochier* demonstrates as well that it is quite unlikely that Member States would manoeuvre themselves into backwater by encouraging detrimental forum shopping.[258] There are no cases known yet, which indicate the courts changing their practice to adjust to the needs of companies from foreign jurisdictions.[259] The Recast Regulation is amending the EIR[260] inter alia with regard to forum shopping. Forum Shopping will still not be prohibited, but more controls are put into place to prevent abusive forum shopping.[261]

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[254] Gerard McCormack, 'Time to revise the Insolvency Regulation' (2011) IILR 121, 128.
[255] Ibid
[256] Eidenmueller Abuse of Law in the Context of European Insolvency Law (n 32) 11.
[257] For example *Skjevesland v. Geveran Trading Company Ltd* [2003] BPIR 924; *Shierson v. Vlieland-Boddy* [2005] EWCA Civ 974; *Official Receiver v. Eichler* [2007] BPIR 1636; *Official Receiver –v- Mitterfellner* [2009] BPIR 1075; *O'Mahony v National Irish Bank* [2012] BPIR 1174, more details see John Tribe, Bankruptcy Tourism in the EU – myth or reality? (n 202)
[258] McCormack, Time to revise (n 252) 129.
[259] McCormack Jurisdictional competition (n 43) 185.
[260] Adopted by the Council on 12. March 2012, coming into force in 2017
[261] Ibid

1.6.5. Race to Specialisation or Race to Uniformity?

What does forum shopping result in? Is the deserted jurisdiction more likely to bring their legislation in line with the favourable jurisdiction or is it more likely that the deserted jurisdiction is going to specialise their laws in order to win the race? Insolvency forum shopping first came up in the United States, the centre of attraction being Delaware, where the main specialist insolvency court was located. Firms are restructured faster in Delaware and with better returns.[262] This led to uniformity of the law in other states. This "grab race"[263] it is argued, led to a race to the bottom as the regime that liquidated hardest and fastest won the race.[264] It can be argued that a race to uniformity only takes place in markets with homogenous products.[265] A homogeneous market is "a marketplace that hosts trading in a particular type of commodity where each unit traded is functionally identical to every other unit traded."[266] Can an insolvency regime be seen as a homogenous market? In the US, where bankruptcy laws and procedures are uniform, it could be argued that dealing with insolvency is nearly homogeneous. Bankruptcy laws and procedures are uniform in the US.[267] It could be argued that for the EU, due to national diversity between the laws of individual Member States a situation such as in the US is quite implausible.[268] EU insolvency regimes are not homogeneous, therefore it could be argued that it would not lead to uniformity, but to specialisation of the laws. It could be argued that regulatory competition and hence forum shopping would lead to specialisation of the law as Member States who would like to attract companies would require regulations which provide adequate protection for creditors. Creditors would react to "weak insolvency laws" with

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[262] Eidenmueller Abuse of Law in the Context of European Insolvency Law (n 32) 7; more about positive and negative aspects of the "Delaware effect" s. Lynne M LoPucki, *Courting Failure* (The University of Michigan Press 2005); Lynne M LoPucki, and Sara D. Kalin, 'The Failure of Public Company Bankruptcies in Delaware and New York: Empirical Evidence of a 'Race to the Bottom' (2001) 54 Vanderbilt Law Review 231; Lynne M LoPucki and Doherty, JW 'Why are Delaware and New York Bankruptcy Reorganizations Failing?' (2002) 55 Vanderbilt Law Review 1933; Kenneth M. Ayotte and David A. Skeel, 'Why Do Distressed Companies Choose Delaware? An Empirical Analysis of Venue Choice in Bankruptcy' (2003) University of Pennsylvania Law School: Scholarship at Penn Law, Paper 20; Rasmussen, RK and Thomas, RS; "Whither the Race? A Comment on the Effects of the Delawarization of Corporate Reorganizations", (2001) 54 Vanderbilt Law Review 283, 295.

[263] Lynn M. LoPucki 'Global and Out of Control?' (2005) American Bankruptcy Law Journal, 1.

[264] Crawford (n 36) 4.

[265] Ibid

[266] http://www.businessdictionary.com/definition/homogeneous-market.htm

[267] McCormack, Jurisdictional Competition (n 43) 183.

[268] Armour (n 34) 2.

stricter credit terms, this in turn would keep Member States from relaxing the insolvency regulations.[269]

This thesis, however, argues that forum shopping in the EU does not result in specialisation of laws, but in uniformity. Forum shopping expedites alignment and convergence of insolvency systems as jurisdictions mimic each other in their rescue-friendliness. The convergence with more rescue-friendly regimes is the true path to avoid forum shopping. This thesis demonstrates through the analysis of the changes introduced by the ESUG that the German legislator imitated the English system, at least in parts which led to greater uniformity between the English and the German insolvency laws.

Therefore the arguments above are accurate if a race to uniformity is seen as a race to the bottom; however, this thesis is based on the assumption that a race to uniformity is not a race to the bottom, but a race to the top, this is now explained.

1.6.6. Race to the Top or Race to the Bottom?

It could be argued that unifying the law provokes a race to the bottom, obliging Governments to lower standards and regulations and as such should be categorised as a negative occurrence. The "Delaware effect" is described as a "race to the bottom".[270] Inter-jurisdictional competition would tend to result in modification of laws and regulations only being determined by adopting the preferences of parties initiating the case whereas preferences of indirectly involved market participants would not be taken into account.[271] The outcome of this would be that the legal level of protection declines.[272] It could be argued that courts compete against each other and that forum shopping "represents an unconscionable sell-out to the case placer."[273] There is argument that the negative image of forum shopping results from the idea that the most competitive regime for liquidation is the one showing the best returns for

[269] Armour (n 34) 2.
[270] Crawford (n 36) 5.
[271] Reuss (n 196) 18.
[272] Ibid
[273] McCormack, Jurisdictional Competition (n 43) 182.

secured creditors, without taking other objectives into account or the most lenient towards debtor behaviour on the personal side.[274] In other words the one who "grabs first",[275] the one who liquidates fastest and hardest wins the race.

1.6.7. Forum shopping - A situation of Prisoner's Dilemma?

This "grab race" could be explained with the so-called "prisoner's dilemma"[276]. A creditor's first reaction in an insolvency scenario would probably be to try to realise his assets before other creditors are able to do the same. This would be the rational behaviour from the standpoint of an individual creditor, but this would not be beneficial for the collective interest of all creditors. Such a "grab race", a "disorderly piecemeal dismantling" of a company would result in losses for all creditors.[277] Applying a prisoner's dilemma to an insolvency situation falls short in a sense that prisoners have only one possibility to decide on, whereas institutionalised and experienced creditors can learn from experience and therefore move from being "one-shot players" to become "repeat players".[278] For "repeat players", achieving long-term goals is more important than the quick win.

1.6.8. Homogeneity of Markets

It could be argued that the non-homogenous market in the EU leaves arguments about a race to the bottom in this sense rather unlikely. Whereas in the US the predomination of Delaware mainly results from low taxation rates, it could be argued that within the EU there is greater focus on the professionalism of insolvency service companies facing fierce global competition.[279] The system of main and secondary proceedings in the EU curtails the possibilities for a "race to the bottom" as this system is laid out to safeguard local creditors, and not for them to obstruct rescue proceedings.[280]

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[274] Crawford (n 36) 4
[275] LoPucki 'Global and Out of Control' (n 263)
[276] Original "prisoners dilemma theory" see Albert W. Tucker, *'A two Person Dilemma: The Prisoner's Dilemma'* (1983) VCI 14, No.3 The Two-Year College Mathematics Journal 228.
[277] Crawford (n 36) 5.
[278] Crawford (n 36) 9.
[279] Armour (n 34) 2.
[280] Ibid

It is argued that a reaction to forum shopping is to eliminate weak rules, and not ending up in a "destructive race to the bottom".[281] A "race to the bottom" could only be assumed if companies were allowed to enter into "regulatory arbitrage", i.e. taking advantage of a regulatory difference between two or more markets, bringing the Member States to acknowledge that creditor protection rules in place would be subverted.[282] Creditors would have the possibility of achieving regulatory arbitrage by adjusting their terms of credit, which in turn would offer an incentive scheme for a debtor to choose a creditor-friendly insolvency regime.[283] In this context it is argued that the main motive of a Government is not to lower standards, but to change existing law for the better, with the result of increasing existing standards and regulations.

1.6.9. A Race to Rescue

Defining "uniformity" in the Delaware sense equals uniforming the law to lower standards with the aim of highest returns for secured creditors, in the form of fastest and hardest liquidation, which is seen as a race to the bottom.[284] This thesis defines a race to uniformity not as a race to the bottom, but a race to the top, as the race to uniformity is construed as a race to rescue.

The thesis argues that the overarching aim of a modern insolvency law is to increase the chances for restructuring, in other words, fostering rescue culture. The view is taken that an improvement of restructuring opportunities is an essential feature of a modern insolvency culture.[285] "The role of the formal rescue mechanism is to facilitate the survival of the company and its business[286] in order to maximise the value of the available assets,"[287] in other words rescue should not be a self-fulfilling aim, but a modern insolvency regime should provide a framework which allows sensible restructurings, restructurings which are economically sensible. A modern insolvency system

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[281] Armour (n 34) 3.
[282] Ibid 47
[283] Ibid, 48
[284] LoPucki 'Global and Out of Control' (n 263); Crawford (n 36).
[285] Vallender Insolvenzkultur (n 5) 839.
[286] See Terminology 0.7.
[287] Review Group, 'A Review of Company Rescue and Business Reconstruction Mechanisms Insolvency Service' (May 2000), 10.

still has to provide for liquidation procedures for companies which are not worth restructuring.[288]

Hence jurisdictions such as Germany, which were historically less rescue-friendly have been pushed in policy terms to align their systems with more rescue-friendly regimes. This is important for this thesis because it shows how Insolvency Darwinism leads to a global convergence of insolvency systems so that the major jurisdiction imitate each other in their rescue-friendliness.[289] It could be argued in line with the mainstream "Delaware" arguments that lowering standards can only result in a race to the bottom, however, if a race to the top is defined as a race to rescue as the overarching policy aim of a modern insolvency system, than in fact lowering standards in order to facilitate restructurings cannot be categorised as a race to the bottom. Therefore convergence in EU jurisdictions, harmonising the laws and the trend towards uniformity, driven by various Member States imitating other Member States should be seen as race to the top and in line with the Darwinian approach a race to perfection.

The example of the ESUG, analysed in this thesis, shows that in practice, although there might be no uniformity of the EU insolvency market yet, that the German legislator went along this path towards homogeneity as a result of forum shopping activities. This thesis demonstrates in Part B that the changes introduced by the ESUG in fact led to an alignment of insolvency laws.

1.6.9.1. Forum Shopping from a National Viewpoint- a Driver of Legal Perfection

The race to rescue within the EU should be seen as a positive phenomenon, a race to the top and driver for insolvency law perfection. The urge to stop in principle unwanted forum shopping encourages a jurisdiction to rethink its position and to improve the situation by the willingness to change, to be able to compete again. This can be achieved by adopting and aping certain

[288] Review Group, 'A Review of Company Rescue and Business Reconstruction Mechanisms Insolvency Service' (May 2000), 10.; See as well UNICITRAL, 'Legislative Guide on Insolvency Law'15, 16 (key objectives of an effective and efficient Insolvency Law).
[289] See introduction 0.5.

qualities of other nation's laws, not just copying foreign laws verbatim, but looking at general principles and ideas and applying them to the existing framework and background.[290]

This in itself could be regarded as positive as jurisdictions are encouraged to adapt to changes and not having the possibility of ignoring changes in other jurisdictions if they want to survive the competition. Law would not develop as quickly and soundly without the phenomenon of forum shopping. It teaches jurisdictions to look further afield and be open for different approaches and ideas. It could be argued that there is little stimulus for EU countries to compete against each other on insolvency cases; however this is underrating side-effects of forum shopping in, gaining a good reputation as a favourable insolvency regime resulting in positive effects on the economy as discussed above.[291] England is already known as the "restructuring capital of Europe"[292], especially German companies made or tried to make use of the English insolvency regime as explained before.[293] The reaction of the German legislator to reform the existing insolvency regime is an example which is demonstrated in this thesis that led in parts to the mimicking of rescue-friendly regulations in order to be able to withstand the competition of the more rescue-friendly regime in England.

1.7. Application to the Research Question

The effects of forum shopping are applicable to the research question about movements of German companies to England to gain from beneficial English insolvency proceedings, thus encouraging the German Government to change insolvency laws by introducing the ESUG.[294] This is a good example of a driver for improvement and adaptability to change. The Government Draft states that the impetus for the reform was the move of German companies to England which started a general discussion "Germany, as a restructuring jurisdiction"

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[290] See Methodology 0.7.
[291] McCormack, Jurisdictional Competition (n 43) 180.
[292] Ibid
[293] See introduction 0.2.1.
[294] Gesetzesentwurf der Bundesregierung, 'Entwurf eines Gesetzes zur weiteren Erleichterung der Sanierung von Unternehmen' (BT. Drs. 17/5712) <http://rsw.beck.de/aktuell/gesetzgebung/gesetzgebungsvorhaben-zusaetzliche-materialien/erleichterung-der-unternehmenssanierung-(esug)> introduction.

("Sanierungsstandort Deutschland").[295] McCormack sees the reforms as an attempt "... to stop the flight of the corporate geese from Germany".[296] The forum shopping activities increased awareness for weaknesses in the German system.[297]

This thesis examines forum shopping from a Darwinian perspective. Germany and England as Members States of the EU compete with each other because movement of capital to another Member State has a negative effect on the departed country's economy.[298] A reputation as a "bad restructuring jurisdiction" could also have an impact on the choice of business location preventing company incorporations in Germany in the first place. Freedom of establishment allows companies to choose a regime that fulfils their needs, so Member States ought to be motivated to attract companies and be willing to adapt to changes keeping up with business demands. It requires especially bearing in mind that forum shopping is not a one-dimensional task but in itself an act of investment.[299] The quality of the legal restructuring framework of a country has an impact on the willingness to invest and the access to debt capital for companies.[300] The overarching policy drivers of modern insolvency regimes to foster rescue culture causes less rescue-friendly regimes to mimic these rescue-friendly regimes, demonstrated in Part B of this thesis.

1.8. Mini-Conclusion

Taking the examples of England and Germany, this research argues that forum shopping activities foster the development, improvement, reform and revision of existing laws. In other words, it is argued that forum shopping facilitates "perfection" in the generally accepted norms of paradigmatic insolvency provisions. Darwin's core theory can be applied to insolvency law regimes in looking at different jurisdictions competing with each other, much like genes in the biological field competing for supremacy. By analogy to living

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[295] Gesetzesentwurf der Bundesregierung, 'Entwurf eines Gesetzes zur weiteren Erleichterung der Sanierung von Unternehmen' (BT. Drs. 17/5712) <http://rsw.beck.de/aktuell/gesetzgebung/gesetzgebungsvorhaben-zusaetzliche-materialien/erleichterung-der-unternehmenssanierung-(esug)> introduction.
[296] McCormack Time to revise the Insolvency Regulation (n 252) 129.
[297] Ibid
[298] See chapter 1.5.
[299] Crawford (n 36) 5, 6.
[300] Eidenmueller, Frobenius (n 206) 546.

creatures, jurisdictions should be adaptable to changes in their business environment in order to survive the competition amongst the EU Member States, where the barriers are low and hence the competition more likely. As law can be seen as a product, like other products it faces international competition, resulting in the attempts by jurisdictions to perfect their own regime. It is a special form for governments of comparison as forum shopping is a direct competition with the necessity to react. Competition is more prevalent as argued in this research as the ESUG is an example, at least in parts, of changes influenced by forum shopping activities.

Forum shopping is seen as a positive phenomenon, which fosters the development of a rescue culture, with the opportunity for the debtor and creditors to choose the jurisdiction with the most adapted regime for their needs. The overall economy benefits from the choice between different jurisdictions, as companies may be rescued instead of liquidated, which is of course, the conclusive overall aim of sophisticated insolvency law regimes. Forum shopping is seen as positive as long as it is not misused in a fraudulent way.

Although this thesis argues that forum shopping results in a race to uniformity, this uniformity does not imply a race to the bottom, but a race to the top. Uniformity is not defined here as lowering standards in the Delaware sense with the aim of hardest and fastest liquidation for return to secured creditors, but uniformity in the sense of a race to rescue, aligning regimes to be more rescue-friendly as the overarching policy aim of modern insolvency regimes.

Chapter Two

Roots, Development and Practice of Rescue Culture in Germany

"The necessity of a new concept for a modern, business-orientated and yet social insolvency law" (Hans-Jochen Vogel, former Minister of Justice)

2.1. Introduction

Following the exposition of the core thesis in chapter one, it is important to give a brief overview of the roots, development and practice of the "rescue culture" in Germany. It is imperative to understand the development of German insolvency law before focussing on changes introduced by the ESUG. Understanding modifications of the ESUG would be difficult without first examining certain key stages of development and the overall understanding of the background of restructuring law. To estimate whether a change introduced by the ESUG leads to insolvency law perfection requires comprehension of the general aims of the legislator on introducing the InsO. The relevant specific changes are analysed in the respective chapters.[301]

Having said that, it would go beyond the scope of this thesis to discuss German insolvency history in its entirety.[302] Points of comparison in the following chapters will be pre- and post- ESUG; post-ESUG being defined as post-Insolvency Code 1999 (InsO). Where the analysis in Part B requires reference to earlier legislation, it is integrated in the relevant point of discussion.

The nature and purpose of this chapter is to give an outline of the development of the InsO, looking at major aims and changes of the InsO and progression of law up to the introduction of changes through the ESUG. Focal points are chosen considering changes introduced later through the ESUG. The aim of the thesis is to compare and contrast the situation in Germany pre- and post-

[301] Chapters four to eight

[302] For example see Wilhelm Uhlenbruck, 'Zur Geschichte des Konkurses' (2007) DZWiR 4; Gerhard Pape, Wilhelm Uhlenbruck, Joachim Voigt-Salus, Insolvenzrecht (second edition C.H. Beck Munich 2010).

ESUG with comparable laws in England. The centre of analysis is based on changes in this reformed law. The InsO itself introduced several other changes to previous law, but this is outside the centre of discussion here unless discussed during the ESUG reform process.

2.2. Insolvency Code 1999 ("InsO" ("Insolvenzordnung"))

Effort to reform the (Konkursordnung 1877, "KO") can be traced back to the early 20th century.[303] However, only the demand for reforms starting after the recession triggered by the oil crisis in 1973 drew the attention of the wider public.[304]

The German insolvency landscape offered two totally different procedures for dealing with an insolvent company: the German Bankruptcy Act 1877 ("Konkursordnung 1877" (KO))[305] and the Rules of Conciliation 1934 ("Vergleichsordnung" (VglO)).[306] The aims of the VglO, namely the protection and restructuring of the honest debtor, were in contradiction to the aim of the KO, namely the best possible satisfaction of creditors.[307] This actually resulted in harming the interests of creditors.[308] The VglO provided for the participation of those debtors, which were reluctant to a restructuring according to the creditor's ideas. After a significant loss of time this resulted in a bankruptcy procedure, hence in liquidation rather than restructuring.[309] Rights of other parties involved in the procedures were treated differently, which could lead to

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[303] Details in Bundesministerium der Justiz, *Erster Bericht der Kommission fuer Insolvenzrecht* (RWS Cologne 1985)152.

[304] Gesetzesentwurf zur Insolvenzordnung, (BT Drs. 12/2443). <http://dip21.bundestag.de/dip21/btd/12/073/1207302.pdf>, chapter 5. Vorgeschichte zur Reform.

[305] Wolfram Henckel; Walter Gerhardt, 'Insolvenzordnung- Grosskommentar' (Walter de Gruyter Berlin 2004), p.4; The KO came into force in 1900. The KO introduced by Kaiser Wilhelm I., described as the 'Pearl of the Empire Justice Acts' ('Perle der Reichsjustizgesetze'), had a serious defect: the lack of restructuring procedure. The reason referred to for such a lack of a possibility for companies in financial distress, was that the insolvency was seen as an instrument of 'elimination of a surplus of business entities' or a 'natural selection'.[305] After the First World War this liberal attitude towards the economy was seen as outdated. An extraordinary shock came with the global economic crisis in 1929, where several insurance companies and banks faced insolvency. The urgent need for a possibility to overcome financial difficulties for businesses crystallised and it took revenge that the legislator set aside a restructuring process in the Bankruptcy Act 1877. The reaction was finally to introduce in 1934, an additional form of insolvency law for companies – known as Rules of Conciliation 1934 ("Vergleichsordnung" (VglO).

[306] Ibid; This Act focused on finding a settlement solution rather than liquidating a company, as both debtors and creditors would mutually benefit from the continuance of the company.

[307] Bt Drs. 12/2443 (n 304) 73,74.

[308] Ibid

[309] Ibid 74.

a shifting of assets and consequently a wrong allocation of economic resources.[310]

Furthermore, the KO and VglO were not able to meet the demands for the realisation of liabilities, as most companies did not have sufficient assets required to gain access to a formal procedure.[311] This lack of functionality was casting doubt on the persuasive power of the legal system.[312]

Next to the clash of interests of the two procedures and their loss of functionality, the procedures of the KO and the VglO were outdated, the most significant deficit being that the law was not allowing a functioning legal framework for rescuing a company as a decision for either the insolvency procedure under the KO or the settlement after the VglO had to be reached before chances of a possible restructuring could be assessed properly.[313] The legislator spoke about the loss of functionality of insolvency law ("Funktionsverlust des Insolvenzrecht"), which would question the persuasiveness of the legal system.[314] Kilger created the term "bankruptcy of bankruptcy" ("Konkurs des Konkurses") as the KO and VglO were not able to fulfil their function any more.[315]

The possibilities under the VglO were restricted to measures to settle the debtors' debts, but did not include any instruments to enhance the finance or capital structure.[316] The standing of the trustee in a composition settlement ("Vergleichsverwalter") was too weak. The Commission argued that the "moralising" value preconditions (""moralisierende"

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[310] Bt Drs. 12/2443 (n 304) 73,74.
[311] Wilhelm Uhlenbruck, Joachim Brandenburg, Volker Grub, Wilhelm Schaaf, Jobst Wellensiek, 'Die Insolvenzrechtsreform- Ein typischer Fall der Überjustizialisierung' (1992) Betriebs-Berater 1734, 1734; Bt Drs. 12/2443 (n 304), 72: in the years 1985 to 1990, 75% of all bankruptcy filings have been rejected due to failing coverage of the procedural costs ("Abweisung mangels Masse"). In 1950 it was only 27% in 1960 35% and in 1970 47%. The recovery rate for unsecured creditors was in average only 5%. The reconciliation procedure nearly descended to insignificance; since 1983 less than 1% of the insolvency cases a settlement was confirmed by the courts. In 1950 the proportion was still at 30%, in 1960 at 12% and in 1970 at 8%.
[312] BT. Drs. 12/2443 (n 304) 72.
[313] BT. Drs. 12/2443 (n 304) 72.
[314] Ibid
[315] Ibid103; Erster Bericht der Kommission fuer Insolvenzrecht (n 303) 5.
[316] Ibid 155.

Wuerdigkeitsvoraussetzungen") would no longer fit into a modern business life and would exclude the restructuring of viable companies.[317]

In the case of a discrepancy between outdated laws and a changing political and social environment, dogmatic judicial skill is called for to cover this up interpretatively.[318] However, if values of the dogmatic system of order ("Ordnungssystem") deteriorate themselves losing their societal ability to achieve consensus ("gesellschaftliche Konsensfaehigkeit"), a discussion with regard to legal policy ("rechtspolitische Eroerterung") becomes necessary.[319] In other words, an adaptation in form of reformed laws becomes necessary to avoid the existing laws becoming inoperable, or in an analogy to Darwin, becoming extinct. The KO was based on three basic principles of order ("Ordnungsprinzipien"), first, the *par conditio creditorum*, in other words the equal treatment of all creditors, second, the demand for economic neutrality ("wirtschaftliche Neutralitaet") and, third, the totality of enforcement measures ("vollstreckungsrechtliche Totalitaet").[320] These basic principles were not in line with the changing environment and the legislator failed to include challenges resulting from changing social reality.[321] These values of the German insolvency system were lost and a broad-ranging debate was started. It became clear that a healthy national economy was able to afford only a limited number of insolvencies and losses, if it did not want to suffer itself.[322] The economists argued that the insolvency of a company could be taken as second chance for a new start.[323] Beginning in the late nineteen seventies a radical re-thinking came to the fore, realising that economic failure is not always due to personal blame, but reasons for insolvency are multi-layered.[324]

The shortcomings of the old legal framework were obstacles to the best possible realisation of a debtor's assets, as to be expected from a modern up-

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[317] Erster Bericht der Kommission fuer Insolvenzrecht (n 303) 5.
[318] Volkmar Gessner, Barbara Rhode, Gerhard Strate, Klaus A. Ziegert, *Praxis der Konkursabwicklung* (Bundesanzeiger Verlagsgesellschaft Cologne 1978) 2

[320] Erster Bericht der Kommission fuer Insolvenzrecht (n 303) 2,3.
[321] Ibid, 3.
[322] Wilhelm Uhlenbruck, 'Gerichtliche oder außergerichtliche Sanierung? - Eine Schicksalsfrage Not leidender Unternehmen' (2001) BB, 1641, 1642
[323] Uhlenbruck, Zur Geschichte des Konkurses (n 302) 4.
[324] Ibid

to-date insolvency law and were consequently replaced by implementing the InsO. The reforms leading to the InsO started in 1978[325], taking inspiration from Chapter 11 of the US Bankruptcy Code.[326] These finally came into force in Germany on 01. January, 1999[327], replacing the KO and the VglO in the former West German States and the Total Execution Code ('Gesamtvollstreckungsordnung') in the former East German States.[328]

2.2.1. Aims of the InsO

The InsO changed the insolvency landscape extensively. Its main goals were focused on a uniform insolvency proceeding ("Einheitliche Insolvenzverfahren)[329]; timely and easier opening of proceedings ("Rechtzeitige und leichtere Eroeffnung des Verfahrens");[330] inclusion of secured creditors ("Einbeziehung der gesicherten Glauebiger");[331] abolition of general priorities in bankruptcy ("Abschaffung der allgemeinen Konkursvorrechte");[332] transformation of settlement and compulsory settlement to insolvency plan ("Umgestaltung von Vergleich und Zwangsvergleich zum Insolvenzplan"); regulation of transferred restructuring ("Regelung der uebertragenen Sanierung")[333] and integration of the rights of employees ("Einbindung der Arbeitnehmerrechte").[334]

In the following, the exposition concentrates on changes truly relevant for the analysis in Part B. It would go beyond the scope of this thesis to compare and contrast the InsO with the KO and the VglO, but it is essential to provide all the information necessary to compare and contrast the situation pre- and post-ESUG.

The InsO aims to release the debtor from the stigma of insolvency.[335] Insolvency was always affected by the idea of failure and the stigma

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[325] Eva Maria Huntermann; Christian Graf Brockdorff, *Der Glaeubiger im Insolvenzverfahren* (Walter de Gruyter Berlin 1999) p.2.
[326] BT- Drs. 12/2443 (n 304) 194.
[327] Wilhelm Uhlenbruck, 5 Jahre InsO-Kein Grund zum Feiern (n 76) 1.
[328] Andreas Remmert, 'Introduction to German Insolvency Law' (2002) I. C.C.L.R. 427,427.
[329] BT. Drs. 12/2443 (n 304) 83, 84.
[330] Ibid 84-86.
[331] Ibid 86-90.
[332] Ibid 90-94.
[333] Ibid 94-95.
[334] Ibid 95-98.
[335] Ibid

associated with insolvency.[336] Sambart wrote about the "retirement of the rotten, lazy and weak people out of the market".[337] The key words for insolvency during the world economic crisis 1929/31 were "instruments of elimination of super numerous economic entities" or "natural selection"[338] in the sense of business Darwinism, meaning that companies were eliminated in a natural way. Insolvency was regarded a self-cleansing process in eliminating those companies not able to withstand the prevailing competition. Regarding failure the accusation of personal fault did not leave sufficient room for consideration that certain situations might also have been caused by external factors. The reform process leading to the InsO was characterised by taking into account that reasons for insolvency were more complex and that the debtor was not always to blame. It was the aim of the legislator to create a modern and functional insolvency law, which would fit seamlessly into the legal and economic conditions, meaning that the legalities of the market would also regulate the handling of insolvencies.[339]

2.2.2. Uniform Insolvency Proceeding

The Government Draft envisioned a self-contained set of rules with a procedure to provide "a flexible framework for an effective and fair handling of insolvencies".[340] The law should outline basic conditions for the decision of liquidation or restructuring, eliminating the tendency towards liquidation given under the old laws. With the introduction of a uniform insolvency procedure, the insolvency proceedings are subjected to a homogenous main purpose, independent from the way how to achieve this; namely the realisation of estate liabilities ("Verwirklichung der Vermoegenshaftung").[341] It offers an independent process structure to consistently assess the rights of all parties involved.[342]

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[336] Uhlenbruck, 'Gerichtliche oder außergerichtliche Sanierung?' (n 322) 1641.
[337] Werner Sambart, *Das Wirtschaftsleben im Zeitalter des Hochkapitalismus*, 2 Hbd, 1955, 577, see Uhlenbruck, 'Gerichtliche oder außergerichtliche Sanierung' (n 322) 1641.
[338] Ibid
[339] Bt Drs. 12/2443 (n 304) 77.
[340] Ibid, 82
[341] BT. Drs. 12/2443 (n 304) 83.
[342] Ibid

The Insolvency Commission suggested the retention of both a liquidation procedure and a special reorganisation proceeding which should have replaced the settlement proceedings within such a uniform insolvency proceeding.[343] They proposed two main different purposes for the reorganisation and the bankruptcy procedure. Whereas the major aim for the reorganisation procedure should have been the preservation of a viable business ("Erhaltung eines lebensfaehigen Unternehmens"), the main purpose for the bankruptcy procedure should have been the satisfaction of creditors through liquidation ("Glaeubigerbefriedigung durch Liquidation").[344]

Nevertheless, the Government decided to introduce a single, homogenous procedure, as it would offer a flexible tool leaving it to the parties to decide on the most advantageous process aim, which would preclude potential prejudice through a formal judicial "setting of the course".[345] It was argued that only such a uniform procedure would fulfil the requirements of market conformity.[346] Special emphasis was put on this due to negative experiences with the non-uniform procedures of the KO and the VglO.[347] The decision whether to restructure or liquidate had to be made at a time when chances of restructuring could not be estimated properly. In other words, neither the KO nor the VglO offered companies in financial distress a functioning legal framework for a successful restructuring.[348] The differing aims of the KO and the VglO led to the possibility forestalling bankruptcy by filing for settlement under the VglO, thereby harming creditors and compromising restructuring.[349]

The primary purpose of a collaborative realisation of liability ("Gemeinschaftliche Haftungsverwirklichung als Hauptzweck")[350] is, put in other words, the best possible settlement for outstanding creditors[351] and not

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[343] Erster Bericht der Kommission fuer Insolvenzrecht (n 303) 5.
[344] BT. Drs. 12/2443 (n 304) 88.
[345] Ibid
[346] Ibid, details to this procedure: 148-294.
[347] See chapter 2.2.
[348] BT. Drs. 12/2443 (n 304) 73.
[349] Ibid
[350] Ibid 83, 84.
[351] Jobst Wellensiek, 'Uebertragende Sanierung' (2002) NZI 238, 238, section1 states "Das Insolvenzverfahren dient dazu, die Glaeubiger eines Schuldners gemeinschaftlich zu befriedigen, indem das Vermoegen des Schuldners verwertet und der Erloes verteilt oder in einem Insolvenzplan eine abweichende Regelung insbesondere zum Erhalt des Unternehmens getroffen wird. Dem redlichen Schuldner wird Gelegenheit gegeben, sich von seinen restlichen Verbindlichkeiten zu befreien. " (The aim of the insolvency procedure is to satisfy all creditors of one debtor collectively, in the way that the assets are realised and the proceeds distributed or dissenting arrangements are made in an insolvency plan in particular to rescue the company. The honest debtor gets the chance to discharge from his residual debts."); the KO and the VglO did not comprise a section on the

the preservation of an independent entity.[352] This main purpose characterises the entire insolvency proceedings; there is only an emphasis in section 1 sentence 2, opening to individual debtors the possibility of discharging their residual debts ("Restschuldbefreiung").[353]

Concluding, the German Government did not[354] see the rescue of a company itself as the primary goal and also not as independent objective of insolvency law.[355] The suggestion of the Commission to introduce an independent restructuring proceeding with the aim of preserving viable businesses was not implemented.[356] Liquidation, rescue of the company and business restructuring are non-hierarchical possibilities.[357] It depends on how optimum creditor satisfaction can be achieved, which could be a restructuring, but restructuring is not regarded as an objective in its own right.[358] It was argued that reforming insolvency law could not abolish the fact of insolvency itself, but could "facilitate its economic, reasonable and fair fulfilment."[359] A company will be rescued under economic conditions, if a going concern makes more sense for all participants in comparison to liquidation; what it takes is a "microeconomic investment decision".[360] It was, however, not a self-contained aim of the Insolvency Reform to procure restructuring, but to "enable meaningful restructuring and prevent absurd restructurings".[361]

Although the rescuing of a company is not seen as an independent objective, the Government put emphasis on the fact that the idea of rescuing companies instead of liquidating them was still one of the major aims of the insolvency reform, which can be seen by looking at the various changes towards facilitating restructuring The insolvency procedure should be seen as a

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procedural goal as it was assumed that the targeted lawyer was able to deduce the objectives of the law. Still today it would be possible without section 1 to deduce the aims of the InsO, however the formulated objective could be used for the interpretation of the law.(see Henckel (n 305) section 1, recital 1).

[352] BT. Drs. 12/2443 (n 304) 76.

[353] The original Government Draft comprised three subsection in section 1; however the changes of the adapted section 1 were only of an editorial nature; the wording was reduced to the main elements; the insolvency plan procedure was highlighted as a way to satisfy the creditors.(Rechtsauschuss, 'Beschlussempfehlung und Bericht zur Insolvenzordnung BT Drs. 12/2443' (BT-Drs. 12/7302 to Bt.-Drs. 12/2443 Insolvenzordnung 1999) http://dipbt.bundestag.de/doc/btd/12/073/1207303.pdf, 155.

[354] And still does not

[355] BT. Drs. 12/2443 (n 304) 84, the preservation of work places is not a self-contained objective either.

[356] Erster Bericht der Kommission fuer Insolvenzrecht (n 303) 88.

[357] Ibid

[358] Ursula Schlegel, 'Law for further Facilitation of the Restructuring of Companies': A Turning Point in the History of the German Insolvency Regime? Part 1' (2011) 8 Int. C. R. Issue 6

[359] Erster Bericht der Kommission fuer Insolvenzrecht (n 303) para 33.

[360] BT. Drs. 12/2443 (n 304) 77.

[361] Ibid

"unique opportunity to jettison, restructure, change the management and draw energy from the experience of potential downfall".[362]

2.2.3. Easier Access to the Proceedings

Another main aim of the InsO was to enable a timely and easier opening of the proceedings ("Rechtzeitige und leichtere Eroeffnung des Verfahrens").[363] Especially by expanding reasons to file for insolvency to the case of "imminent illiquidity" ("drohende Zahlungsunfaehigkeit"), a possibility for an earlier access to insolvency proceedings was introduced by the InsO.[364]

Furthermore, several incentives were introduced for the debtor to file for insolvency at an early stage.[365] The most important one (also to avoid personal liability) is the obligation to file for insolvency under section 64 GmbHG[366] within three weeks, if a reason for insolvency[367] is given.[368]

Several other amendments were implemented to facilitate the opening of insolvency proceedings and to encourage early applications. Only by opening proceedings can the efficiency advantages of the new proceeding be exploited.[369] Measures taken to reach this aim were the introduction of a new ground for the commencement of the proceedings, namely imminent illiquidity; new rules with regard to the formal opening of proceedings; new rules on the ranking of insolvent's assets; measures to relieve the insolvent's estate of assets; modifications to lower the costs of the proceedings; and the intensification of the right of challenge ("Anfechtungsrecht"), all serving to enhance the insolvent's assets.[370]

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[362] BT. Drs. 12/2443 (n 304) 77.
[363] Ibid, p.84-86
[364] Section 18 InsO; section 18 sub. 2 InsO defines that a debtor is likely to become insolvent, if he presumably will not be able to satisfy the existing duties of payment at the due date („Der Schuldner droht zahlungsunfaehig zu werden, wenn er voraussichtlich nicht in der Lage sein wird, die bestehenden Zahlungspflichten im Zeitpunkt der Faelligkeit zu erfüllen.")
[365] BT. Drs. 12/2443 (n 304) para 73
[366] Section 64 GmbHG: Haftung für Zahlungen nach Zahlungsunfaehigkeit oder Ueberschuldung (Liability for payments after the occurrence if illiquidity or over-indebtness).
[367] Reasons for insolvency are a) inability to pay its debts, section 17 InsO and b) over-indebtedness, section 19 InsO; more on differences of insolvency reasons see Michael Schillig, 'Balance sheet insolvency: controversy in different jurisdictions. Part 1: the UK' (2012) 8 B.J.I.B. 459 and Michael Schillig, 'Balance sheet insolvency: controversy in different jurisdictions: Part 2: Germany' (2012) 9 B.J.I.B. 551.
[368] Sections 64, 84 GmbHG.
[369] BT-Drs 12/2443 (n 303) para 69.
[370] Ibid, para 101.

2.2.4. Inclusion of Secured Creditors

The old law was characterised by a lack of coordination between insolvency law and financial securities ("Insolvenz- und Kreditsicherungsrecht") in that rights from collaterals ("Kreditsicherheiten"), especially from movable collaterals ("Mobilarsicherheiten"), could be exercised regardless of the requirements for economically rational insolvency proceedings.[371] This was seen as the main reason for the break-up automatism ("Zerschlagungsautomatik") of the KO.[372] The InsO introduced amendments restricting the individual access ("Individualzugriff") of secured creditors in the general interest of the insolvency procedure.[373]

2.2.5. Abolition of the General Priorities

Section 61 subsection 1 KO contained priority rights for certain creditors. This classification of priority rights for certain creditors was seen as arbitrary. Moreover, a classification of creditor groups in a catalogue of priorities was seen contradicting the need for protection in the individual case.[374] Therefore this regulation was abolished with the introduction of the InsO.

2.2.6. Transformation of Settlement and Compulsory Settlement to the Insolvency Plan

The most important change of the InsO was the introduction of the insolvency plan. It was seen as the key element of the InsO[375] and will therefore be discussed in more detail below.[376]

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[371] BT-Drs 12/2443 (n 303) para 69.
[372] Ibid
[373] ibid
[374] Ibid 90.
[375] Ibid para 154.
[376] See chapter 2.3.5.

2.2.7. Regulation of the "Transferred Restructuring" ("uebertragende Sanierung")

During the reform proceedings discussion took place on whether to render the transferred restructuring[377] more onerous and diminish it in comparison to the restructuring of a company as a going concern.[378] The InsO did not take up this suggestion as the transferred restructuring was one of the restructuring tools widely used in Germany and therefore continued to be offered as an alternative restructuring tool.[379] A transferred restructuring could also be taken as a basis for an insolvency plan.[380]

The last main aim of the InsO was the amendment with regard to the implementation of employees' rights which, however, not within the parameters of this thesis, is not discussed here any further.

2.3. The Insolvency Landscape post InsO

The insolvency landscape changed quite dramatically after the introduction of the InsO. In the following, a chronological overview of the insolvency regime in Germany up to the implementation of the ESUG is given.

2.3.1. Single Gateway Insolvency Procedure

With the introduction of the InsO in 1999, a single gateway insolvency procedure was created, which offered a variety of types of asset realisation without a hierarchy amongst them.[381] The decision as to how to realise a debtor's assets in the best possible way was left to the participants as explained in more depth below.[382]

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[377] See Terminology 0.7.
[378] Bt. Drs. 12/2443 (n 304) 94.
[379] Ibid
[380] Ibid
[381] Andrea K. Buth, 'Der Insolvenzplan als Sanierungsplan- Grundzüge und betriebswirtschaftliche Aspekte' (1997) DStR 1178, 1178.
[382] See 2.3.2- 2.3.7.; Ibid; Section 1 InsO states "The insolvency proceedings shall serve the purpose of collective satisfaction of a debtor's creditors by liquidation of the debtor's assets and by distribution of the proceeds, or by reaching an arrangement in an insolvency plan, particularly in order to maintain the enterprise. Honest debtors shall be given the opportunity to achieve discharge of residual debt."

Figure two:

Sequence of an Insolvency Proceeding in Germany

2.3.2. Regular Insolvency Proceedings

To start formal insolvency proceedings, either the insolvent debtor or his creditors have to file for insolvency with the local insolvency court.[383] Such court-filing has to be carried out without undue delay, no later than three weeks

[383] Section 13 subsection 1 sentence 2 InsO.

following the occurrence of illiquidity or over-indebtedness.[384] After the filing, German law differentiates between preliminary and final insolvency proceedings.[385] In the case of the implementation of an insolvency plan, the process is governed by different rules. This procedure is discussed separately.[386]

2.3.3. Preliminary Insolvency Proceedings

A period of maximum three months, which is called the preliminary insolvency proceedings ("vorlaeufiges Insolvenzverfahren" or "Eroeffnungsverfahren"), is used to examine whether the preconditions for the commencement of insolvency proceedings are met.[387] In general, a preliminary IOH is appointed to investigate and give an expert opinion about the economic situation of the insolvent debtor.[388] If there are not enough assets to even cover the costs of the proceedings, the procedure will not be opened, but closed immediately, which is called "mass poverty" ("Massearmut").[389]

The court has the possibility to appoint a "strong" or a "weak" preliminary Insolvency Office Holder (IOH)[390] ("starker oder schwacher Insolvenzverwalter").[391] A strong preliminary IOH is handed all rights and duties of the debtor; he takes over the administration of the debtor's estate.[392] Where the court orders that the debtor can continue to administer its estate, though only with the consent of the preliminary IOH, the IOH is called a weak preliminary IOH.[393] Under normal circumstance, the court will appoint a weak preliminary IOH.[394]

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[384] Jennifer Bierly-Seipp, Uwe Pirl, *German insolvency proceedings under the Insolvency Code 1999-Part 1* (2003) Vol 19 I.L. & P. Issue 1, .2.
[385] Ibid 1.
[386] See chapter 2.3.5.
[387] Bierly-Seipp, Pirl (n 384) 1.
[388] Section 22 subsection 1 lit. 3 InsO.
[389] See section 207 InsO.
[390] See Terminology 0.7.
[391] Section 21 InsO.
[392] section 22 subsection 1 InsO.
[393] Section 22 subsection 2 InsO
[394] Ludwig Haarmeyer in Kirchhof, H.-P.; Lwowski, H.-J.; Stuerner, R., 'Muenchener Kommentar zur Insolvenzordnung' (Vol 1, third edition Muenchen 2013), section 21 recital 46.

The second purpose of preliminary insolvency proceedings is to secure the status quo for the creditors who are involved.[395] This should prevent a further worsening of the debtor's financial situation. The most common measure in this context is a restraining order pertaining to the debtor's dispositions.[396] The preliminary insolvency proceedings are not allowed to take more than three months.[397] Such opening proceedings with an open outcome ("ergebnisoffenes Eroeffnungsverfahren") were introduced on the proposal of the Insolvency Law Commission. They argued that it would be necessary for the safeguarding of creditors for the reasons given above. Interestingly enough, the Discussion Draft ("Diskussionsentwurf") of the Federal Ministry of Justice dated 15.08.1988 and the Draft Bill of 1989, ("Referentenentwurf") pursued a contradictory path by demanding the opening of proceedings without any preliminary proceedings. It was argued that an immediate opening of proceedings as a general norm would prevent the deteoriation of assets ("Masseverschlechterung") while at the same time helping to increase the opening ratio of the proceeding ("Eroeffnungsquote").[398] The procedure was criticised for being overloaded with remedies and it would therefore undermine the necessity for a speedy procedure ("Eilcharakter"), bearing the risk that any restructuring attempt would be too late after the decision about the opening of the procedure.[399]

These suggestions were criticised massively because an instant opening would be hostile towards restructuring ("sanierungsfeindlich") and the positive experience with the sequestration practice ("Sequestrationspraxis") would be negated by the legislator.[400] An abbreviated preliminary phase was introduced.[401] An expert hearing in 1993 highlighted again that parties involved in insolvency practice were of the opinion that a hasty opening of proceedings would run counter to the aim of the legislator to enhance restructurings.[402] This

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[395] Ludwig Haesemeyer, *Insolvenzrecht* (3rd edition, Carl Heymanns Verlag 2003) 106.
[396] Section 21 subsection 2 no. 2 InsO
[397] Bert Froendhoff, Zur Sanierung auf die britische Insel (2007) Handelsblatt Nr.93 vom 15.05.07, 2.
[398] Hans Haarmeyer, 'Muenchener Kommentar zur Insolvenzordnung' (Vol 2 third edition 2013) Entstehungsgeschichte section 21, recital 36
[399] Ibid
[400] Haarmeyer, Muenchener Kommentar zur Insolvenzordnung (n 391) recital 37.
[401] Ibid, recital 7.
[402] Haarmeyer, Muenchener Kommentar zur Insolvenzordnung (n 391), recital 8.

led to the above described period of three months, enabling the preliminary IOH to prepare the proceedings and to examine the value of a restructuring.[403]

2.3.4. Final Insolvency Proceedings

With the commencement of the final insolvency proceedings, the debtor loses his power with the IOH taking over all dispositions and administration of the company.[404]

On a set "reporting date" ("Berichtstermin")[405] the IOH is to give an account of the situation of the company while the creditors are determined at a later "examination date" ("Pruefungstermin")[406]. This is important as the creditors decide whether the company is to be liquidated or restructured.[407] Their decision depends on the best realisation of assets for the creditors as a whole, which, remains the main purpose of insolvency proceedings.[408] The principle of equal treatment has to be seen in the light of only creditors in equivalent positions having to be treated equally.[409] During the insolvency proceedings all creditors are represented in the compulsory creditors' meeting ("Glaeubigerversammlung")[410] as well as in the optional creditors' committee ("Glaeubigerausschuss").[411] After having assessed the claims of creditors in comparison with the debtor's assets, an insolvency plan could become an option if there is a reasonable possibility of rescuing the company.[412]

The proceedings end either in cancellation ("Aufhebung") or their cessation ("Einstellung") by order of the court.[413] The outcome of the procedure is not determined, as the aim of section 1 InsO concerns the satisfaction of the creditors in the best possible way.[414]

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[403] Haarmeyer, Muenchener Kommentar zur Insolvenzordnung (n 391), recital 8.
[404] Bierly-Seipp, Pirl (n 384) issue 1, 3.
[405] section 29 subsection 1 InsO
[406] section 29 subsection 2 InsO
[407] Christoph Paulus, 'Grundlagen des neuen Insolvenzrechts' (2002) DtStR 1869, 1869.
[408] See chapter 2.2.1.
[409] Ibid, equals the parri passu principle.
[410] Section 74 et seq. InsO
[411] Section 67 et seq. InsO
[412] ibid
[413] Haesemeyer, *Insolvenzrecht* (n 395) 7.69.
[414] Business restructuring is the most favoured restructuring tool in German Insolvency Law. There are two practical ways of business restructuring: through a take-over company by selling the assets to a third person, or the

2.3.5. Insolvency Plan Procedure

One of the main outcomes of the insolvency reforms in 1999 was the introduction of the insolvency plan procedure. The insolvency plan took the place of settlement and compulsory settlement under the old VglO.[415] The insolvency plan being also part of the InsO, its primary goal remains the collective satisfaction of the creditors' claims, section 1 InsO. Restructuring can often prove to be the instrument to achieve that goal.[416] However the plan can even provide for liquidation, as the purpose is not further defined in the InsO.[417] In providing an insolvency plan as a restructuring tool to set a "legal framework for an amicable completion of insolvency, through negotiations and autonomous exchange processes",[418] the restructuring of companies is considered the main aim in choosing this procedure.[419] The plan is seen as a universal instrument to realise the insolvent's assets. The realisation of a debtor's assets can be omitted in the interest of the restructuring of the debtor or his business. Claims can be deferred, abated or partly abated and there is more variety in allocation of the proceeds.[420] A major change with regard to the old law was the introduction of the possibility for the debtor, but also for other parties involved and here especially main creditors, to initiate settlement proceedings.[421]

2.3.5.1. The Proceeding

The process can be divided into three parts: 1. drafting of the plan[422]; 2. acceptance of the plan and its content[423]; and 3. implementation, execution and control of the execution of the plan.[424] The whole procedure begins with the presentation of the insolvency plan to the court, which both the IOH and

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incorporation of a rescue company, where the assets are sold after the restructuring process. (Wellensiek (n 351) 233).

[415] Kölner Tage, 'GmbH-Beratung während Krise und Insolvenz; Krisenvermeidung,-bewältigung, Abwicklung' (Verlag Dr Otto Schmidt Cologne 2002) 153.

[416] Bierly-Seipp, Pirl (n 384) Issue 2, 2.

[417] Remmert, (n 328), 430

[418] Uhlenbruck, Brandenburg, Grub, Schaaf, Wellensiek,(n 311) 1736

[419] In fact 90% of the plans are used to restructure the company

[420] Bt. Drs. 12/2443 (n 304) para 156.

[421] Ibid 194.

[422] Sections 217-234 InsO

[423] Sections 235-253 InsO

[424] Sections 254- 269 InsO

the debtor are authorised to present.[425] The insolvency plan consists of a descriptive and a constitutive part.[426]

The descriptive part should include "the measures taken or still to be taken after opening the insolvency proceedings in order to create the basis of the envisaged establishment of the rights held by the parties involved."[427] It must contain the cause analysis, business strategy and overall concept of the plan,[428] as well as measures already implemented since the commencement of insolvency proceedings, and also those planned for the future.[429] The plan has to contain detailed information so that

the creditors themselves are able to estimate which proceedings are the most favourable for them.[430] On the basis of this information and financial outcomes, the court should be able to compare the realisation and distribution according to law on the one hand and according to the plan on the other.[431]

The constitutive part should specify how the plan intends to change the legal position of the parties concerned.[432] The most important and difficult aspect of this part is the formation of interest groups.[433] Section 222 InsO requires that the involved parties ("Beteiligte")[434] are split up into different groups based upon their rights and legal status.[435] The legislator expects a greater economic effectiveness from this group formation, as the interests of creditors are represented by their corresponding group.[436] It is of importance for such groups to be distinguishable on the basis of appropriate criteria in order to prevent any manipulation in the sourcing of majorities.[437] The formation of groups is essential as their internal voting decides whether the plan is

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[425] Section 218 subsection 1 sentence 1 InsO
[426] Section 219 InsO; sections 229 and 230 InsO.
[427] Section 221 InsO.
[428] Buth (n 381) 1178.
[429] Karl-Heinz Maus, 'Schuldnerstrategien in der Unternehmensinsolvenz (Teil 2)' (2002) DtStR, 1104, 1106.
[430] BGH v. 03.12.2009-IX ZB 30/09; BHG v. 19.05.2009-IX ZB 236/07
[431] Schmidt, Uhlenbruck (n 417) para 835.
[432] Section 221 InsO.
[433] Bierly-Seipp, Pirl (n 384) Issue 2, 3.
[434] Pre ESUG: "creditors", now the shareholders are part of the insolvency plan proceeding, see chapter 4, xxxxx
[435] Bt Drs. 12/2443 (n 304) 199; Ralf Kussmaul, Bernhard Steffan, 'Insolvenzplanverfahren: Der prepackaged plan als Sanierungsalternative' (2000) DB 1850, 1851.
[436] BT Drs. 12/2443 (n 304) 199; (to section 265 which is now section 222 InsO; section 222 Abs. 1 subsection 2 InsO specifies three compulsory groups: the preferred (secured) creditors, the regular (unsecured) insolvency creditors and the subordinated creditors. Other groups or of sub-groups could be formed by combining creditors with congenial economic interests; s. Schmidt, Uhlenbruck (n 417) para 835,155.)
[437] BT Drs. 12/2443 (n 304) 199

accepted or rejected.[438] An insolvency plan is accepted by a group when a) the majority within the group votes for the plan and b) the creditors voting in favour own more than fifty per cent of the total sum of the claims of the group.[439] In the case that no majority can be reached within a group according to the above mentioned criteria, the so-called "ban on obstruction" ("Obstruktionsverbot") will be applied to overcome the otherwise failed acceptance.[440] The ban on obstruction means that a plan is accepted when firstly, the majority of the groups voted in favour and secondly, the groups voting against the plan would not have their position worsened by the insolvency plan being implemented.[441]

The consequences for all creditor groups have to be illustrated.[442] On completion of the draft of the insolvency plan, the court will distribute it to the debtor, the IOH, the creditors' committee and the workers' council.[443] The insolvency plan has to be debated and voted on in a creditors' meeting in court; in the case of acceptance the court will issue its consent to the plan.[444]

With the "original" insolvency plan procedure[445] creditors were still able to delay the implementation of the insolvency plan by arguing that they would be in a worse position with the plan than without,[446] substantiating this together with their application.[447] Furthermore, section 253 InsO pre ESUG gave an individual creditor the right to appeal against the court's order confirming the plan.[448] The court's resolution becomes binding only after any appeals have been dismissed or the period of time allowed for an appeal has passed.[449] Once the insolvency plan comes into effect, it is binding for all creditors.[450] The insolvency proceedings as such are cancelled upon implementation of the plan. The IOH and the creditors' committee take on

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[438] Bierly-Seipp, Pirl (n 384) Issue 2, 3.
[439] Ibid, Section 244 subsection 1 InsO.
[440] Section 245 InsO
[441] Schmidt, Uhlenbruck (n 417) para 835, 156.
[442] Ibid
[443] Bierly-Seipp, Pirl (n 384) Issue 2, 4.
[444] Ibid
[445] Meaning after the introduction in 1999
[446] Old section 251 I 2 InsO
[447] Old section 251 II InsO
[448] Old section 253 InsO, more see chapter 4.2.5.2.
[449] Bierly-Seipp, Pirl (n 384) Issue 2, 4.
[450] Section 254 subsection 1 InsO.

responsibility for monitoring the execution of the plan.[451] In the case that a plan is finally rejected after all, normal insolvency procedures are taken up again.

2.3.5.2. Usage of the Insolvency Plan

Since the introduction of the insolvency plan in 1999 and until the ESUG reform in 2012, a total of 291.351 insolvency procedures were opened.[452] In approximately 2.894 and hence 1% of all those insolvency plans were approved and carried out. A steady increase in the usage of the insolvency plan can be observed over the years.[453] Figure three shows that however, even in the last year pre-ESUG, using an insolvency plan still remained the exception, seeing that the number of approved plans came to only around 1.5% of totally opened proceedings.

Figure three:
Company Insolvencies and the Number of Insolvency Plans 1999-2013 in Germany

Year	Number of opened Insolvency proceedings	reported insolvency plan applications	percentage of insolvency plans to opened insolvency proceedings
1999	10.468	70	0.67%
2000	14.434	92	0.64%
2001	16.997	108	0.64%
2002	21.428	167	0.78%
2003	23.061	173	0.75%
2004	23.898	234	0.98%
2005	23.247	244	1.05%
2006	23.291	282	1.21%
2007	20.491	202	1.48%

[451] Sec. 260 et seq. InsO; Robert Buchalik, 'Faktoren einer erfolgreichen Eigenverwaltung' NZI (2000) 294, 300.
[452] IFM Bonn, Insolvenzplaene bei Unternehmensinsolvenzen und Insolvenzen von Unternehmen in Deutschland, http://www.ifm-bonn.org/statistiken/gruendungen-und-unternehmensschliessungen/ (last visited 29.09.2014).
[453] However, this can be traced back to the general increase of insolvency proceedings.

2008	21.359	310	1.45%
2009	24.301	437	1.80%
2010	23.482	355	1.51%
2011	23.586	363	1.54%
2012	21.308	349	1.64%
2013	19.474	382	1.96%

Source: Schultze&Braun; http://www.schubra.de/de/veroeffentlichungen/insolvenzstatistiken.php

Uhlenbruck described the InsO as a "permanent building site".[454] There were already some changes to the InsO before it took effect [455] and, following substantial criticism, the legislator undertook a "reform of the reform" in 2001.[456] The Government introduced the "Act to Facilitate Insolvency Proceedings 2007" ("Gesetz zur Vereinfachung des Insolvenzverfahrens 2007"),[457] which brought in changes to the InsO in order to facilitate the existing proceedings. This should particularly trigger off impulses for economic activities, notwithstanding insolvency.[458] The admissibility of written procedures was extended; the possibility of a prohibition to prevent exploitation and confiscation ("Verwertungs- und Einziehungverbotes") in the opening proceedings was introduced; a termination period for rental and leasing contracts was adopted. In addition, an otherwise possible transferred restructuring ("uebertragende Sanierung") already before the report meeting as also the use of closed lists in the insolvency courts were declared illegal.[459]

The main formal rescue tool, the insolvency plan, did not bring about the effect hoped for. Also following the latest reform, the insolvency plan remained an anomaly[460] as reflected in the statistics. Compared to the years before, the plan was still not used significantly more after 2007.[461]

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[454] Wilhelm Uhlenbruck, 5 Jahre InsO-Kein Grund zum Feiern (n 76) 1.
[455] Ibid
[456] Ibid, Insolvenzaenderungsgesetz 2001 (BGBl 2001, I 54)
[457] Gesetz zur Vereinfachung des Insolvenzverfahrens (BGBl 2007 I 509).
[458] Ibid
[459] Werner Sternal, 'Das Gesetz zur Vereinfachung des Insolvenzverfahrens' (2007) NJW 1909, 1910.
[460] Stefan Schmid, 'Sanierung durch Insolvenzplan-Bemerkung zur Theorie über praktische Fragen' (2000) NZI 452, 454.
[461] Schubra statistic, 3.29% in 2006 and 2008 e.i. 3.63%, http://www.schubra.de/de/veroeffentlichungen/insolvenzstatistiken.php (last visited 29.09.2014).

The insolvency plan could be regarded a useful restructuring tool, if it only became an approved plan. However, obstacles seemed to be too high, to get to the point of an approved plan. By setting the hurdles too high the legislator missed the aim of having available restructuring tool in place. It was predictable that the removal of these obstacles were needed in order to be better adapted to the needs of the environment.

A real advantage of the plan is the fact of it being binding for all creditors.[462] This type of "*inter omnes* effect" would not be possible in an arrangement without an insolvency plan.[463] Complexity of the insolvency plan would normally come as a disadvantage. Given the right case, it is argued that it could provide a workable instrument to restructure companies.[464] The Legislation served to create a restructuring tool in offering some new ways of rehabilitating companies in financial distress.[465] For the first time, the insolvency plan gives the debtor a fair chance to find an agreement with his creditors, apart from and preventing liquidation as the general procedure.[466]

That the insolvency plan gives the debtor a fair chance to avoid liquidation is also reflected by the outcome of approved plans. Even though by no means representative, only 2% ended in liquidation, and the vast majority in restructuring, with the main focus on restructuring as a going concern.[467]

As demonstrated, the insolvency plan seems to be a theoretically well devised instrument to restructure a company in financial distress. However, practical experience shows that it is hardly ever used, mainly due to the complexity of the whole process. In the words of Nietzsche this would be an example of the German sense for flourishes and pensiveness ("Deutscher Tief- und Schnoerkelsinn")[468], or in other words the tendency of the German legislator to overregulate: the tendency towards regulating all relevant and possible

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[462] Section 254 InsO
[463] Bierly-Seipp, Pirl (n 384), Issue 2, 3.
[464] ibid
[465] Kussmaul, Steffan (n 435), 1853.
[466] Bernhard Steffan, *Sanierung in der Insolvenz* (Rhein Ahr Campus Remagen 2004) 37.
[467] Ibid
[468] Horst Eidenmueller, 'Sollte ein vorinsolvenzliches Sanierungsverfahren eingefuehrt werden?' in Paulus C. Sanierung im Vorfeld von Insolvenzverfahren- Vortraege zur gemeinsamen Tagung des BMWi und des BMJ (2010) Zeitschrift fuer Wirtschafts- und Bankrecht 1337, 1345

questions and details and not being able to remove "legislative clutter",[469] including every little detail, leads to complexity and inflexibility which in turn leads to less practical usage.

Complex procedures are often the cause for high costs.[470] In a time of financial distress, quick action is of vital importance, which may already determine whether a company stands a chance being rehabilitated. The enforcement of the plan might present a further disadvantage. As mentioned above, the minority protection under section 251 InsO, gives creditors the possibility to oppose the plan.[471] Even if the consent of all creditor groups can be reached, this is in general quite time- consuming. The time factor must be regarded as a serious disadvantage. A successful restructuring in general necessitates a swift reaction from all parties involved as any delayed action worsens the financial situation of the debtor. Another major disadvantage came with a change in taxation law. In 1998, tax exemption on restructuring profits was abolished.[472] This worsened the already tight cash flow in companies during a restructuring process, as they were now obliged to pay tax on any restructuring profit, becoming due even before finalisation. This unfavourable development was, of course, putting the entire restructuring process in jeopardy.[473]

It may also be seen as a handicap that the IOH was appointed by the court and not by the debtor or the creditors. With feasibility and enforcement of the plan depending on the qualification and competence of the IOH, his appointment is, of course, a "vital question".[474]

The hurdles described above illustrate that the insolvency plan procedure was not adapted to the needs of the economic environment. Practice demanded

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[469] See David Milman, 'Corporate Insolvency Law 2015: the ever changing legal landscape' (2015) Company Law Newsletter 1, 4.
[470] For example, an insolvency plan costs about 137.000 Euros, http://www.gib.nrw.de/service/specials/sanierungsberatung/untersuchungen/studien/downloads-und-link/Insolvenzen_2007_CR.pdf, , 25
[471] Hardy Gude, Peter Kranzusch, 'Die volkswirtschaftliche Relevanz von Insolvenzplanverfahren', slide 13. <https://www.kfw.de/migration/Weiterleitung-zur-Startseite/Startseite/KfW-Konzern/KfW-Research/Economic-Research/Veranstaltungen-Vortr%C3%A4ge/Veranstaltungen-2009/PDF-Dateien/25.06.-Gude-Kranzusch.pdf> (last visited 17.09.2015).
[472] Kussmaul, Steffan, (n 435) 1853.
[473] Ibid
[474] http://www.gib.nrw.de/service/specials/sanierungsberatung/untersuchungen/studien/downloads-und-link/Insolvenzen_2007_CR.pdf, see further chapter 4. 2.4, 4.3.3, 4.5.2.

an efficient and unbureaucratic procedure, allowing the debtor to find a solution with its creditors. The aim was to create a procedure "for an amicable completion of insolvency, through negotiations and autonomous exchange processes".[475] However especially the possibilities of individual parties to obstruct the proceedings[476] and the lack of influence of creditors and debtors on the appointment of the IOH[477] created hurdles which fettered the possibility of an amicable completion of insolvency. The existing structure of the insolvency plan proceeding was hence not well adapted to the needs of the insolvency market. A further need for adaptation was therefore predictable.

2.3.6. Self-Administration

Within the insolvency plan procedure, the InsO also introduced the possibility for the debtor to apply for a so-called self-administration ("Eigenverwaltung"). Instead of involving an IOH, the debtor remains in possession, with a court appointed trustee ("Sachwalter") monitoring the process.[478] Chapter five examines self-administration in more depth.

2.3.7. Transferred Restructuring ("Uebertragende Sanierung")

A transferred restructuring is not a separate restructuring tool, but simply means the transfer of parts of the assets to a new legal entity, for example an investor or "hove-off company" (Auffanggesellschaft). This option does not represent a genuine rescue of the company as a going concern, but a rescue of the business. The new company is in general released from existing liabilities as they stay normally with the insolvent company, whereas the debts are not restructured. The asset deal is managed by the IOH. The transferred restructuring has the advantage that it can be implemented more quickly than an insolvency plan. However, an asset deal bears the risk that intangible assets, such as licences are not transferred to the new company and that long

[475] Uhlenbruck, Brandenburg, Grub, Schaaf, Wellensiek, (n 311) 1736.
[476] See above and chapter 4.2.5
[477] See above and chapter 4.2.4
[478] Sections 270 to 285 InsO.

term contracts need the approval of for example the landlord to be transferred.[479]

2.3.8. Bond Act ("Schuldverschreibungsgesetz")[480]

The existing insufficiencies of the insolvency regime and growing competition amongst EU member states, together with the world financial crisis in 2008/2009, caused the German Government to rethink the future of German insolvency law with a more holistic approach. The Government became more concerned about the actual competitiveness of its jurisdiction, one reason being the increasing numbers of forum shopping, as explained in chapter one.[481]

One example of forum shopping being a driver of insolvency law perfection was the introduction of a more restructuring-friendly Bond Act ("Schuldverschreibungsgestz, SchVG"). The old SchVG had rather marginal practical relevance, as it allowed restructuring of a bond only through the change of the terms and conditions of the bond, solely to avoid cessation of payment or even insolvency.[482] The old Act made it very difficult to restructure bonds.[483] In other words, only strictly defined "emergency actions" were allowed; a medium term restructuring was not possible.[484] The law was harmonised in a reaction to recent developments in international bond offerings, with particular emphasis on giving bondholders a more active participation in debt restructurings. Bondholders have much greater flexibility in amending any terms of relevance to the bonds.[485] Under the assumption of a qualified majority, the creditors' committee is free to agree upon necessary corporate action, with the exception of incurring new obligations. In other words, creditors are allowed to renounce their principal claims or agree upon

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[479] Volker Beissenhirtz, 'Restructuring Corporate Debt in Germany' (2009) Tax Planning International Report, 1
[480] Full name: Act to Reform Collective Bond Offerings and Enforcement of Investors' Rights, 2009 (Gesetz zur Neuregelung der Rechtsverhältnisse bei Schuldverschreibungen aus Gesamtemissionen und zur verbesserten Durchsetzbarkeit von Ansprüchen von Anlegern aus Falschberatung) (BGBl 2009 I 50).
[481] See Introduction 0.2.2.
[482] Barbara Klein, 'Umstrukturierung von Anleihen' (02.2011) bdp aktuell 71 < http://www.bdp-aktuell.de/71/> (last visited 17.09.2015).
[483] Heiko Tschauner, Maximilian Baier 'Reorganisation of a retail group under German law' (2013) Ins. Int. 38, 40.
[484] Ibid
[485] Ibid, 41.

a DES.[486] Furthermore, additional requirements were introduced for bond offerings, so as to improve the rights of both bondholders and those of individual investors in securities.[487]

2.3.9. MoMIG

Another step in reacting to increasing competition and forum shopping was to introduce the 'Act for the Modernisation of Limited Liability Company Law and Prevention of its Misuse' ('Gesetz zur Modernisierung des GmbH-Rechts und zur Bekaempfung von Missbraeuchen.') which came into force on 1st November 2008.[488] The introduction of this Act does not represent a direct change in the insolvency regime, as being a company law Act; however, the introduction has an indirect influence on the insolvency landscape as well. The aim of this law was to modernise and deregulate the law concerning private limited liability companies ('Gesetz betreffend die Gesellschaften mit beschraenkter Haftung, GmbHG).[489] Business start-ups should be made easier and registration processes accelerated. The GmbH should be made more competitive internationally.[490] The law introduced less stringent requirements on having a headquarter in Germany.[491] This in turn could lead to reduce motivation to transfer the COMI to other EU member states as it is easier now for German businesses to incorporate a GmbH in Germany.

2.3.10. Gesetz zur weiteren Erleichterung der Sanierung von Unternehmen -ESUG ('the Law for further Facilitation of the Rehabilitation of Companies')

The "small" insolvency reform steps in the InsO reforms in 2001 and 2007 and the reforms of the Bond Act did not reach far enough and voices demanding for a more homogenous approach to change the existing insolvency laws increased. This led to the initiative for a fundamental reform of insolvency law

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[486] Klein Umstrukturierung von Anleihen (n 482)
[487] Angelo Lercara, Michael H. Meissner, 'Reform of the German Bond Act and its impact on the German debt capital market' J.I.B.L.R. 298, 299.
[488] Act for the Modernisation of the Limited Liability Company Law and the Prevention of its Misuse' ('Gesetzes zur Modernisierung des GmbH-Rechts und zur Bekaempfung von Missbraeuchen." BGBl 2008 I 48).
[489] Lercara (n 487) 299.
[490] ibid
[491] Ibid

in Germany by Chancellor Merkel in 2009. The Ministry of Justice states on their website under "Insolvency Reforms" that "Reforming insolvency law is among the most important endeavours of the Federal Government in the broad field of economic law..."[492]

The financial crisis, in particular, exposed the weak points in the existing system and brought to the fore that the law must be amended in a way to successfully cope with a similar crisis.[493] The forum shopping cases and the ensuing competition with the legal systems of the other EU Member States caused the Government to prioritise insolvency reforms. With both already implemented and still planned changes in the field of insolvency law, the Government sees Germany now better equipped for the future.[494] Whether the Government was right with this prediction is analysed in Part B of this thesis.[495]

In 2009, the Ministry of Justice presented an initial paper on the "introduction of a restructuring plan procedure for systematically significant financial institutions and protection against threats to the stability of the financial system."[496]

A more general Bill soon followed, leading to a three- phase reform plan published by the Ministry of Justice in 2010.[497] This plan aimed to facilitate the restructuring and rescuing of viable businesses, including the improvement of the legal restructuring for out-of-court arrangements at the pre-insolvency stage, as well as to simplify insolvency plan procedures and especially to encourage early restructuring.[498] The first approach to this plan was reforming the insolvency plan and self-administration; "the goal of the first phase is to

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[492] Bundesjustizministerium http://www.bmj.de/EN/Subjects/Economy/Reformof%20InsolvencyLaw/_node.html;jsessionid=20B45D09A1CD9EF10B4AA3ED639E1537.1_cid297.

[493] BT.-Drs. 17/5712 (n 294) Introduction.

[494] Ibid

[495] See chapter four to eight

[496] BMJ (2009) http://zip-online.de/volltext.html?offset=7id=6ea9ab1baa0efb9e19094440c317e21b>; This, in a further step, led to the "Act for the Restructuring and Orderly Liquidation of Financial Institutions, the Setting-up of Restructuring Funds for Financial Institutions and the Prolongation of Limitation Periods for Organ Liability in the Law relating to Shares Act", ("Restructuring Act") (" Gesetz zur Restrukturierung und geordneten Abwicklung von Kreditinstituten, zur Errichtung eines Restrukturierungsfonds fuer Kreditinstitute und zur Verlaengerung der Verjaehrungsfrist der aktienrechtlichen Organhaftung" ("Restrukturierungsgesetz")) which was passed on the 28th October 2010. This Restructuring Act puts its particular focus on the restructuring of financial institutions and will as such not be part of this thesis.

[497] Report of the German Insolvency Law Congress (18.March 2010), Reuter, INDat-Report 3/2010, 42.

[498] Ibid

have insolvency law be increasingly understood as an opportunity to reorganise a company";[499] the second phase aimed to address individual bankruptcy and pre- insolvency restructuring, and the third phase will deal with group insolvencies and the position of IOHs.[500]

The first step of this plan was implemented by introducing the "Law for Further Facilitation of the Rehabilitation of Companies' ("Gesetz zur weiteren Erleichterung der Sanierung von Unternehmen" ESUG).[501] In September 2010, the Government presented a first Discussion Draft ("Diskussionsentwurf"),[502] followed by several position papers on behalf of such groups as the German Lawyer Association ("Deutscher Anwaltsverein", DAV)[503] and the Federal Working Group Insolvency Courts ("Bundesarbeitskreis Insolvenzgerichte", BAK)[504] which then led to a Draft Bill ("Referentenentwurf") of the Act in January 2011[505] and followed up on by a Government Draft ("Regierungsentwurf") in February 2011.[506] In April 2010 the Upper House of Parliament ("Bundesrat") published their opinion on the Government Draft[507] and the House of Parliament ("Bundestag") finally adopted the Act after having considered changes made by its own Law Committee "Rechtsausschuss des Bundestages" on 27th October 2011.[508] The adopted Act ultimately passed the "Bundesrat" on 25th November 2011,[509] and

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[499] Report of the German Insolvency Law Congress (18.March 2010), Reuter, INDat-Report 3/2010, 42.
[500] Report of the German Insolvency Law Congress (n 497)
[501] Gesetz zur weiteren Erleichterung der Sanierung (BGBl. 2011 I 64).
[502] Bundesministerium der Justiz, 'Diskussionsentwurf *Gesetz zur weiteren Erleichterung der Sanierung von Unternehmen* ("Discussion Draft") (Berlin September 2010) <(https://www.insolvenzrecht.de/inhalte/materialien/esug/diske-esug-v-29062010/)>
[503] Deutscher Anwaltsverein, 'Stellungnahme des Deutschen Anwaltsvereins zum Diskussionsentwurf fuer ein Gesetz zur weiteren Erleichterung der Sanierung von Unternehmen (ESUG)' (01.09.2010) <http://rsw.beck.de/aktuell/gesetzgebung/gesetzgebungsvorhaben-zusaetzliche-materialien/erleichterung-der-unternehmenssanierung-(esug)> (last visited 17.09.2015)
[504] Bundesarbeitskreis Insolvenzgerichte, 'Stellungnahme zum Gesetzesentwurf "weitere Erleichterung der Sanierung von Unternehmen' (09.08.2010) <http://rsw.beck.de/aktuell/gesetzgebung/gesetzgebungsvorhaben-zusaetzliche-materialien/erleichterung-der-unternehmenssanierung-(esug)> (last visited 17.09.2015).
[505] Bundesminsterium der Justiz, 'Referentenentwurf fuer ein Gesetz zur weiteren Erleichterung der Sanierung von Unternehmen' (25.01.2011) <http://rsw.beck.de/aktuell/gesetzgebung/gesetzgebungsvorhaben-zusaetzliche-materialien/erleichterung-der-unternehmenssanierung-(esug)> (last visited 17.09.2015).
[506] Bt. Drs. 17/5712 (n 294).
[507] Bundesrat, 'Stellungnahme zum Gesetzesentwurf der weiteren Erleichterung der Sanierung von Unternehmen' (BR-Drs. 127/11) <http://rsw.beck.de/aktuell/gesetzgebung/gesetzgebungsvorhaben-zusaetzliche-materialien/erleichterung-der-unternehmenssanierung-(esug)> (last visited 17.09.2015).
[508] Rechtsauschuss, 'Beschlussempfehlung und Bericht zu dem Gesetz der Bundesregierung BT-Drs 17/5712' (BT-Drs. 17/7511) http://rsw.beck.de/aktuell/gesetzgebung/gesetzgebungsvorhaben-zusaetzliche-materialien/erleichterung-der-unternehmenssanierung-(esug) (last visited 17.09.2015).
[509] Bundestag,'Bundesrat - Unterrichtung ueber Gesetzesbeschluss des Bundestages ' (BR-Drs. 679/11) <http://rsw.beck.de/aktuell/gesetzgebung/gesetzgebungsvorhaben-zusaetzliche-materialien/erleichterung-der-unternehmenssanierung-(esug)> (last visited 17.09.2015).

was published on 13th December 2011.[510] The ESUG then came into force on the 1st March 2012.[511]

The ESUG amends the InsO. The Government Draft covers several reforms plans. It addresses various shortcomings of the German insolvency regulations. The former insolvency procedure was seen as unpredictable for creditors and debtors, especially due to the lack of influence on the choice of the according IOH.[512] Another drawback was the lack of opportunity to convert debt into shares.[513] The duration of insolvency proceedings with the aim of restructuring was hard to measure as entry into force of an insolvency plan could be delayed for months or even years by legal action of individual creditors.[514] Self-administration did not have enough practical relevance with a lot of courts not using this tool and debtors did not have the security that their application for self-administration would be allowed by the court at all.[515] Insolvency plan procedures remained the exception, especially because of these existing uncertainties.[516] Applications for the opening proceedings were in general made at a time when the assets were already depleted and chances of restructuring had ceased to exist.[517] Therefore, the main aim of the Government was to improve the framework for the restructuring of companies in distress and to foster early restructuring to safeguard employment.[518] The ESUG addresses four major areas where changes were introduced to facilitate the restructuring of companies: (1) Creditors' influence; (2) Self administration; (3) insolvency plan procedures and (4) Other changes.[519] These changes are analysed, compared and contrasted in Part B; the development from the Discussion Draft up to the final Government Draft are presented in detail in context with the relevant changes.

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[510] BGBl. 2011 I 64, 2582.
[511] ESUG (n 1).
[512] Bt. Drs. 17/5712 (n 294).
[513] Ibid
[514] Ibid
[515] Ibid
[516] Bt. Drs. 17/5712 (n 294).
[517] Ibid
[518] Ibid
[519] Barbara Klein, Sanieren statt liquidieren (04.2012) bdp aktuell 73 <http://www.bdp-aktuell.de/73/insolvenzrecht.htm>.

2.4. Mini Conclusion

As demonstrated above, the insolvency landscape in Germany changed dramatically after the introduction of the InsO in 1999. The legislator realised that basic principles of the order ("Ordnungsprinzipien") of the KO and the VglO were no longer in accordance with the changed environment. An adaptation of the existing laws had become necessary, to adjust to the actual social reality by rebuilding the functioning of insolvency laws. [520] Whereas the KO and the VglO were marked by the "stigma of insolvency",[521] the introduction of the InsO represented a landmark, acknowledging that failure was and still is not always based on personal fault, but often caused by external factors, such as the economic climate or a downturn in a certain industry sector. Creating a framework which allows a second chance for a "blameless" debtor, the InsO introduced a single, homogenous insolvency procedure instead of separate procedures due to the negative experience of two separate insolvency procedures, namely the KO and the VglO. Rescuing the company was not seen as a self-contained objective, but the aim was to facilitate meaningful restructurings and prevent absurd ones.[522] The primary purpose of the InsO was (and still is) the collaborative realisation of given assets for the creditors.[523]

Although the InsO was a helpful step towards a more rescue-friendly and better functioning insolvency regime in Germany, practice showed several deficiencies and imperfections. Since the introduction of the InsO, the German legislator adapted the existing laws further; in the words of the "mountaineer's dilemma",[524] following the first major adaptation with the InsO in 1999, some valleys had to be crossed in form of insufficient acceptance of the given laws, especially with the insolvency plan as the main rescue tool. Adaptation took place in form of the changes introduced by the InsO 2001, 2007 and the SchVG. However, these piecemeal reforms did not have the expected and

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[520] Barbara Klein, Sanieren statt liquidieren (04.2012) bdp aktuell 73 <http://www.bdp-aktuell.de/73/insolvenzrecht.htm>, 3.
[521] See chapter 2.2.
[522] See chapter 2.2.
[523] Section 1 InsO
[524] Jones (n 148) 95, 96.

desired outcome. The growing competition amongst the Member States of the EU emerging from forum shopping from one state to another, the financial crisis in 2008 and the growing criticism about the weaknesses of the German insolvency landscape, led to the initiative of Chancellor Merkel for fundamental reforms.

Part B analyses whether the peak has been reached with the introduction of the ESUG, or whether these changes are just another interval on the way to the peak or even a step into the next valley.

Chapter Three

Roots, Development and Practice of Rescue Culture in England

"A framework of law ...sufficiently flexible to adapt to and deal with the rapidly changing conditions of our modern world"

(Cork Report para 198)

3.1. Introduction

Before comparing and contrasting different specified changes introduced by the ESUG with the tools existing in England, it is fundamental to first critically examine the roots, development and practice of the rescue culture in England.

Understanding the development of insolvency law in England is fundamental to be able to discern whether changes implemented by the ESUG were causally connected to forum shopping activities and whether this in turn resulted in a more perfect insolvency regime in Germany.

The remarks in chapter two[525] apply mutatis mutandis; it would go beyond the intent of this thesis to embrace English insolvency history.[526] Due to the nature of this thesis, the issues for discussion have a wider angle of vision compared to the one in chapter two. With regard to the German part, the scope of analysis is based on the changes implemented by the ESUG, which can be identified quite easily. On the other hand, it is certainly more difficult to define the key areas, taking the English regime, as points of comparison are unquestionably found under variable headings and contexts. This chapter concentrates therefore more on giving a general critical overview, leaving a more in-depth review and analysis of the key areas of this thesis to be found in chapters four to eight as part of the analysis determining comparable laws

[525] See chapter 2.1.
[526] See Carruthers (n 54).

for comparing and contrasting with those changes of significance introduced by the ESUG.

Therefore the nature and purpose of this chapter is to give a review of the development of the rescue culture, starting with the Cork Report, the introduction of the Insolvency Act 1986 and subsequent changes through the Enterprise Act 2002 (EA), to be followed by a synopsis of the insolvency landscape in England, including the changes up to the present day. This overview should help to give a detailed picture of the insolvency landscape in England, enabling comprehension of the core issues discussed in Part B.

3.2. The Development of the Rescue Culture

3.2.1. Cork Report

The outset of the "rescue culture" in England can in general be traced back to the Report of the Review Committee chaired by Sir Kenneth Cork, known as the "Cork Report". It could be argued that Cork's experience goes back to the case of Wilstar Securities[527] in early 1974, for which he was appointed administrator. He began to perceive that rescuing a business could be of greater benefit to all parties concerned than liquidation or administrative receivership.[528]

The initial impetus to give the mandate to the Cork Committee was the entry of the UK into the European Community in 1973 and associated requirements to consider the EC Draft Bankruptcy Convention. The Committee report looked at the effects of implementing the European Convention, coming to recommend essential modifications of national law in their presentation in 1976.[529] Shortly following publication, the Secretary of State Edmund Dell

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[527] "The collapse of the Stern Group occurred in May 1974 and a scheme of arrangement was sanctioned by the High Court as a result of which Sir Kenneth Cork of Cork Gully became the *administrator* of the Stern Group." see *William George Stern v. The Commissioner of Customs and Excise*, Decision number: 1970, Case Reference: (LON/84/416).

[528] Ibid

[529] Cork Report (n 57) Introduction: "We were appointed on the 27 January 1977 by your predecessor, Mr Edmund Dell MP, with the following terms of reference: (i) to review the law and practice relating to insolvency, bankruptcy, liquidation and receivership in England and Wales and to consider what reforms are necessary or desirable; (ii) to examine the possibility of formulating a comprehensive insolvency system and the extent to which existing procedures might, with advantage, be harmonised and integrated; (iii) to suggest possible less formal procedures as alternatives to bankruptcy and company winding up proceedings in appropriate circumstances; and (iv) to make

revealed that he would set up the Insolvency Law Review Committee[530] again to be chaired by Kenneth Cork, "to carry out a fundamental and exhaustive reappraisal of all aspects of the insolvency law of England and Wales".[531]

England was at a point of having to adapt to the changing environmental economic conditions. Changes in the environment require variability in existing laws, in other words the need for reforms. The more drastic the changes in the environment were becoming, given the political and economic background in England at the time, the more the need for reforms undertaking a clear and holistic approach to change the existing law.[532]

The Committee concluded in the last chapter of the Cork Report that due to the extensive economic and social changes a radical reform would be needed in order to create an insolvency law meeting the requirements of a modern society.[533] The existing procedures were based on their original objectives, developed over generations with their respective needs in mind, but noticeably not corresponding anymore with current requirements. In other words, the legislator had neglected to adjust the law in line with the changing environmental circumstances. It was with exactly this in mind that the Cork Committee was constituted.

The Committee proposed substantial changes which are summarised under certain main objectives.[534] The first aim was to "simplify and modernise the present cumbersome, complex, archaic and over-technical multiplicity of insolvency procedures..."[535] Furthermore, the Committee saw the need to encourage the continuation of a business as a going concern[536] and to improve the distribution of assets for a better settlement of the creditors,[537] but at the

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recommendations." See further: Ian F Flechter, 'The Genesis of Modern Insolvency Law-An Odyssey of Law Reform' (1989) JBL 371.

[530] Known and referred to as "Cork Committee"

[531] Cork Report (n 52).

[532] See chapter 1.3.2.

[533] Cork Report (n 57) para 1975.

[534] The recommendations can be found throughout the Cork Report (n 57); a list of the recommendations can be found in para 1980 of the Cork Report

[535] Cork Report (n 57) para 1980 (1).

[536] Ibid, para 1980 (2).

[537] Ibid, para 1980 (3) and (4) and (5).

same time recommending stricter control over dishonest directors.[538] Cork had three visions in mind when proposing new formal insolvency procedures to promote the rescue of companies in financial distress: 1.) rescue opportunities should be taken early to enhance chances for a turn-around ; 2.) provision of a breathing space for a company to get back on its feet without the pressure of individual creditors, and 3.) the administration process should consider not only the interests of creditors and shareholders, but also of any other party potentially affected by the impending insolvency.[539]

Special attention should be drawn to the presentation of the "aims of good modern insolvency law" in the Report,[540] with particular emphasis on the aim "to maintain possible commercial enterprises capable of making a useful contribution to the economic life of the country".[541] In other words, companies should be rescued if economically viable.[542] A good modern insolvency law should provide a framework which is at the same time "sufficiently flexible to adapt to and deal with the rapidly changing conditions of our modern world."[543]

The Cork Committee already acknowledged a process which can be compared to Darwinism in their report, highlighting that insolvency law is embedded in its political, social and economic environment, not being rigid and undergoing continuous changes. The law has to be built around this changing environment, realising that adaptation is an ongoing process as the conditions of life are; especially the economic environment never stays exactly the same. A framework, as suggested by the Cork Committee, should allow for the necessary flexibility to adapt to "the rapidly changing conditions of our modern world".[544]

The key recommendations were: the introduction of a uniform insolvency code, a restructuring process, special insolvency courts, ring-fencing a part of the

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[538] Ibid, para 1980 (6).
[539] Vanessa Finch, *Corporate Insolvency Law Perspectives and Principles* (second edition, Cambridge University Press 2009) 364.
[540] Cork Report (n 57) para 198
[541] Cork Report (n 57) para 198 (i)
[542] Tribe, John (2012) Crystal balls and insolvency: what does the future hold? International Company and Commercial Law Review, 23(12), 405
[543] Cork Report (n 57) para 198 (k)
[544] Ibid

company's net floating charge revenues for unsecured creditors[545], the abolition of fixed charges on future assets, the reduction of the number of preferential creditors, the intensification of the possibility of challenging current law and the introduction of the profession of insolvency practitioners.[546] These are examined in more detail in the analytical chapters four to eight.

The political climate in England underwent rapid changes in 1979 with Thatcher's Conservative government policy to minimise government intrusion on the economy by reducing public expenditure.[547] This, of course, also affected the work of the Cork Committee in that the Government requested an interim report with the focus on reducing the costs of insolvency administration.[548] In February 1984, the Government published its White Paper *A Revised Framework for Insolvency Law*.[549] The Final Report of the Cork Committee, when first published in 1982, included a critical and detailed examination of the existing insolvency procedures and insolvency. It laid down the foundation of the "rescue culture" in England and presented a standardisation of corporate and personal insolvency law wherever possible,[550] eliminating the fragmentation in this area of law.[551] The Report as a whole is seen as a "phenomenal and epoch-making achievement"[552] and "a major landmark in the evolution of our insolvency law".[553]

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[545] "Ring -fencing means that where a company goes into liquidation, administration or administrative receivership, or where there is a provisional liquidator, and there is a floating charge over assets of the company, the liquidator, administrator or administrative receiver must set-aside (ring-fence) a prescribed part of any assets realised to distribute to the unsecured creditors, rather than to the floating charge - holder." < (https://www.insolvencydirect.bis.gov.uk/casehelpmanual/D/Distributions/BankruptcyCompanyCases.htm)> (last visited 18.09.2015).

[546] Cork Report (n 57) para 1980; besides the new administration procedure the Cork Report also gave the impulse for the so called "London Approach". The „London Approach" explanation.

[547] Ian F Flechter *Law of Insolvency* (fourth edition Sweet & Maxwell London 2014) I. 1-032.

[548] Carruthers (n 54) 114. Insolvency Service, 'Bankruptcy: Interim Report of the Insolvency Law Committee, Cmnd. 7968, following a government Green Paper : Bankruptcy: A Consultative Document ("Interim Cork Report") (Cmnd. 7976 London 1979) mainly concerned with questions of manpower implications of the Insolvency Service (see Ian F Flechter *Law of Insolvency* (4th edition Sweet & Maxwell 2014) I. 1-032).

[549] Insolvency Service, 'A Revised Framework for Insolvency Law' (Cmnd 9175 London 1984).

[550] Carruthers (n 54) 117.

[551] Ian Flechter, The Genesis of Modern Insolvency Law-(n 529) 371.

[552] Ibid, 372

[553] Ibid

3.2.2. Insolvency Act 1986

The Government took on only certain recommendations of the Cork Report in the Insolvency Act 86,[554] contrary to Cork's proposal for the adaptation of his rescue approach in its entirety.[555] In his own words, Cork later stated that "they ended up by doing the very thing we asked them not to do. They picked bits and pieces out of [the Cork Report] so that they finished with a mishmash of old and new."[556] For instance, some suggestions were not accepted by the Inland Revenue, as they did not want to lose their tax priority[557]; so the recommendation of the Cork Report to reduce the number of preferential creditors, especially Crown Preference[558] was not adopted. The Lord Chancellor did not favour a new Insolvency Court, so also other proposals which would have led to a certain increase in Government expenditure were excluded.[559] The IA 86 did not abolish fixed charges on future assets as specifically recommended.[560] The suggested introduction of a ring-fencing exceeding 10 % of a company's net floating charge revenues for unsecured creditors[561] was not embraced by the legislator.[562]

Two distinct rescue procedures in particular were put into place by the IA 86: the CVA and the administration.[563] These particular elements were introduced to fill the gap in those cases where the receivership procedure could not be carried out due to the lack of a floating charge.[564] Both these procedures are discussed in more detail later in this chapter.

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[554] Hereafter: IA 86; Andrew Keay, 'What future for liquidation in the light of the Enterprise Act Reforms' (2005) JBL 143.
[555] For a timeline of the Act see Carruthers (n 54) 121.
[556] Sir Kenneth Cork, *Cork on Cork: Sir Kenneth Cork Takes Stock* (Macmillan London 1988) 197; in this book he dedicated one chapter (chapter 10) to the topic "Reforming Insolvency Laws". He demonstrates that the Cork Committee had even more ideas in terms of trade and rehabilitation.
[557] Carruthers (n 54) 118.
[558] See Cork Report (n 57).
[559] Carruthers (n 54) 118.
[560] See Cork Report (n 57).
[561] See footnote 545.
[562] David Milman, 'Insolvency Act 1986: Part 1' (1987) Comp Law 61, 64.
[563] David Milman, 'Moratoria on Enforcement Rights: Revisiting Corporate Rescue' (2004) Conv.89, 90; for the administration procedure see Cork Report (n 57) Chapter 9; for the CVA see Cork Report (n 57) 97.
[564] Cork Report (n 52) para 495-497.

The IA 86 introduced *wrongful trading* as a new statutory procedure and it also established the profession of insolvency practitioners in terms of formal qualification.

Drawing an analogy to evolutionary theories, this only half-hearted implementation of the Committee's recommendations could be seen as a lack of will for adaption, assuming, of course, that the proposals made in the Cork Report could in fact be regarded the "best" regime possible under the given environmental conditions. As at least some recommendations were implemented, this partial adaptation was seen to result in a somewhat improved insolvency landscape. It was, however, foreseeable already at this stage that further changes would become necessary in future, as a really optimum adaption to the environmental conditions had not taken place. This is an example of a fettered Darwinian approach in English Insolvency law reforms.

3.2.3. Insolvency Act 2000

The IA 86, especially the new administration procedure, was less effective than expected. In comparison to administrative receivership cases, only a few administration and CVA procedures were carried out.[565] The disadvantage of the administration procedure as laid down in the IA 86 was mainly that it took up time as a court order was needed, with the required detailed report by the proposed administrator also causing significant delays.[566] Furthermore, the possible intervention on the part of a floating charge holder in naming an administrative receiver[567] could block the appointment of an administrator. The CVA procedure was not very well received either.[568]

The Department of Trade and Industry[569] saw a need for reform and published two different consultative documents which dealt with the efficiency of

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[565] Ulrich Ehricke, Malte Koester, Carsten-Oliver Mueller-Seils 'Neuerungen im englischen Unternehmensinsolvenzrecht durch den Enterprise Act 2002' (2003) NZI 409, 409.
[566] Goode (n 58), para 10-07.
[567] Ibid
[568] See chapter 3.3.4.
[569] Which is now called 'Department for Business Innovations and Skills' (BIS).

corporate rescue systems.[570] The document in 1993 mainly concerned the efficiency of restructuring procedures and their marginal acceptance.[571] The 1995 paper concentrated on the CVA procedure.[572] Both these documents did not lead to a Government Bill, and it was only in 1999 that the Government took up the reform ideas. The first important document in the context of company rescue was a *"Review of Company Rescue and Business Reconstruction Mechanisms 1999"*.[573] The main focus was put on the further development of the rescue culture.[574] The Report, published in May 2000, included a number of recommendations[575] dealing with corporate rescue mechanisms and the recent development of the rescue culture. It dealt, moreover with the position of the Crown as a preferential creditor and the situation of company directors and their advisors.[576]

The recommendations were partly implemented in the Insolvency Act 2000 (IA 2000), which included changes especially to the CVA procedure. The changes were particularly concerned with rules to provide for greater flexibility in the negotiation of a CVA.[577] It was, for example, no longer required for the nominee to be an insolvency practitioner, being a member of the Recognised Professional Body (RPB)[578] became sufficient.[579] The most important change, however, was the introduction of a moratorium for small companies.[580] The IA 2000 also modified the conditions with regard to the disqualification of directors as enacted by in the Company Directors Disqualification Act 1986.[581]

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[570] DTI, 'Company Voluntary Arrangements and Administration Orders, A Consultative Document (1993) 11, 29. DTI, Revised Proposals for a New Company Voluntary Arrangement Procedure, A Consultative Document (1995).
[571] DTI, Company Voluntary Arrangements and Administration Orders (n 570).
[572] DTI, Revised Proposals (n 570).
[573] The Review Group was set up with the terms of reference: "to review aspects of company insolvency law and practice in the United Kingdom and elsewhere relating to the opportunities for, and the means by which, businesses can resolve short to medium term financial difficulties, so as to preserve maximum economic value; and to make recommendations.", s. Review Group (n 287) foreword.
[574] Ibid
[575] Ibid, Executive Summary with a summary of the recommendations.
[576] Ibid, para 8,9
[577] Review Group (n 287) para 8, 9.
[578] Recognised Professional Body under section 391 of the Insolvency Act 1986.
[579] IA 2000, section 4
[580] Vernon Dennis; Alexander Fox, *The New Law of Insolvency* (The Law Society, London 2003) 37; To be categorised as a small company, two or more of the requirements of section 247 (3)-(5); (7) of the CA 85 must be in place: an annual turnover of 2, 8 million or less; balance sheet assets of no more than 1, 4 million and no more than 50 employees.
[581] Goode (n 58) 1-14.

The "mountaineer's dilemma mentioned in chapter one[582] could be applied in this context. The Cork Report set the starting point on the way to the peak, whereas the IA 86 and the IA 2000 could in specific areas be regarded high points, with the practical experiences and defects as valleys in between. Further changes would have to be made to exit this valley. Previous insufficiencies led to changes, which in turn resulted in better content of the existing insolvency laws.

3.2.4. Enterprise Act 2002

The amendments introduced did still not result in the expected rise in applications for the new administration and CVA procedures. The administration procedure, in particular was less effective than forecast. As figure four shows, in the first year after the IA 86 came into force in 1987, the number of administrations in comparison to all insolvency procedures in England accounted for only 1.02%, with restructuring procedures coming in at a disappointing 9.25%.

[582] See chapter 1.3.2.

Figure Four:

Receiverships, Administrations, CVA's and Liquidations in England and Wales registered at Companies House

Year	Receivership Appointments	Adminstrator Appointments	In Administration (EA 2002)	Company Voluntary Arrangement	Liquidations
1987		131		21	11,439
1988		198		47	9,427
1989		135		43	10,456
1990		211		58	15,051
1991	7,815	206		137	21,827
1992	8,523	179		76	24,425
1993	5,362	112		134	20,708
1994	3,877	159		264	16,728
1995	3,226	163		372	14,536
1996	2,701	210		459	13,461
1997	1,837	196		629	12,610
1998	1,713	338		470	13,203
1999	1,618	440		475	14,280
2000	1,595	438		557	14,317
2001	1,914	698		597	14,972
2002	1,541	643		651	16,306
2003	1,261	497	247	726	14,184
2004	864	1	1,601	597	12,192
2005	590	4	2,257	604	12,893
2006	588	0	3,560	534	13,137
2007	337	3	2,509	418	12,507
2008	867	2	4,820	587	15,535
2009	1,468	0	4,161	726	19,077
2010	1,309	4	2,831	765	16,045
2011	1,397	0	2,808	767	16,886
2012	1,222		2,532	839	16,165
2013	917		2,365	577	14,990
2014	724		1,790	563	14,043

Source: https://www.gov.uk/government/collections/insolvency-service-official-statistics

In July 2001, the British Government presented the White Paper "*Insolvency-A Second Chance*"[583] in addition to the previous approaches to rescue culture. This paper aimed to establish a better balanced system especially with regard to the creditors' rights. Another goal was to put more emphasis on the maximisation of economic value, especially by aiming to rescue companies in financial difficulties instead of liquidating them unnecessarily and destroying economic value.[584] The major suggestions were to reduce the possibilities of appointing an administrative receiver;[585] the streamlining of the administration procedure[586] and the abolition of the Crown preference.[587]

The administrative receivership procedure was criticised as it neither encouraged maximisation of value nor did it offer an adequate level of transparency and accountability for stakeholders, in particular creditors.[588] This became evident from the fact that the administrative receiver was not obliged to act in the interest of all creditors involved, but only in that of his appointing creditor.[589] This, of course, did not meet the international standard of insolvency law as a collective procedure.[590]

The White Paper suggested a change in favour of more collective insolvency procedures, involving all creditors, especially by limiting the possibility of appointing an administrative receiver in favour of a better balanced administration procedure, which however, had to be reformed to give it more effectiveness to be used as an insolvency tool.[591] It should have been streamlined in such a way to give a company in distress the extra "breathing space" to establish a rescue plan offering the perspective for a better outcome for the creditors than could be expected in a liquidation scenario.[592]

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[583] DTI, 'Insolvency Service Productivity and Enterprise: Insolvency A Second Chance' (Cm 5234 2001): main recommendations were *inter alia* the abolition of the Crown Preference, para 2.19, the de facto abolition of the administration receivership, paras 2.3 and the removal of the 2.2-report, para 2.10.
[584] Ibid, 8
[585] DTI 2001 (n 583) paragraphs 2.2 - 2.6 and 2.18.
[586] Ibid, paragraphs 2.7 – 2.17
[587] Ibid, paragraph 2.19.
[588] Ibid, Executive Summary
[589] Ibid 2.18.
[590] Ibid 2.3.
[591] Ibid 2.6
[592] Ibid, 2.7

This paper also established the basis for the EA. The EA aimed to facilitate the rescue of viable companies[593] by a fast and fair procedure for all creditors focussed on rescue.[594] Hewitt, the Trade and Industry Secretary, stated in the second reading of the EA that the Bill "strengthens the foundation of an enterprise economy by establishing an insolvency regime that will encourage honest but unsuccessful entrepreneurs to try again."[595] The UK Government clearly wanted Britain to become a place where entrepreneurs were welcome.[596]

Again, an analogy to the "mountaineer's dilemma" mentioned in chapter one could be drawn in this context. [597] The IA 86 represented the first peak on the way to an improved restructuring landscape. Insufficiencies in practice were the valley which led to another peak with the changes introduced by the IA 2000. The next valley appeared in the form of further challenges as the law seemed insufficient to pursue the aim of a functioning rescue culture. Continuing with this analogy, the summit in this context would be having a framework to allow all viable companies to survive. The EA 2002 could be regarded as one step nearer to this goal. As will be explained below, the EA introduced several changes on the way to a more perfect rescue regime.

3.2.4.1. Main Changes introduced by the EA 2002

The EA put its focus on reforming the whole administration procedure aiming to make it less bureaucratic, simpler, faster and more cost-effective.[598] The keyword used in this context was "streamlining" the administration procedure.[599]

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[593] Ruth Pedley, R. 'The Enterprise Bill' (2002) 18 I.L. & P. 123.
[594] Marion Simmons, 'Some Reflections on administrations, crown preference and ring-fenced sums in the Enterprise Act' (2004) JBL 423, 424.
[595] Vanessa Finch V, 'Re-Invigorating Corporate Rescue' (2003) Journal of Business Law 527, 530.
[596] Grier, N. 'The Enterprise Act 2002' (2004) Scots Law Times 1.
[597] See chapter 1.3.2.
[598] Carsten-Oliver Mueller-Seils, *Rescue Culture und Unternehmenssanierung in England und Wales nach dem Enterprise Act* 2002 (Nomos Schriften zum Insolvenzrecht 9 Baden - Baden 2006)70, 71.
[599] DTI 2001 (n 583), para 2.7; The entire Part II of the IA was abolished and the new Part II only is composed of the new section 8, which refers to the new Schedule B 1, regulating the administration procedure.

As anticipated earlier, legislation introduced by the IA 86, did not reach far enough to adapt to the needs of the economic environment.[600]

The Act included several changes: the administrative receivership was virtually abolished[601], an out of court appointment procedure was introduced[602] and the report under rule 2.2 of the Insolvency Rules[603] was abolished as well.[604] An automatically expiring period of twelve months for the proceedings allowing for only one possible prolongation was introduced to keep the procedure time-effective.[605]

Cork had already proposed the abolition of the Crown's status as preferential creditor for unpaid taxes back in 1985[606], which was only implemented with the EA.[607] To strengthen the position of unsecured creditors, the EA introduced a requirement that a portion of a company's net floating charge revenues was to be ring- fenced for the disposition of unsecured creditors.[608] The receiver tended to focus on getting the secured debt paid off as soon and as effectively as possible because he was practically "the bank's man".[609] The new administration regime improves the position of unsecured creditors by obliging the administrator to consider the interests of all creditors,[610] and not only, as in administrative receivership, those of secured creditors holding a qualified floating charge.[611]

The most significant change, however, was the amendment of section 8 of the IA, by which a single statutory procedure was introduced.[612] The old section 8 providing for a multi-purpose administration was replaced by a single- purpose

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[600] See 3.2.2.
[601] Stephen Foster, 'Enterprise Act 2002: Changes to Corporate Insolvency' (2003) Insolvency Lawyer' 174.
[602] Simmons, (n 594) 424.
[603] Hereafter: IR 86; the Insolvency Rules were amended in 2015, the amendments will come into force in April 2016: The Insolvency (Amendment) Rules 2015 (2015 No. 443) <http://www.legislation.gov.uk/uksi/2015/443/pdfs/uksi_20150443_en.pdf>
[604] Finch Re-Invigorating Corporate Rescue (n 595) 532.
[605] Gill Todd, 'Administration post Enterprise Act – What are the options for exits' (2006) 19 Ins. Int. 17.
[606] Cork Report (n 57) 319,320.
[607] Neil Levy, Paul French 'The Enterprise Act 2002: preparing for the next recession?' (2003) NLJ 1117.
[608] Finch Re-Invigorating Corporate Rescue (n 595) 533
[609] Roger McCormick, 'Stepping Out With the Rescue Culture Club' (2006) JIBF 99, 99.
[610] Para 3 (2) Schedule B 1
[611] Omar, 'Four Models for Rescue (n 56) 131.
[612] Foster (n 601) 174.

administration with a three- part hierarchy.[613] The multi-purpose administration had shown that the actual purpose of administration was not sufficiently concentrated so as to lead to the rescue of the company.[614] This underlines that the focus of administration must clearly be on corporate rescue as the "single, overarching purpose".

Administration was designed to be a temporary measure, providing a basis for either liquidation or rescue, with a more positive outcome than an immediate winding up.[615] Several documents, *inter alia,* a substantial report pursuant to rule 2.2 IR 86, had to be enclosed with the application for an administration order; this application automatically caused a moratorium.[616] A holder of a qualified floating charge had the power of veto, enabling him to obstruct the administration procedure by appointing an administrative receiver.[617] The administrative receivership was not a reorganisation procedure in the sense of including a mechanism to restructure the company, for example in terms of a compromise settlement. It was more a cover under which a restructuring, for example in the form of a CVA, could be carried out.[618] For this reason, administrative receivership was incompatible with international insolvency law.[619] Section 72 a (1) of the IA 86 rules that the owner of a qualifying floating charge is no longer entitled to appoint an administrative receiver.[620]

In order to speed up administration procedures, the EA made it possible to obtain an administration order also without a specific court order.[621] Under the old regime, the formality of getting a court order involved regular delays and

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[613] Para 3 (1) Schedule B 1 states:" The administrator of the company must perform his functions with the objective of – (a) rescuing the company as a going concern, or (b) achieving a better result for the company's creditors as a whole than would be likely if the company were wound up (without first being in administration) (c) realising property in order to make a distribution to one or more secured or preferential creditors." old section 8 of the IA1986: "a) the survival of the company, and the whole or any part of its undertaking, as a going concern; b) the approval of a voluntary arrangement of under Part I; c) the sanctioning under section 425 of the CA 85 of a compromise or arrangement between the company and any such persons as are mentioned in that section; and d) a more advantageous realisation of the company's assets than would be effected on a winding up."
[614] Omar, Four Models for Rescue (n 56) 130.
[615] Andrew Keay; Peter Walton, *Insolvency Law Corporate and Personal* (third edition Jordan Publishing Limited London 2012) 95.
[616] Ibid 96.
[617] Finch, Corporate Insolvency Law Perspectives and Principles (n 539) 281.
[618] Mueller-Seils, (n 598) 50.
[619] Ibid 67
[620] IA 86 section 72 a (1) states: "the holder of a qualifying floating charge in respect of a company's property may not appoint an administrative receiver of the company."
[621] Simmons (n 594) 424.

high expense.[622] Having to obtain an official court order was often the reason for a floating charge holder to appoint an administrative receiver as a quicker alternative.[623]

A more "revolutionary" amendment was the possibility for the company and its directors themselves to commence an administration procedure without needing to involve the court. In contrast to the commencement by a floating charge holder, the company has to be insolvent or nearly insolvent.[624] In order to counteract the possible abuse of a moratorium by directors in minimising company assets at the expense of their creditors, the EA prohibits the out-of-court route under certain circumstances.[625]

3.2.4.2. Foremost Purpose

England and Germany seem to pursue different routes in their insolvency proceedings. As described in chapter two, the aim of an insolvency proceeding in Germany is the realisation of asset liabilities ("Verwirklichung der Vermoegenshaftung").[626] In other words, the foremost purpose is to achieve the best possible settlement for all outstanding creditors,[627] and not so much the preservation of an independent entity.[628] The German Government neither regards the rescue of the company itself as the primary goal of insolvency law, nor as an independent objective.[629] The way to achieve the optimum creditor satisfaction could be restructuring, but rescuing the company is not a purpose

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[622] Goode (n 58) 323.
[623] Ibid; this alternative to appoint an administrator is available for floating charge holders, as a quasi-substitute for the abolition of administrative receivership. It is not necessary that the company is insolvent; instead the security must be realisable.
[624] para 22 Schedule B1 of the IA 86.
[625] Para 23, 24 and 25 Schedule B1 of the IA 86.
[626] BT. Drs. 12/2443 (n 304) 83.
[627] Wellensiek, (n 351). 238, section1 states "Das Insolvenzverfahren dient dazu, die Glaeubiger eines Schuldners gemeinschaftlich zu befriedigen, indem das Vermoegen des Schuldners verwertet und der Erloes verteilt oder in einem Insolvenzplan eine abweichende Regelung insbesondere zum Erhalt des Unternehmens getroffen wird. Dem redlichen Schuldner wird Gelegenheit gegeben, sich von seinen restlichen Verbindlichkeiten zu befreien. " (Insolvency proceedings serve to satisfy the creditors of a debtor collectively by realising the assets of the debtor and dividing the proceeds or by making divergent arrangements in an insolvency plan, in particular for the maintenance of the undertaking. The honest debtor gets the chance to be discharged from his residual debt.) The KO and the VglO did not comprise a section on the procedural goal as it was assumed that lawyers were able to deduce the objectives of the law. Still today it would be possible without section 1 to deduce the aims of the InsO; however, the formulated objective could be used for the interpretation of the law.(Henckel (n 305) section 1, recital 1).
[628] BT. Drs. 12/2443 (n 304) para 31.
[629] Ibid section 1

in its own right. [630] The German Law Commission, however, suggested different aims for the reorganisation and the bankruptcy procedure; preservation of a viable business ("Erhaltung eines lebensfaehigen Unternehmens") versus the satisfaction of creditors through liquidation ("Glaueberbefriedigung durch Liquidation").[631]

England, on the other hand, opted for a single - purpose administration with hierarchical gradation, including further objectives for cases where the main target could not be achieved.[632] This, however, tells only half the truth, bearing in mind that this is only codified for the administration procedure and not for any other available formal insolvency procedures.

The German legislator argued that the aim of an insolvency proceeding could only be a "microeconomic investment decision".[633] The rescue of a business should not be a self-contained aim in itself, and unreasonable restructurings were to be avoided.[634]

At first glance, it seems that England is pursuing the rescue idea more intensely than Germany. The pre-eminent purpose of administration, "rescuing the company as a going concern"[635] appears to be in contrast with the best realisation of assets for the creditors in Germany. However, a closer look reveals that the results are probably quite similar. In England, the IOH would only rescue the company as a going concern if this proved to be the most sensible solution, otherwise he would decide for one of the other options available in the hierarchy. This is underlined by the findings of Frisby, showing that the new objective did not result in higher rescue rates.[636] It can, therefore, be stated in conclusion that an IOH will only undertake the rescue of a company where it makes economic sense. In Germany, although the overriding purpose is the realisation of assets for the satisfaction of the

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[630] Schlegel Part 1 (n 358) 417, more details see chapter 2.2.1.
[631] Bt Drs. 12/2443 (n 304) 88.
[632] See more details chapter 3.2.4.2.
[633] BT. Drs. 12/2443 (n 304) 77.
[634] Ibid
[635] See IA 86, Schedule B1.
[636] Sandra Frisby, 'Report on Insolvency Outcomes for the Insolvency Service' (2006); almost half of the samples of administration procedures ended in a break-up-sale of the corporate estate instead of in rescuing the company, this would mean that the Enterprise Act did not achieve its objective.

creditors, there is still a clear emphasis on the part of the Government to restructure the company or the business rather than liquidating it as the recent reforms were aimed at enhancing the rescue culture.[637]

Summarising, it could be argued that although the aims are different, a case by case examination with regard to the choice of handling an insolvent business would probably result in only minor differences.

3.3. The Current Insolvency Landscape in England

After this brief overview on developments and roots of the rescue culture in England, the second part will evaluate the current insolvency landscape, referring to changes in the procedures where appropriate. It is important to look at their formal aspects, as they lay the foundation for later discussion and comparison of several details of these procedures.

3.3.1. Entry into Insolvency

There is no single entry into an insolvency proceeding in England; the parties themselves have to decide which procedure to choose when filing for insolvency. As discussed in chapter two, the German legislator, on the other hand, decided for a single entry point for the insolvency process.[638] It was argued that a single entry would offer an efficient and flexible tool, leaving it to the parties involved to decide which way to go within the procedure, without prejudice through a formal judicial "setting of the course".[639] Germany learned from the past, when the KO and the VglO had different aims which in consequence were leading to the problems as discussed in chapter two.

It could also be seen as positive to have no single entry into the proceedings, making them more flexible, as there are more options to choose from. The appropriate procedure could be chosen with regard to the needs of the

[637] BT. Drs. 17/5712 (n 294) 1.
[638] crossreference chaper 2.3.1.
[639] Erster Bericht der Kommission fuer Insolvenzrecht (n 303) 152.

individual case, offering different levels of formal requirements which might help to speed up the process in general.

It could, however, be argued that the English system comprises more complexity already because of its offering the choice of different procedures. The argument about negative aspects of this complexity implies that management of the debtor, possibly not having full knowledge of the different options, may fail to choose the most appropriate one.[640] The subsequent change to another procedure, even though quite possible still, would most likely be time- consuming and therefore not really conducive to an insolvency proceeding.

3.3.2. Liquidation and Administrative Receivership

Before the introduction of the administration procedure, the insolvency landscape was characterised by liquidation and the administrative receivership procedure.[641]

With liquidation still remaining as one of the main formal procedures in dealing with an insolvent company, the focus of this thesis rests on restructuring tools rather than liquidation. The aim of this research is to demonstrate that forum shopping activities are a stimulus for insolvency law perfection which is defined as a race to rescue, so focussed on restructurings. As explained in chapter two, one main aim of the ESUG was to foster the rescue culture in Germany, so all changes introduced were concentrated on facilitating restructuring, rather than on changes with regard to liquidating companies. Liquidation procedures are therefore not the subject of this analysis.

The administrative receivership procedure is of negligible significance for this thesis, as it has been virtually abolished and is of only minor practical

[640] Review Group Report (n 287) para 149.
[641] The term "administrative receivership" was first introduced by the IA 86, The "old –style" receivership procedure was not an insolvency procedure at all, simply a procedure for secured creditors to enforce their securities; see Goode(n 58) 315.

relevance today. Furthermore, it arguably does not foster the rescue culture[642] and therefore provides no point of comparison regarding the changes in Germany introduced by the ESUG. Receivership is only outlined here briefly to better understand the development of insolvency law in England, as several changes resulted out of "negative" features of this procedure.

Administrative receivership is basically a debt enforcement tool available to holders of debentures with a floating charge for cases where companies default under the terms of the underlying loan.[643] The administrative receiver will act as an agent for the company;[644] however, if appointed by a debenture holder, to act on his behalf as well, his role being to realise the security for the floating charge holder.[645] As the administrative receiver has to juggle different interests, Goode describes him as "a protean character, changing his colour, shape and function according to circumstances".[646] As pointed out above, the administrative receivership was virtually abolished with the introduction of the EA 02 and remains relevant only for floating charges created before the 15.September 2003.

3.3.3. Administration

The administration procedure was introduced on the recommendations of the Cork Report to facilitate restructuring by appointing an independent administrator to take over the management of the company.[647] The company is protected by a moratorium, giving 'breathing space' for the administrator to find an exit strategy.[648] The administrator as such could be appointed by either the court or, under the new regime, by the holder of a floating charge, the

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[642] Although Armour and Frisby argue that "it can nevertheless generate savings for parties, by allowing a concentrated creditor who has invested in information-gathering about the debtor to conduct a private insolvency procedure. It is suggested that this procedure is likely to be more efficient than one conducted by a state official, and that it is likely to reduce the costs of debt finance, a matter of particular importance for small and medium-sized businesses." see Sandra Frisby, John Armour 'Rethinking Receivership' Oxford J Legal Studies 21 (1) (2001) 73.
[643] Section 29 (2) IA 86.
[644] Section 44 (1) IA 86.
[645] Goode (n 58) 331.
[646] Ibid 332
[647] Finch, *Corporate Insolvency Law Perspectives and Principles* (n 539) 363; although Goode does not see the administration procedure as a restructuring procedure, see Goode (n 58) 393.
[648] Rebecca Parry *Corporate Rescue* (Sweet & Maxwell 2008), 9.

company itself or by its directors.[649] This "out of-court- route" was introduced by the EA.[650]

The purpose of an administration procedure can be found in Para 3 (1) Schedule B 1 of the IA 86, with the primary objective of "rescuing the company as a going concern".[651]

Paragraph 59, Schedule B1 of the IA 86 defines the general powers of an administrator.[652] In spite of being regarded an agent for the company it is, nevertheless, his obligation to act in the interest of all creditors.[653] The administration procedure will end automatically after twelve months, as introduced by the EA, with the possibility for the court to prolong this period.[654]

The administration procedure is often used in combination with a CVA.[655] The main reason for this is to obtain the benefit of the administration moratorium.[656] During a moratorium creditors are not allowed to enforce their individual rights. This prohibition ensures that the status quo is frozen and the technical and organisational units of the business are preserved.[657] In addition, the security holders are not allowed access to their securities; neither leased assets nor assets under retention of title can be taken into possession.[658] This gives the company the necessary 'breathing space' to work out a substantial restructuring plan.[659] Furthermore, the combination is attractive due to the

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[649] Keay and Walton (n 515) 99,100.
[650] See chapter 3.2.4.
[651] See chapter 3.2.4.
[652] General Powers. (1)The administrator of a company may do anything necessary or expedient for the management of the affairs, business and property of the company. .
(2)A provision of this Schedule which expressly permits the administrator to do a specified thing is without prejudice to the generality of sub-paragraph (1). .
(3)A person who deals with the administrator of a company in good faith and for value need not inquire whether the administrator is acting within his powers.]
[653] Derek Ellery, *A Brief Guide to Administration* (2009) CSR 1, 1.
[654] See chapter 3.2.4.1.
[655] Strictly speaking an administration procedure is not in itself a restructuring procedure, but a temporary regime with several possible gateways. Another procedure is always necessary, such as a CVA; the norm is voluntary workouts, especially in large corporate restructurings. (See further John Townsend, 'Comparing UK and US business rescue procedures: are Administration and Chapter 11 perceived to be workable and affordable?' (2007) 23 IL I.L. & P 66).
[656] Ken Baird, Look Chan Ho, 'Company Voluntary Arrangement: The Restructuring Trends' (2007) Ins. Int.124, 124.
[657] Ibid
[658] Ibid
[659] Keay, What future for liquidation in the light of the Enterprise Act Reforms (n 554) 144.

absence of class issues present in a SoA and the fact that the administration set-off rules are available to a CVA distribution.[660]

As figure four shows,[661] the numbers of administrations have risen steadily since its introduction. Keay predicted that the number of administrations would probably double again over the next few years in comparison to previous years.[662] At the time, the figures for 2006 were not yet available and his prognosis was not far from reality. In 2011, 2808 administrators were appointed, compared to 2257 in 2005,[663] an increase of 24%.[664]

This increase in the number of administrations can not only be seen in correlation with the decreasing number of liquidations, but also with the abolition of being able to appoint an administrative receiver.[665] Another explanation for the increase in administration is the extended power to appoint an administrator out-of-court.[666] With these two changes, English insolvency practice adapted to the overall changing environment, in particular to the need for a more rescue-focused procedure, which made the regime more perfect.

Creditors also have advantages in choosing administration instead of liquidation. They benefit from a better and more efficient disposition of a company's assets, generally resulting in higher returns compared to liquidation.[667] This could also be traced back to the fact that the company gets "breathing space" to find a solution for a turn- around, in contrast to the situation of a company being wound up.[668] The case of *Buchler v Talbot*[669] demonstrates another advantage in opting for administration. Unlike in the

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660 Keay, What future for liquidation in the light of the Enterprise Act Reforms (n 554) 144.; rule .2.85 IR 86
661 See page 73
662 Keay, What future for liquidation in the light of the Enterprise Act Reforms (n 554) 146.
663 *http://www.insolvency.gov.uk/otherinformation/statistics/statisticsmenu.htm*
664 Since the introduction of the EA, the number of administrative receiverships has declined, whilst administration appointments have risen. Since the introduction of the EA, administrators are being appointed from a far wider range of firms, especially smaller and new entrance firms use the administration market. (See further Stephen Foster, 'Enterprise Act 2002: Changes to Corporate Insolvency' Insolv. L. (2003), p. 178; Alan Katz, Michael Mumford, 'Study of Administration Cases' (2007) Insolvency Intelligence, 97 and Sandra Frisby, 'Not quite warp factor 2 yet ? The Enterprise Act and corporate insolvency (Part 1)' (2007) 6 JIBFL 327).
665 Foster (n 601)178; Katz analysed in his article, Katz, Mumford, M. (n 664) 97, the development of administration cases with regard to the implementation of the EA. The overall trend could be summarised as follows: increase of administration cases as a proportion of all corporate insolvencies; administration is substituting for administration receivership and creditors voluntary liquidation.
666 Ibid, 1.
667 Katz, Mumford, M. (n 664) 97.
668 Fiona Tolmie, *Corporate and Personal Insolvency Law* (second edition, Cavendish Publishing Abingdon 2003) 63.
669 *Buchler v Talbot* [2004] 2 WLR 582.

case of liquidation, costs for the administration procedure can be paid out of the assets of the company subject to a floating charge, making more funds available for the unsecured creditors. The overall figures, however, show that the incentives of applying for administration are not high enough for creditors in general to request administration instead of liquidation.[670] In other words, the changes introduced paved the way towards a better regime, but the adaptation was still not in line with the existing conditions.

Abolishing the Crown Preference was another moderate step towards a more perfect insolvency regime, as a preferential status could well be misused to appoint a liquidator to benefit from a total settlement of debts.[671] Now these creditors will not be satisfied in advance any more, which could be an inducement to rescue the company in order to finally obtain a potentially better return.[672] This has not only had an impact on the returns that creditors receive out of an insolvency process,[673] but possibly also on the number of appointments of liquidators.

Also directors are offered incentives to appoint an administrator instead of deciding for a liquidation. They have more influence in administration procedures, which are designed to be of a temporary nature only. Investigations into the potential responsibility of directors are not as strict as they would tend to be in the case of liquidation. [674] Critics say that the administration procedure is even used by directors to hide fraudulent or wrongful trading, as the chances of exposure are minor.[675] This is coupled with the fact that the administrator, unlike a liquidator, cannot commence wrongful trading under section 214 IA 86.[676]

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[670] Keay, What future for liquidation (n 554) 143, 151.
[671] See section 251 Enterprise Act 2002; Finch Re-Invigorating Corporate Rescue (n 595) 532.
[672] Ibid
[673] Ibid; estimates an additional sum of around 70 million pounds per annum flowing to other creditors
[674] Keay and Walton (n 515) 95; Keay, *What future for liquidation in the light of the Enterprise Act Reforms* (n 554) 153.
[675] Ibid; Katz analysed 100 administration cases with regard to potential abuse of the appointment process and found out that "there was a clear justification for administration in 57 per cent of the sample cases-amounting to 94 per cent by asset value.(Katz, Mumford, (n 664) 101.
[676] Todd (n 605)19, 9; Furthermore, in an administration procedure the directors do not have to attend a creditors' meeting as it is only the duty of the administrator. As such, directors are much less exposed. Frisby's research found out that director-led appointments are becoming more common, as the management is reassured that the appointment of an administrator does not have to be "the beginning of the end". Frisby emphasises that the research conclusion that most administrators were appointed by the company must be treated with caution. One must keep in mind that the management is often encouraged by the charge holder, or at least the appointment is

Surprisingly, a comparison of the outcomes of administration and receivership as well as pre- and post- EA administration, did not result in a higher rescue rate in administration procedures.[677] Frisby analyses this further and argues that corporate rescue happens mainly before the company undertakes formal procedures such as administration. At this point, when insolvency intervenes, a rescue is often too late; the best outcome, however, could be the rescue of the business as such and not so much the company itself.[678]

3.3.4. Company Voluntary Arrangement

A second rescue tool in England is the CVA, which was introduced by the IA 86. In a CVA, the directors of a company propose a composition or scheme of arrangement, approved by its members, to all its creditors.[679] The CVA is a formal procedure, though without the involvement of the court, but nevertheless a binding arrangement between the company and its creditors.[680] The CVA was introduced as a "shortstop to insolvency"[681] with the idea of leaving the directors in charge. Essential to this form of rescue procedure is a perception of "anti-juridification", where the court sanctions the proceeding, but has no oversight.[682] The intention was to have a procedure less cumbersome than the SoA and give the debtor the chance to start a rescue attempt right before the actual state of insolvency.[683] It was a procedure "intended to be an additional, and particularly flexible, option in the case of corporate insolvency,

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often a result of negotiations and consultations. (See Goode (n 58) para 10-32 and Sandra Frisby, Not *quite warp factor 2* yet? (n 664) 327.

[677] Ibid; Almost half of the samples of administration procedures ended in a break-up-sale of the corporate estate instead of in rescuing the company, this would mean that the Enterprise Act has the opposite effect.

[678] Frisby *Not quite warp factor 2 yet?* (n 664); The interviewees were in general of the opinion that supporting the main creditors in the pre-insolvency phase is one of the most effective and appropriate responses to financial distress. Frisby suggests that the pursuit of corporate rescue is too high an entry point for the aim of administration, rather one should see the positive performance in the area of business rescue. Business rescue has the advantage that it will almost always maximise value and will normally achieve a better result for the creditors than in the case of liquidation. Therefore one could argue that the EA does not have a real impact on the incidence of corporate rescue. However it may perhaps be too early to judge its overall impact as new legislation always needs time to produce lasting results. One key factor will be whether the participants will adopt the changes and put them into practice. John Alexander of Carter Backer Winter stated: "If the new Act is going to work it is going to need a change in the attitude of banks and those insolvency practitioners with whom they have been used to working" in Finch Re-Invigorating Corporate Rescue (n 595) 528; see further: John Alexander, 'The Enterprise Act 2002' [2003] 19 I.L. & P. 3.

[679] Part I IA 86.

[680] Flechter, Law of Insolvency (n 547) 477.

[681] John Flood, Robert Abbey, Eleni Skordaki, Paul Aber 'The Professional Restructuring of Corporate Rescue: Company Voluntary Arrangement and the London Approach' (1995) London, Research Report 45, 8.

[682] Ibid 12

[683] John Tribe, 'Company Voluntary Arrangements and rescue: a new hope and a Tudor orthodoxy' (2009) J.B.L. 454, 465.

in addition to liquidation, administration and administrative receivership."[684] It gives the debtor the chance to start a restructuring before the onset of insolvency.[685]

The aim of a CVA is to provide for a rescue tool which balances the creditors' needs of protection and the debtor's interest not to be disturbed in the day-to-day business as cost effectively and simply as possible.[686] The debtor remains in charge of the day-to-day business. The advantages and disadvantages of leaving the debtor in possession are examined in chapter five.

The directors, the liquidator and the administrator are authorised to commence CVA proceedings.[687] A CVA commences by distributing the proposal of a restructuring plan.[688] The necessary content of the proposal is listed in rule 1.3 IR 86. The proposal is prepared by the nominee. He has to prepare a report for the court as well, in which he has to analyse the proposal with regard to its possible potential success.[689] The IA 86 only comprises minimum standards as far as the content of the proposal is concerned.[690] A mandatory component is that it is either a composition of debts or a scheme of arrangement.[691] The proposal has to comprise certain protections for preferential and secured creditors,[692] moreover the parties are more or less able to agree upon any terms as long as it is pursued with the aim of improving the rescue options, bearing all involved parties in mind.[693] Typical contents of a CVA are the delay of payments for the creditors; an arrangement to pay in instalments; a moratorium, a deferral, a (part -) remission of the claim, an injection of new capital or a DES.[694] The directors are legally responsible for the proposal. The

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[684] *Commissioners of Inland Revenue v The Wimbledon Football Club Ltd and others*: [2004] EWCA Civ 655, at paragraph 53.
[685] Insolvency is not a precondition for a CVA, unlike for the administration procedure (see section 123 IA 86).
[686] Tribe, Tudor Orthodoxy (n 683) 465; Geoffrey Weisgard, Michael Griffith *Company Voluntary Arrangements and Administrations* (third edition Jordan Publishing Limited London 2013) 2.
[687] Section 1 (1) and (3) IA 86.
[688] Tolmie (n 568) 89.
[689] Ibid; example of a proposal see Weisgard (n 686) appendix two, 329.
[690] Rules 1.3 (1) and (2) IR 86 lists the requirements for a proposal; the explanation why a CVA process is suggested and why it is likely that the creditors will approve it (rule 1.3 (1)) and the detailed record of the companies situation (1.3 (2)).
[691] Section 1 IA 86; A composition of debts is an arrangement between the debtor and the creditors for a pro rata settlement of the creditors. A scheme of arrangement comprises all supposable arrangements, as long as the creditor does not abandon his claim without any reward; Jo Windsor, Carsten O Mueller-Seils, Michael Burg, Unternehmenssanierung nach englischem Recht – Das Company Voluntary Arrangement (2007) NZI 7, 8.
[692] Flood (n 681) 43.
[693] Ibid
[694] Flood (n 681) 43.

supervisor is not party to the agreement, which is solely between the debtor and its creditors.[695]

In taking the first step of the process a director has to approach the selected "nominee",[696] who will then work out the official proposal and formulate a report for the court, evaluating the proposal with regard to its potential success.[697] The nominee's function is to mediate and facilitate between the company and its creditors.[698] He is not an advocate of the directors.[699] One of his most important jobs is the preparation of the report. The preparation of the report including the statement of affairs is of great importance as it represents the basis of future actions.[700] In this report he is not only reflecting the companies' wishes, but has to apply his own independence and has to verify the information in the proposal.[701] He has to find a fair balance between the interests of all involved parties.[702]

The CVA is forwarded to both the creditors' and the shareholders' committees; they decide about the proposal separately from each other.[703] The votes of the secured creditors remain out of consideration in the creditors' committee.[704] Section 4 A IA 86, states that a proposal is approved on the agreement of both meetings, but also if only the creditors' meeting agreed to it. At least a three-quarter majority by value of the creditors voting at the meeting is required.[705] Once approved, the proposal is binding for all creditors with voting power.[706]

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[695] Weisgard (n 686) 27.
[696] Who is in general an insolvency practitioner; Keay and Walton (n 515) 131.
[697] Ibid
[698] Weisgard (n 686) 57.
[699] Ibid
[700] Flood (n 681) 22.
[701] Weisgard (n 686) 57; SIP 3 gives further guidance as to the required conduct of the nominee.
[702] Ibid, 3.5 and SIP 3; more on the nominees duties see *Pitt v Mond* [2001] BPIR 624; *King v Anthony* [1998] 2 BCLC 517, [1999] BPIR 73, CA.
[703] Tolmie (n 568) 96.
[704] Rules 1.17-1.20 of the IR 86; Rule 1.19 (3) and 1.52 (4) IR 86. The calculation of the necessary majorities amongst the creditors takes place in two steps: first of an all a ¾ majority of the creditors at the creditors meeting with the power to vote is necessary. If this is reached it must be checked if the dismissive votes do not exceed 50 % of the claims of all creditors with voting power invited to the meeting.
[705] For details see IR 86, r. 1.19. (1) and 1.52. (1); see as well Stephen Mayson, Derek French, Christopher Ryan *Company Law* (second edition, Oxford University Press 2011/2012) 743; The IR 86 differentiate between connected and unconnected creditors. There are two votes conducted at the creditors meeting and the distinction is important as the connected creditors are not allowed to vote at the second vote. The second vote needs a majority of 50%: see rule 1.19 IR 86 (This is because a second vote is conducted at CVA creditors meetings. At the second vote connected creditors cannot participate in the vote. At the second vote a majority of 50% of the connected creditors is needed to approve the CVA proposal).
[706] Section 5 (2) IA 86.

With the coming into force of the CVA, the nominee turns into the supervisor, who is responsible for the implementation of the plan.[707] In other words the nominee is allowed to take over the function of the supervisor which is the norm. Whereas the function of the nominee is a limited and short-term one, the supervisor takes over a long term commitment.[708] The supervisor has to be a licensed insolvency practitioner (IP).[709] The IA 2000 softened this requirement, by allowing that a person should not be disqualified if he is a member of a RPB.[710] There is an ongoing debate about the question whether this might lead to non-qualified persons dealing with this sensitive matter and in the worst case having ruthless consultants, acting contrary to the creditors' interests.[711]

Next to these formal qualifications, it is of great importance to have a supervisor in place with strong professional relationships, interdisciplinary as well as cross-jurisdictional.[712] It could be argued that the role of the supervisor is quite passive as he has to work with the existing management, leaving no room for "real" powers.[713] Often one part of the role of the supervisor is to find new investors or potential buyers.[714] In accordance with section 2 IA 86; rule 1.7 IR 86, the proposal has to be filed with the local insolvency court. The court has no real power with regard to the proposal as it is not allowed to refuse it; the court has a passive and administrative function in the entire procedure.[715] It has a more active role with regard to a potential moratorium.[716]

Creditors with voting rights and company directors have 28 days to challenge but only for reasons of unfair prejudice and material irregularity.[717] With the CVA coming into force, the nominee takes on the role of supervisor and is responsible for the implementation of the plan.[718] The completion of the CVA

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[707] Keay and Walton (n 515) 147.
[708] Flood (n 681) 24.
[709] Section 4 (1) IA 2000
[710] Section 4 IA 2000, Weisgard (n 686) 24.
[711] Weisgard (n 686) 24.
[712] Ibid
[713] Ibid
[714] Flood (n 681) 25 (he calls them "white knights" or "angels").
[715] Weisgard (n 686) 30.
[716] Ibid
[717] section 6 IA 86
[718] Keay and Walton (n 515) 147.

depends on its construction; typically the proceedings end with the assets having been realised, the opening of a liquidation procedure or with the ending of a determined period.[719]

Since the introduction of the CVA in 1986, the CVA was used increasingly, however in 2013 and 2014 the usage decreased as shown in figure four.[720] The overall figure, was and still is disappointing, because of the reasons examined in the following paragraphs.

All figures here must be treated with caution, as they can only give an idea about which procedures were used most frequently. They do not give an answer as to whether a CVA is a useful tool for rescuing a company. The main advantages for a company would be that the simple framework avoids sapping the assets, which is often the case informal insolvency procedures.[721] It is intended to offer a more effective and quicker way of finding an agreement with the creditors than the possibility of a SoA under section 895 of the CA 06.[722] In particular, the difficulty in forming creditor groups does not exist within the CVA procedure.[723]

The reason why this procedure is not used more frequently could be the incalculable effect in the case of a later default of the company, and the possibility of a less desirable position for the creditors.[724] It is argued that the process is too debtor–friendly, especially as creditors are usually required to give substantial waivers or concessions.[725] The procedure as such is often time-consuming.[726]

The main disadvantage is seen in the non-binding character for creditors in general. Due to the absence of a moratorium, they are still able to enforce their debts individually, which could then lead to the failure of the entire CVA.[727] *The*

[719] Windsor, Mueller-Seils, Burg (n 691) 11.
[720] See page 92.
[721] Omar, Four Models for Rescue (n 56) 129.
[722] Mueller-Seils (n 598) 50, 51.
[723] Windsor, Mueller-Seils, Burg, M (n 691) 10.
[724] Omar, Four Models for Rescue (n 56) 129.
[725] Ibid
[726] Ibid
[727] Keay and Walton (n 515) 126

Review of Company Rescue and Business Reconstruction Mechanisms 1999[728] recommended amongst other things the introduction of a moratorium for small and medium sized companies.[729] The IA 2000 took up on this proposal and introduced a moratorium for small and medium sized companies.[730]

A moratorium gives the company 'breathing space' and can be generally defined as "a legally authorized postponement of the fulfilment of obligations" or "an agreed suspension of activity".[731] Detailed regulations about the moratorium can be found in Schedule A, regulating inter alia the preconditions for a moratorium,[732] the effects of a moratorium[733] and regulations on the implementation of a moratorium.[734] Effects during a moratorium are for example that the creditors are not allowed to enforce their individual rights. This prohibition ensures that the status quo is frozen and the technical and organisational unit of the business is preserved. In addition, the security holders are not allowed to access their securities; neither leased assets nor assets under retention of title can be taken into possession. A moratorium prevents a petition to wind up the company. No other proceedings, executions or legal processes may be commenced or continued.[735]

In 2009 the Insolvency Service published a consultation paper asking about the expansion of the moratorium to all CVA's,[736] allowing medium and larger-sized companies to obtain the benefit of a breathing space to be able to negotiate with their creditors.[737] The Government decided not to extend the moratorium to large companies, mainly as for large companies there would be

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[728] The Review Group was set up with the terms of reference: "to review aspects of company insolvency law and practice in the United Kingdom and elsewhere relating to the opportunities for, and the means by which, businesses can resolve short to medium term financial difficulties, so as to preserve maximum economic value; and to make recommendations.", Review Group (n 287) foreword.
[729] Review Group (n 287).
[730] Dennis and Fox, (n 580) 37; To be categorised as a small company, two or more of the requirements of section 247 (3)-(5); (7) of the Companies Act 1985 must be in place: an annual turnover of 2, 8 million or less; balance sheet assets of no more than 1, 4 million and no more than 50 employees.
[731] Collins English Dictionary; more on moratoria for CVA's: Tribe, Tudor Orthodoxy (n 683).
[732] Schedule A1, para 6-11.
[733] Schedule A1, para 12-23.
[734] Schedule A1. Para 29-39.
[735] Schedule A1 IA 86.
[736] Insolvency Service, 'Encouraging Corporate Rescue- A consultation' (2009) <http://webarchive.nationalarchives.gov.uk/+/http://www.insolvency.gov.uk/insolvencyprofessionandlegislation/con_doc_register/compresc/compresc09.pdf> (last visited 09.01.2013).
[737] Ibid

already a procedure with an automatic moratorium in place, namely administration.

The moratorium for small and medium sized companies was introduced as the administration procedure would in general be too expensive, offering these companies a moratorium through a CVA.[738]

However it could be argued that a moratorium is superfluous or even cumbersome. [739] A "consensual CVA" could be seen as the restructuring tool of the future.[740] Tribe argues that the lack of a moratorium could even be heartening for the creditors as the need for a moratorium might be associated with liquidity problems.[741] If a moratorium is not an option, this might encourage the creditors to work on a consensual approach as there is no alternative available. This in turn could promote a more open discussion amongst the parties and the openness to find an amicable solution. The moratorium needs approval by the court. This implies higher costs and delay in the procedure. The lack of a moratorium means therefore more time efficiency and lower costs.[742] One could argue as well that a moratorium throws the door wide open for using the moratorium to remove substantial items of equipment.[743] The lack of a moratorium as an advantage is reflected in practical experiences as well. On the website of a CVA specialist firm it says "We have never used the formal CVA moratorium, because in practice it's too cumbersome for the company and far too risky for the nominee."[744] Instead they work on achieving a de facto moratorium with the debtor and the creditors.[745] In other words they try to aim for a consensual solution, agreeing informally to find a consensual agreement to succeed with the CVA proposal. To attain such consensuality, it is indispensable to have a knowledgeable, experienced nominee and supervisor in place, who has next to his insolvency

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[738] John Tribe 'The Extension of Small Company Voluntary Arrangements: A Response to the Conservative Party's Corporate Restructuring Proposals' in Paul J Omar (ed), International Insolvency Law-Reforms and Challenges (Ashgate Publishing Limited Farnham 2013) 230.
[739] Tribe Tudor Orthodoxy (n 683) 4.
[740] Ibid, 23
[741] Ibid
[742] Ibid 4
[743] Tribe, The Extension of Small Company Voluntary Arrangements (n 738) 230.
[744] KSA Group *CVA guidelines*, www.companyrescue.co.uk (last visited 08.08.2015).
[745] Ibid

expertise, a clear business sense and certain personal attributes.[746] Integrity and independence contribute to a success of such a consensual approach as well.[747] It is recommended that work be done on the question of how the attitudes and perceptions of the involved parties could be changed, rather than more formal rules imposed, like a moratorium, with a certain aftertaste of a forced consent.[748] Leaving the creditors more room to play a part in the decision making process might have the psychological effect of producing agreement to a consensual solution. Showing the creditors the benefits of such an approach would be the best way forward.[749] The challenge is that the creditors often do not have the foresight; being selfish and not seeing the overall picture.[750] Therefore it could be argued that the absence of a moratorium, at first glance debtor unfriendly, could be still seen as rescue-friendly, as the lack of a moratorium could encourage creditors to participate as they are not forced into a standstill, but have more freedom to play an active role of finding a solution beneficial for themselves, lack of a moratorium also fosters a rescue attempt.

The intention behind implementing the CVA was to offer a simple restructuring tool as an alternative to the existing administration procedure. The CVA procedure is very flexible, leaving room for manifold possibilities. Apart from simple agreements such as extensions for payment or remission, more innovative solutions such as debt-equity-swaps[751] are put forward. Some disadvantages still remain, however, even after the positive changes implemented in the IA 2000, including uncertainties about the outcome of the procedure and the open question of whether the company will finally be able to adhere to the arrangements agreed upon. Particularly for smaller companies, drawing benefits from the moratorium, it should be regarded a definite alternative to consider.

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[746] Wilhelm Uhlenbruck, 'Das Bild des Insolvenzverwalters-Der Versuch einer Orientierung im Widerstreit viefaeltiger Interessen' (1998) KTS 2. More on qualities of IOH's see chapter 6.
[747] Tribe, The Extension of Small Company Voluntary Arrangements (n 738) 221.
[748] See as well: Vanessa Finch, 'Re-Invigorating Corporate Rescue' (2003) Journal of Business Law 527, 527
[749] Tribe The Extension of Small Company Voluntary Arrangements (n 738) 221.
[750] John Tribe, *Companies Act schemes of arrangement and rescue: the lost cousin of restructuring practice?* (2009) B.J.I.B. & F.L 386, 389.
[751] Windsor, Mueller-Seils, Burg, M (n 691) 11.

3.3.5. Schemes of Arrangement

Another restructuring mechanism could be the SoA under section 895 CA 06. Strictly speaking, a SoA is not an insolvency procedure as such, but it authorises a company, whether insolvent or not, to come to a compromise agreement with its creditors with the aim of restructuring the company to help it out of its financial distress.[752] This method was introduced for the first time as early as 1870.[753]

The SoA has languished away for many years, especially since the establishment of the CVA, being regarded as more burdensome and cost intensive in comparison to the latter. However, it did undergo a revival in recent years due to its flexibility.[754] Especially in complex and international cases the SoA is attractive due to its wide variety of possible compromises and arrangements.[755] Furthermore due to its "cram-down"-like effect it is especially popular in cases where a consensual agreement between the creditors is unlikely.[756]

The procedure normally starts with the debtor's presentation of a proposal of a scheme to the members and creditors.[757] There is no requirement to involve an IOH. The debtor stays in charge and presents the proposal.

The court will order meetings of creditors, members and other relevant parties involved. It will then decide to refuse or sanction the outcome of these meetings.[758] Under normal circumstances, the court will sanction the scheme if the majority of creditors or group of creditors representing 75% in value of the company's debts agree on the compromise solution laid down in the

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[752] Tolmie (n 568) 82, see as well and for other common uses of the schemes of arrangement: Louise Gullifer, Jennifer Payne, *Corporate Finance Law – Principles and Policy* (Second edition, Hart Publishing Oxford and Portland 2015), 15.3.
[753] Joint Stock Companies Arrangement Act 1870; 33& 34, Vict c 104.
[754] See Paul J Omar, 'Drawing boundaries between the Brussels and European insolvency regulations: the example of schemes of arrangement' (2013) 2 CRI 43, 43.
[755] Tribe Companies Act schemes of arrangement (n 750) 388.
[756] Pilkington, (n 136) 1.
[757] Section 895 CA 2006.
[758] David Milman, 'Schemes of arrangement and other restructuring regimes under UK company law in context' (2011) Comp. N.L. 1, 2.

scheme.[759] The main characteristic of this procedure is the fact that in addition to the necessity of a three-quarter majority as mentioned above, groups of shareholders and creditors have to be formed each of which has to approve the plan by at least a simple majority.[760] Once approved and sanctioned by the court, the scheme binds all creditors.

The court has a discretion under section 899 CA 2006, there is no obligation of the court and there is no entitlement to such a sanction.[761] This sanction of the court could be seen as a disadvantage, but in a complex case its involvement might be of benefit as the various rights of the parties involved have to be balanced. Whereas in a CVA there is a potential for litigation, within a scheme these issues might be resolved before the sanction of the court.[762]

As discussed in chapter seven in more detail the outcome of a scheme has a "cram down nature",[763] which could be seen as the most important advantage of the SoA as it is binding for all creditors once the scheme has been approved.[764] In comparison, a CVA is binding only for those creditors who had received notice of the meeting and were subsequently entitled to vote on attending.[765] However, the recent changes to the CVA procedure devalue this advantage of the SoA, as a CVA now binds all creditors who were entitled to vote at the meeting, even if they were not present.[766] The procedure is flexible and there is no need to involve an IP.[767]

It is argued that the formation of the groups are burdensome and complicated.[768] Furthermore, the procedure could be seen as rather complex and cumbersome.[769] It is known to be time-consuming and will be more

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[759] See section 899 (1) CA 2006.
[760] David Milman, 'Schemes of arrangement: a triumph of judicial adaptability' (2003) Comp. N.L. 1, 2.
[761] Milman, SoA and other restructuring regimes (n 758) 1; *Scottish Lion Insurance Co Ltd v (First) Goodrich Corp* (2009) CSIH 6; [2010] BCC 650.
[762] Milman, SoA and other restructuring regimes (n 758) 1; Re Energy Holdings (No.3) Ltd [2010] EWHC 788; [2011] 1 BCLC. 84.
[763] Pilkington (n 136) 13.
[764] Goode (n 58) 28.
[765] Ibid
[766] Keay and Walton (n 515) 173.
[767] Ibid, 326
[768] Finch, Corporate Insolvency Law Perspectives and Principles (n 539) 328.
[769] Tolmie (n 568) 83.

expensive than a CVA procedure.[770] In addition, the absence of a moratorium between formulating the scheme and its coming into effect by a court order, pushes the company into a "period of high vulnerability" for any creditor action.[771] Moreover, supervision by the court is in general also more demanding compared to the CVA procedure.[772]

It could well be argued that the SoA is superfluous as the CVA provides for a similar procedure offering more advantages and therefore seeming to be the better procedure to decide on. However, looking at insolvency practice, it becomes obvious that both procedures are used for different cases. It seems that both procedures are adapting well to different individual circumstances of cases, so both are bound to maintain their place also in future. The differences between these procedures, even though they may be only marginal, will finally be decisive in selecting the procedure best suited for the individual case. Finch, for example, makes the point that the possibility of handling a case without the need of an IP could speak in favour of the SoA.[773] The procedure could be handled more "efficiently, expertly, accountably and fairly than procedures involving external practitioners" and consequently take a justified place in modern company law;[774] always on the proviso that the company is managed by a qualified director fully capable of initiating turnarounds.[775]

3.3.6. Use of Schemes by Foreign Companies

The SoA procedure is not only used by English companies, but by foreign companies. This "restructuring migration"[776] or "the new forum shopping" is a way of getting into the benefit of the English SoA procedure without the necessity of moving the COMI to the favourable country. This possibility was used as well by German companies, for example *Rodenstock*[777], *Primacom*

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[770] Keay and Walton (n 515) 173
[771] Finch, Corporate Insolvency Law Perspectives and Principles (n 539) 328.
[772] Tribe, Companies Act schemes of arrangement (n 750) 386.
[773] Finch, Corporate Insolvency Law Perspectives and Principles (n 539) 356.
[774] Ibid
[775] Ibid
[776] For example: Robert Hickmott 'Forum shopping is dead: long live migration!' (2007) JIBFL 272.
[777] See appendix one

and *German Residential Asset Note Distributor.*[778] The SoA procedure offers a more efficient and user-friendly procedure than the local alternative procedures; [779] such as the minimal formal requirements, the flexibility with regard to the content and the binding nature once approved.[780]

The English courts can under section 895 (2) (b) CA 06 sanction a SoA with regard to any company "liable to be wound up under the Insolvency Act", which includes foreign companies.[781] However, case law defines three pre-conditions restricting an English Court granting such an order with regard to an overseas company.[782] The first condition is a sufficient connection with England;[783] the second is that there has to be a reasonable possibility for the persons applying for the winding-up order to benefit from the order. The third condition is that there has to be at least one person interested in the distribution of the debtor's assets under jurisdiction of the court, over whom the court has jurisdiction.[784] There are several cross border aspects to consider, such as the question of the applicable law and the recognition of the scheme, to discuss these further would go beyond the scope of this research.[785]

3.3.7. Pre-Packaged Administration

One possible way to solve the problems of a company in financial distress is the so- called "pre-packaged administration" (in short "pre-packs"). Pre-packs could be defined as "an arrangement under which the sale of all or part of a company's business or assets is negotiated with a purchaser prior to the appointment of an administrator, and the administrator effects the sale

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[778] See further with pre and post restructuring debt figures; other cases are wind Hellas. La Seda, Marconi and many more Pilkington (n 136) table cases, 2, 3.
[779] Pilkington (n 136) 1; see table p. 2, 3 cases with over £20 billion of debts which were restructured through this procedures for companies registered outside the UK.
[780] More on the benefits of the SoA see chapter 8.
[781] See section 221 (1) InsO.
[782] *Re Real Estate Development* [1991] BCLC 210 (Ch); approved by *Re Latreefers Inc* [1999] 1 BCLC 271 (Ch).
[783] Ibid
[784] Elms (n 139) 114; *Re Drax Holdings* [2004] 1 WLR 1049; *Re Sovereign Marine & General Insurance Co Ltd* [2006] BCC 774.
[785] See further Francisco Garcimartin, 'The review of the Insolvency Regulation: Hybrid procedures and other issues' <http://www.eir-reform.eu/uploads/papers/PAPER%206-1.pdf> (last visited 18.09.2015).

immediately on, or shortly after, his appointment."[786] In other words, it is a mechanism of selling an insolvent business as a going concern.[787]

Pre-packs are in frequent practical use due to their following advantages: "speedy routes to recovery", often resulting in repaying trade creditors in full, keeping costs low, recovery plans allowing turnarounds to be implemented in time, supporting the management team in helping to maximise value.[788] On the other hand, pre packs are criticised due to possibly undesirable consequences, for example legal risks including delays and uncertainties. Moreover, pre-packs could facilitate phoenix trading[789], as under sections 216 and 217 of the IA 86.[790]

The gain in importance of pre-packs[791] demands and at the same time facilitates the improvement of this procedure. The above listed advantages seem to match the practical requirements and the procedure is adjusting gradually to the needs of practice. One major amendment was the introduction of the Statement of Insolvency Practice 16,[792] which came into effect on 1st January 2009. The purpose of SIP 16 is to set out basic principles and essential procedures with which insolvency practitioners are required to comply. SIP 16 imposes on the practitioners who are party to a pre-pack sale the keeping of a detailed record of the reasoning and a justification behind the decision. SIP 16 lists the information which should be disclosed to the creditors.[793] In March 2010 the Insolvency Service announced a consultation for "*Improving the transparency of, and confidence in, pre-packaged sales in*

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[786] Statement of Insolvency Practice 16; https://www.r3.org.uk/uploads/sip/Statement%20of%20Insolvency%20Practice%20-%2016%20.pdf. (Last accessed 10th January 2013).
[787] Sandra Frisby, 'Case Comment-Judicial sanction of insolvency pre-packs? DKLL Solicitors v HMRC considered' (2008) Comp. N.L. 1, 1.
[788] Vanessa Finch, 'Pre-Packaged administrations: Bargain in the Shadow of Insolvency or Shadowy Bargains' (2006) JBL 570,571.
[789] Phoenix trading is used if a director of the insolvent company uses the old companies name or a similar name of the company and is as well the director of this successor company. In other words the director takes advantage of the goodwill of the insolvent company and leaving the liabilities on the old company.; see as well Alexandra Kastrinou, 'An analysis of the pre-pack technique and recent developments in the area' (2008) Comp. L. 262.
[790] Vanessa Finch, Pre-Packaged administrations (n 788), 571.
[791] Frisby shows in her article "A preponderance of pre-packs" that pre-packs are on the rise. In the given period 35.5 per cent of going concern sales were based on pre-packs. : Sandra Frisby, 'Preponderance of Pre-Packs?' (2008) 1 JIBFL 23.
[792] Insolvency Service, 'Report on the Operation of Statement of Insolvency Practice 16' (2009).
[793] Ibid

administration"[794] This initiative was based on two concerns the Government raised: the transparency of pre-packs and the necessity of an independent review mechanism.[795] The Government announced in January 2012 that it would not introduce new legislative controls on pre-packs.[796] This conservation of the status quo could be a conclusion of the consultation, based on a realisation that the balance between a speedy procedure and transparency had already been met with the introduction of SIP 16 and further changes would be a step away from perfecting the existing procedure. This was underlined by the recommendations of the Graham Report,[797] which highlights the importance of this tool for the restructuring practice and only suggesting actions which do not involve action by the government, but insolvency regulators and insolvency profession, addressing the flaws of the pre-packs such as transparency and valuation methods.[798]

3.4. Mini-Conclusion

The development of the rescue culture in England took place gradualistically.[799] The Cork Report created the basis for the establishment of a rescue culture, recommending improvements for the existing insolvency landscape to better adapt to the radical changes in the economic environment and the attitude towards insolvency. The picture of "the mountaineer's dilemma" could be transferred to the development of the rescue culture in England as well. Since the first step towards a perfect rescue culture, we had already two major reforms, with the IA 2000 and the EA. Before the next high point could be reached, several valleys had to be crossed in the form of

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[794] Insolvency Service, 'Consultation Document improving the transparency of, and the confidence in, pre-packaged sales in administration' (2010) <http://www.britishprint.com/downloads/managed/industry_info/Pre-pack_consultation_document_-_Final.pdf>

[795] Peter Walton, 'Government consultation: is it time to re-pack the pre-pack?' (2010) Comp. L.N. 1. In March 2011 the summary of the consultation responses were published. The greatest support was found for making no changes. These findings were implemented by the Government.

[796] "The Government is not convinced that the benefit of new legislative controls presently outweighs the overall benefit to business of adhering to the moratorium on regulations affecting micro-business which is an important plank of this Government's deregulatory agenda". (Davey E. 'Written Ministerial Statement, Pre-Packaged Sales in Insolvency' (26. January 2012); Next to the formal procedures discussed above, a company in financial distress could take informal steps together with its creditors and shareholders. These would go beyond the scope of this research.

[797] Teresa Graham, 'Review into Pre-Pack Administration, Report to the Rt Hon Vince Cable MP' (June 2014) <https://www.gov.uk/government/publications/graham-review-into-pre-pack-administration> (last visited 19.09.2015).

[798] Ibid 10.

[799] See in analogy to Dawkins River out of Eden (n 147), footnote 156.

negative experiences, or less positive results than expected. The usage of administration, CVAs and SoAs in comparison to liquidation highlight that England does not have the "perfect" rescue regime yet and that there is still room for improvement. However, it appears that England applies the theory of natural selection quite well, and the country is seen having a 'favourable insolvency regime'. It seem that England adapted well to the changing economic, social and political environment in the continuing struggle for existence within the EU.

Part B

Changes to the Insolvency Act by the ESUG - Forum Shopping as a Driver of Insolvency Law Perfection

"Germany lacks an "insolvency culture"-"Es fehlt an einer "Insolvenzkultur" in Deutschland"

Minister of Justice Leutheusser-Schnarrenberger[800]

Introduction

After evaluating the "Darwinian approach" and giving the necessary background information with regard to the development of the rescue culture in Germany and England, Part B of the thesis looks at the changes introduced by ESUG asking the question whether these changes were driven by forum shopping activities and led to a more "perfect" insolvency regime, representing a turning point towards a new 'rescue culture' in Germany.

Germany's insolvency regime was seen as a "permanent building site"[801]. The existing laws created several barriers for companies in financial distress aiming for an early restructuring.[802] Forum shopping activities from Germany to England gave a thought provoking impulse to discuss "Germany as an "insolvency location" ("Insolvenzstandort Deutschland") and sharpened the view for the weaknesses of the German insolvency regime.[803] Based on the main points of critique of the German system the ESUG focusses on the following overarching aims: stabilisation of the creditors' position; strengthening of the concept of restructuring ("Sanierungsgedanke"), enhancement of transparency and inclusion of the members of the company.[804] The German regime was seen as non-transparent and without

[800] Leutheusser-Schnarrenberger, 7.Insolvenzrechtstag (n 6).
[801] Christian Fuhst 'Das neue Insolvenzrecht – Ein Ueberblick' (2012) DStR, 418,418.
[802] BT. Drs. 17/5712 (n 294) Introduction.
[803] Ibid
[804] Fuhst (n 801) 420

planning security ("Planungssicherheit").[805] The discussion about the "restructuring escape abroad" ("Sanierungsflucht ins Ausland") should be put to an end and Germany should be made competitive for the competition amongst the EU Member States.[806]

The German Federal Minister of Justice, Leutheusser-Schnarrenberger spoke about the necessity of a "rescue culture" in Germany.[807] To an English insolvency lawyer these two phrases sound very familiar. In England the "rescue culture" has been a term of art since the Cork Report and the phrase "second chance" can be found in the White Paper of the Insolvency Service[808] presented by the English Government in July 2001. In the US the phrase "rescue culture"/ "insolvency culture" is understood as the aspiration of all involved parties to maximise stakeholders' satisfaction. The reorganisation of the debtor could contribute to this aspiration. Preconditions for a successful restructuring are in particular professionalism of the involved parties and mutual faith. These qualities however have just started to develop over the last decades.[809] One feature of such a rescue culture is the improvement of the prospects of restructuring of a company.[810] "A modern law alone does not imply automatically that a "rescue culture" can be created in reality.[811]

Chapter four to eight critically examine whether Germany reached its aim to establish a culture of second chance in Germany by the changes of the InsO introduced by the ESUG. They compare and contrast the different identified key areas in Germany and England, looking at the situation in Germany before and after the introduction of the ESUG. The thesis examines whether the changes by the ESUG were driven by forum shopping activities and whether the changes led to a more "perfect"[812] insolvency regime, with the result of an enhanced insolvency culture in Germany.

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[805] BT. Drs. 17/5712 (n 294) Introduction.
[806] Ibid, see as well Gerrit Hoelzle, 'Die „erleichterte Sanierung von Unternehmen" in der Nomenklatur der InsO – ein hehres Regelungsziel des RefE-ESUG' (2011) NZI 124.
[807] Leutheusser-Schnarrenberger, 7.Deutscher Insolvenzrechtstag (n 6).
[808] DTI 2011 (n 583).
[809] Vallender, Insolvenzkultur (n 5) 838.
[810] Ibid
[811] Ibid
[812] See introduction 0.5.2.

The changes are categorised into the following areas: 1. Creditors' participation; 2. Debtor's influence; 3.The role of the insolvency practitioner; 4. the debt-to-equity swap and 5. Preparatory insolvency proceedings.

Within these areas the examination is to compare and contrast the situation in Germany pre and post ESUG to the situation in England. Even if the changes are not or not apparently driven by forum shopping activities it is still worthwhile to compare and contrast them; as argued in chapter one the result of comparing and contrasting to another jurisdiction might not just be the "copying", but learning from the weaknesses of the other system and avoiding these by leaving the status quo or changing it into a different direction. This reciprocal learning encourages eliminating improvable rules by adopting ideal ones.[813]

It would go beyond the scope of this research to compare and contrast every single aspect of restructuring in England and Germany, therefore this part of the thesis focusses on the changes introduced by the ESUG and certain connected topics where they are necessary to understand the context. It is not the author's intention to find out whether England or Germany has the best overall restructuring regime; in fact the aim is to take the changes to the InsO by the ESUG as an example that forum shopping activities can foster and drive insolvency law perfection.

[813] Armour (n 34) 3.

Chapter Four

Creditors' Participation and Obstruction Potential

"Creditors have better memories than debtors."
-Benjamin Franklin

'Obstruction potential is the insolvency plan's Achilles heel'
Schlegel

4.1. Introduction

This chapter aims to compare and contrast the influence of creditors and their obstruction potential in insolvency proceedings in Germany and England, looking at the situation in Germany before and after the introduction of the ESUG. It is shown that the changes through the ESUG were primarily driven by forum shopping activities and led to a more perfect insolvency regime.[814]

The examination in this chapter is restricted to the influence of creditors during an ongoing proceeding, especially their influence on the appointment of the IOH and their blocking potential during the proceedings, rather than an analysis of general creditor protection regulations.[815] The scope is limited to the changes through the ESUG.

"Credit is the lifeblood of the modern industrialised economy."[816] It is an axiom that creditors play an important role in insolvency proceedings as stakeholders of insolvent debtors. Creditors bear primarily the economic risk of failure of a restructuring. Therefore it is of importance to include creditors into the proceedings and make sure that their rights are protected. Creditors' interests are various and can be classified into a primary interest for maximal satisfaction of their claims and secondary interests which concern the

[814] See introduction 0.5.
[815] Felix Steffek, *Glaeubigerschutz in der Kapitalgesellschaft* (Mohr Siebeck Tuebingen 2011).
[816] Cork Report (n 57) 10.

realisation of the primary interest. Those secondary interests are matters of information and trust, control and co-determination, diversification, interest of private autonomous arrangement ("privatautonome Gestaltung") of the creditors' position and avoidance of transaction costs.[817]

Creditors in general could be defined as "all persons having pecuniary claims against the company notwithstanding that they are often difficult to quantify and irrespectively of whether such claims are actual, contingent, unliquidated, or prospective."[818] It is important to differentiate between various types of creditors. One criterion could be to distinguish between pre- and post-restructuring creditors and creditors with claims existing already at the beginning as well as those whose claims are established during the proceedings.[819] Another important matter from the insolvency perspective is to differentiate between unsecured, secured and preferential creditors. Secured creditors hold claims against the debtor which are backed by a form of security. Preferential creditors will have a favoured position by statute, whereas unsecured creditors are left without any form of security. Due to their ranking behind both secured and preferential creditors their claim is limited to any residual amount left out of the proceedings.

4.2. Germany pre ESUG

4.2.1. Different Forms of Creditors

Germany differentiates between creditors holding a right to separation ("Aussonderungsrecht");[820] creditors with a right to separate satisfaction ("Absonderungsrechten"),[821] undisputed preferential creditors ("Masseglaeubiger")[822] and insolvency creditors ("Insolvenzglaeubiger")[823].

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[817] Steffek (n 815).
[818] *Re T&N and others* (No.4) [2007] Bus LR 1411.
[819] Bork, *Rescuing Companies* (n 22) 30.
[820] Section 47 InsO.
[821] Section 49 to 51 InsO.
[822] Section 53 InsO.
[823] Section 38 InsO.

A creditor with a right to separation remains the owner of the assets over which he has rights and can therefore ask for his assets to be separated from the insolvent's estate. Claims of a creditor with the right to separate satisfaction are settled before all other creditors are considered. Undisputed preferential creditors are creditors, whose claims accrued only during an ongoing insolvency proceeding, to be treated with precedence.[824] Insolvency creditors in general are all those holding a justified claim against the debtor at the time of the opening of insolvency proceedings.[825] This differentiation is important in order to identify the ranking for the satisfaction of debts in insolvency proceedings. Although the principle of *par condicio creditorium* prevails, this applies only to creditors within the same group. First in line are the undisputed preferential creditors, then creditors holding the right to separation, then creditors with a right to separate satisfaction, followed by any remaining creditors.[826]

4.2.2. Principle of Creditors' Autonomy ("Glauebigerautonomie")

As noted above the main objective behind all insolvency proceedings in Germany is the common satisfaction of creditors, whereas company rescue is not an aim for its own sake.[827] The insolvency proceedings are governed by the principle of creditors' autonomy ("Glauebigerautonomie"). Courts only have a supervising and mediating role in making sure that processes run smoothly and to encourage the necessary understanding amongst the parties involved.[828] This principle should be understood in the sense that creditors are given the opportunity to participate in the proceedings, but not having the power to organise the procedure itself.[829] The significance behind the principle of creditor autonomy is clearly demonstrated by distinguishing it from individual enforcement proceedings. In the latter case, the aim is to satisfy one particular creditor, whereas the aim of insolvency proceedings is the collective

[824] Section 53 InsO, after satisfaction of separation rights and rights to separate satisfaction and set off claims
[825] Section 38 InsO.
[826] Distribution see sections 187 to 206 InsO.
[827] Beissenhirtz, *Creditors' rights* (n 106) 316; see detailed discussion chapter 2.1.1.
[828] Ibid
[829] Ulrich Ehrike, Muenchener Kommentar zur Insolvenzordnung (Vol 2, third edition Munich 2013) 74 Rn 2.

satisfaction of all creditors.[830] The following is to evaluate whether this principle does in fact dominate the German insolvency landscape.

4.2.3. Creditor Bodies

Elements of the creditors' autonomy are the representation of creditors by means of the creditors' meeting ("Glauebigerversammlung") and, where applicable, through a creditors' committee ("Glauebigerausschuss").

4.2.3.1. Creditors' meeting

The creditors' meeting is the basic organ of self- administration, the constituting body of all creditors.[831] The main aim of such a committee is to include creditors in the sense of using their expertise, sharing responsibility through integration into the process and the possibility of influencing the proceedings.[832] The reason for the establishment of a creditors' meeting is, in other words, to organise the possibility for creditors to safeguard their interests and rights.[833]

The debtor has a chance of restructuring only if he is able to convince the creditors' meeting accordingly.[834] The general function of such a meeting is to approve transactions of special importance ("besonders bedeutsame Rechtshandlungen") for the IOH[835] and to suggest a different IOH where appropriate.[836] This function is broadened in insolvency plan proceedings where the creditors' meeting has a say in the progress, i.e. whether the

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[830] Ibid 74, Rn.1, 3; the Bankruptcy Act 1877 ("Reichskonkursordnung") laid the foundation for creditors' autonomy; from the middle of the 19th century the idea of a self-responsible organisation of insolvency issues (to that time bankruptcy issues) became more prevalent. This was based on the idea that the execution was the right of creditors, therefore it should be the aim in bankruptcy to organise all creditors together to have the possibility to safeguard their interests. Furthermore it was seen as the realisation of principle of party disposition ("Dispositionsmaxime"). The participation of creditors was seen as an autonomy under state supervision and the office holder as a part of the self-administered organisation.

[831] Pape, Uhlenbruck, Voigt-Salus (n 302) 187; Ekkehard Hegmanns, *Der Glauebigerausschuss Eine Untersuchung zum Selbstverwaltungsrecht der Glaeubiger im Konkurs* (RWS Verlag Cologne 1986) 52; Beissenhirtz (n 98) 318.

[832] Ehrike, Mueko (n 829) para 74 Rn 4.

[833] Ibid

[834] Pape, Uhlenbruck, Voigt-Salus (n 302) 189.

[835] Section 160 InsO

[836] Section 57 InsO.

company should be shut down or temporarily continued and in the acceptance of such a plan.[837]

All insolvency creditors, the IOH, creditors with the right to separate satisfaction, members of the creditors' committee and the debtor himself are entitled to participate.[838] Creditors holding a right of separation and undisputed preferential creditors are not eligible as there is no need to include them because they are not satisfied out of the insolvent's estate.[839] A proposal is adopted if the sum of outstanding claims of consenting creditors amounts to more than half the sum of the outstanding claims of all voting creditors.[840] A quorum exists if at least one creditor with voting power is present.[841] There is no statutory minimum level. In the event that no creditor participates it falls to the IOH to take all necessary decisions as any action involving third parties will depend on his authority anyway.[842] The approval is simulated in case of particularly significant legal acts.[843]

It is unsatisfactory that a creditors' meeting is not in fact a group sharing common interests ("Interessengemeinschaft"), but much more a "forced pooling" ("Zwangszusammenschluss").[844] Secured as well as unsecured creditors pursue their own interests without regard for any collective spirit, in other words their aim is to minimise their own potential loss also at the expense of other creditors participating in the creditors' meeting.[845] A conflict of interest

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[837] See section 244ff. InsO, 157 InsO; s Beissenhirtz, Creditors' rights (n 106) 318; rights especially high due to property rights translate: Mueko: 74 recital 6: The creditors' meeting attains specific significance in the context of drawing- up and implementing the insolvency plan, due to the fact that this largely concerns the disposition of the creditors' property rights intended to lead to the debtor's restructuring by placing assets out of reach of public jurisdiction in an insolvency proceeding. The aim is to find private autonomous agreements to avoid the sovereign administration of the insolvent debtor. The process as such remains under sovereign administration, whereby the decision to really proceed is left more to the creditors than would be the case under official insolvency regulations. The creditor's meeting is taking on a key role also in DIP proceedings. ("Im Rahmen der Aufstellung und Durchführung des Insolvenzplans kommt der Gläubigerversammlung ebenfalls ein besonders erhöhter Einfluss zu. Das liegt darin begründet, dass es hier in besonderem Maße um die Disposition von Eigentumsrechten der Gläubiger geht, die zu einer Sanierung des Insolvenzschuldners führen soll, und deshalb der hoheitlichen Entscheidung in einem Insolvenzverfahren entzogen wird. Insoweit geht es um die Möglichkeit, auf privatautonomer Basis die hoheitliche Verwaltung des Konkurses zu vermeiden. Die Verwaltung bleibt demnach hoheitlich ausgestaltet, nur die Frage, ob es zu einer solchen kommt, wird weitergehender als in der Konkursordnung in die autonome Entscheidung der Gläubiger gelegt. Auch im Verfahren mit Eigenverwaltung kommt der Gläubigerversammlung eine überragende Rolle").
[838] section 74 Abs.1 S.2 InsO.
[839] Ehrike, Mueko (n 829) 74 Rn 30.
[840] Section 76 Abs.2 InsO.
[841] Pape, Uhlenbruck, Voigt-Salus (n 302) 195.
[842] Ibid 195,196.
[843] Defined in section 160 Abs.2 InsO.
[844] Ehrike, Mueko (n 829) 74 Rn 2.
[845] Ibid

exists not only between secured and unsecured creditors, but also between the different groups of unsecured creditors.[846] It is questionable whether the members have a duty of allegiance ("Treuepflicht") among themselves. This kind of duty would in general be based on facts of mutual interests, where individual members needed protection as they are depending upon each other.[847] The organisational structure of a creditors' meeting cannot be compared to a group sharing common interests, such as a GmbH[848], as the creditors' committee is not a voluntary association of various members, but a compulsory pooling, impossible to abandon without the foregoing of established claims.[849] In contrast to a GmbH, a creditors' meeting is an association for the representation of interests ("Verband zur Interessenvertretung"), not to be confused with the pursuance of interests ("Interessenverfolgung").[850] Hence, in a creditors' meeting the duties of allegiance have to be replaced by sovereign instruments of reconciliation of interests.[851]

In practice, these meetings often take place without any creditors present; Frind speaks of a "ghost meeting" ("Geisterversammlung"), with only the legal clerk, recording clerk and IOH present.[852] The idea of including creditors to potentially influence the proceedings is not much taken up in practice. It could be argued that the lack of attendance of creditors in creditors' meetings is another instance of disapproving the application of Darwin's theory as the policy aim, the inclusion of creditors into the process is not attained. It could be argued that these regulations need modifications. However, the lack of participation might be traced back to the apathy of the creditors and not due to the unmodified regulations. This at least reflects that creditors' participation is not exercised via the creditors' meeting, therefore other ways of creditors'

[846] Ehrike, Mueko (n 829) 74 Rn 2.
[847] Typical example, shareholders of a GmbH, Ehrike, Mueko (n 829) 74 Rn 9.
[848] Gesellschaft mit beschraenkter Haftung, German equivalent to a private limited company limited by shares
[849] Ehrike, Mueko (n 829) 74 Rn 9.
[850] Ehrike, Mueko (n 829) 74 Rn 9.
[851] ibid
[852] Frank Frind, 'Der Einfluss der Glaeubiger bei der Auswahl des und der Aufsicht ueber den Insolvenzverwalter' (2007) 648.

participation have to be offered to reach the aim of including the creditors into the process more effectively.[853]

4.2.3.2. Creditors' Committee

The creditors' committee is the central creditors' supervisory body, similar to the function of the supervisory board in a company.[854] Its main function and task is to supervise and support the IOH.[855] It has the legal duty to be neutral, with committee members not representing their own particular interests, but the interests of the creditors as a whole.[856] Like the creditors' meeting also the creditors' committee has a say in special important transactions[857] and they play a role in the establishment of an insolvency plan.[858] Moreover, the committee has a voice in the decision whether to close down the company[859] and for the subsequent distribution of the insolvency estate.[860]

All relevant creditor groups are represented in the creditors' committee which also includes a representative of the employees.[861] Non-creditors are also allowed to be members. In actual fact, unsecured creditors will rarely become members. In general, membership is made up of creditors with a right of separation, such as major banks, fiscal authorities, credit insurances and pension fund trusts.[862]

4.2.3.2.1. Establishment

In Germany, there are different ways and means to establish a creditors' committee.[863] Its establishment is decided on by the creditors' meeting.[864] In this context, however, a unique feature of the German insolvency procedure

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[853] The creditors' meeting is only one way of including the creditors into the proceeding; instead of changing the provisions with regard to creditors' meeting it might be more effective to find other ways of enhancing creditors' participation.
[854] Pape, Uhlenbruck, Voigt-Salus (n 302) 187.
[855] Ibid 208
[856] Ibid
[857] Section 160 InsO.
[858] Section 218 InsO.
[859] Section 158 InsO.
[860] Section 187 InsO.
[861] Section 67 subsection 2, Pape, Uhlenbruck, Voigt-Salus (n 302) 210.
[862] Ibid 186; Heike Luecke, 'Creditors' committees -- the Cinderella of English insolvency law?' (2013) 5 CRI 133.
[863] The general rules can be found in section 67 InsO and the following.
[864] Section 68 subsection 1.

comes into play. The court does not order the opening of proceedings straight away after the filing for insolvency, normally allowing for an interim period between filing and opening.[865] During this application phase, the so-called preliminary insolvency proceedings ("vorlaeufiges Insolvenzverfahren" or "Eroeffnungsverfahren"), the court will appoint a preliminary IOH holding limited powers.[866] Certain consequences derive also for the establishment of the creditors' committee, which can be set up by the court before the first creditors' meeting.[867] This method is of exceptional practical relevance as important decisions are often made at an early stage of the proceedings.[868] Such decision on the part of the court can be overruled by the creditors' meeting,[869] but this hardly ever happens in practice due to impending delays and extra cost.[870] The court uses the preliminary insolvency proceedings to decide whether to open proceedings or not. At this stage, numerous decisions are prepared with regard to the progress of restructuring, which emphasises the necessity of a preliminary creditors' committee.[871] Pre ESUG, there was no explicit provision to allow for such a committee, with the exception of cases involving large companies intending to continue trading.[872]

4.2.3.2.2. Inconsistent Outcome

The policy aim for the autonomy of creditors can be seen as inconsistent with the outcome. With major decisions to be taken in the preliminary phase, the

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[865] Schlegel Part 1 (n 358) 416, this interim period is driven by the "insolvency wages" ("Insolvenzgeld", a public funding of the wages, see section 165 Sozialgesetzbuch).
[866] See chapter 2.3.3.
[867] Section 67 InsO.
[868] Reinhard Bork, 'Creditors, Committees: an Anglo-German Comparative Study' (2012) Int. Insolv. Rev. 127, 130.
[869] Section 68 1 2 InsO.
[870] Stefan Sax, 'Consultation paper on German insolvency law reform -- the key points' (2010) 6 CRI 235, 237.
[871] Bork, *Creditors' Commitees* (n 868) 131.
[872] Ursula Schlegel, 'Law for further Facilitation of the Restructuring of Companies: A Turning Point in the History of the German Insolvency Regime? Part 2' (2012) 9 Int. C. R. Issue 1, 13, this was already point of discussion before the ESUG reform, see Frank Frind, 'Staerkung der Gläubigerrechte in der InsO - Bemerkungen zum Stand der Gesetzgebung' (2007) NZI 550, 556 (A creditors' committee does not have to be established in all proceedings and in practice, in only around 20 per cent of all opened proceedings a creditors' committee can be found; there is a concentration of creditors' committees in larger insolvencies. There was no mandatory creditors' committee pre ESUG. (Pape, Uhlenbruck, Voigt-Salus (n 302) 208); for a quorum, the majority of the members present is necessary, the outstanding amounts are not pivotal. In the case of equality of votes, the proposal is classified as rejected (see further Pape, Uhlenbruck, Voigt-Salus (n 302) 217). Members of a creditors committee are personal liable, see section 71 InsO. To substantiate liability, it has to be demonstrated that a member infringed an obligation (see further Nehrlich section 71 recital 6). Section 71 is used frequently in practice; especially in cases of breach of trust through the IOH, the committee is held liable for insufficient control alongside the officeholder (see further Bork *Creditors' Committees* (n 868).139). The potential liability does not prevent creditors from participating in a creditors' committee as in practice the liability is covered by a special liability insurance. In Germany, members of creditors' committees receive a remuneration, section 73 InsO, details are regulated in para 17 InsVV, which provides for a payment of between 35 and 95 Euro per hour, depending on time and scope of the relevant activities.

legislator should have known that neglecting to provide for a creditors' committee accordingly would necessitate further corrective action in the Darwinian sense. The regulations with regard to establishing creditors' committees were not well adapted to the desire of the Government to enhance creditors' participation in insolvency proceedings, as the policy aim was contradicted by the outcome. As it is discussed later, the legislator reacted and adapted the regulations to improve the position of creditors' committees in the preliminary proceedings.[873] The discrepancy between policy aim and legislative outcomes demonstrate the conservatism of German insolvency law. Although the aim was to foster creditors' influence, the reality proved that the majority of cases had no creditors participating in the form of a creditors' committee during the crucial phase of the proceeding.

4.2.4. Influence on IOH Appointment

The appointed IOH is one of the key figures in insolvency proceedings.[874] As already explained earlier, due to the interim period from up to three months between filing for insolvency and the opening of proceedings, one has to differentiate between the preliminary and the final IOH. Once the proceedings are opened, the provisional IOH continues as final IOH.[875]

Before the changes through the ESUG, creditors had practically no influence concerning the appointment of the IOH. Under the old regime,[876] the IOH and the preliminary IOH were appointed by the insolvency court.[877] The creditors were not given the right to be heard before the decision of the court. Following a filing, the court chose and appointed the IOH.[878] It was common practice that the court had so-called shortlists ("Vorauswahllisten")[879] as a judicial aid, from which the candidate for each individual case was chosen. The running of such

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[873] See chapter 4.3.2.2.
[874] More on the role of the IOH in the proceedings, see chapter 6.
[875] See chapter 2.3.3.
[876] Old is defined here as the situation before the changes through the ESUG
[877] Section 56 InsO.
[878] More details on the appointment of the IOH see chapter 4.
[879] See for example: Wilhelm Uhlenbruck, Rolf-Dieter Moenning, 'Listing, Delisting und Bestellung von Insolvenzverwaltern' ZIP 2008 157; Frank Frind, Andreas Schmidt, 'Auswahlkriterien und Grenzen der Justiziabilitaet der Verwalterbestellung' (2004) NZI, 33; Florian Stappner, 'Neue Anforderungen an den Insolvenzverwalter' (1999) NJW, 3441.

shortlists was examined under the overall control of Germany's Federal Constitutional Court, which declared them constitutional.[880]

The creditors' influence on the appointment of an IOH pre ESUG was limited to the right of replacing the IOH and appointing somebody of their own choice, even without being obliged to provide any explanation for this.[881] One could argue that the final decision about the appointment was left with the creditors' committee; it needs to be said, however, that this was generally avoided as a replacement of the IOH came along with delays in the process and extra costs.[882] In actual practice, the influence of creditors was still only marginal and in most of the cases the preliminary IOH, once appointed, would just continue. It could be argued, that this concept laid down in sections 56, 57 InsO would practically result in making a mockery of the principle of creditors' autonomy.[883] Although creditors had in fact no influence on the appointment of the IOH *de lege lata,* it was argued that creditors could prejudice the shortlists by providing the court with experience reports of certain IOH's or by taking part in "informal round tables", specifically organised in order to discuss experiences gathered and share them with insolvency judges.[884] In practice, however, this was not used very often.

In favour of the German practice it was argued that it would be challenging under the time constraint the court is facing, to hear all "relevant creditors", which would be necessary to allow a transparent and fair procedure; the application of the so called "Detmolder Modell"[885] remained a rare "stroke of luck".[886] This model is based on the condition that the main creditors had

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[880] BVerfG vom 03.08.2004; The InsO 1999 wording allowed so-called closed lists ("geschlossene Listen"), permitting new applicants to the list only upon the withdrawal of a previously approved candidate (This method was seen as incompatible with the principle of creditors' autonomy as it did not guarantee the individual suitability. In consequence, the "Law for the Facilitating of the Insolvency Procedure (2007) implemented that the IOH had to be chosen from among all candidates capable to accept an according appointment. This amendment was to bring about the equality of chances with regard to the choice of the IOH. (Gesetzesentwurf BT Drs.16/3227 Entwurf eines Gesetzes zur Vereinfachung des Insolvenzverfahrens, 9, 10.)

[881] See section 57 InsO, more see Frind Der Einfluss der Glaeubiger bei der Auswahl des und der Aufsicht über den Insolvenzverwalter (n 852) 646.

[882] Sax (n 870) 237.

[883] Christian Seide, Christine Brosa, 'Das Auswahlverfahren fuer Insolvenzverwalter im Lichte der Glaeubigerautonomie' (2008) ZInsO, 769, 769.

[884] Frind, Der Einfluss der Glaeubiger bei der Auswahl des und der Aufsicht über den Insolvenzverwalter (n 852) 644.

[885] Ibid, 645

[886] Ibid, 645

already been identified ahead of a filing, having negotiated a joint approach to the insolvency judge with the purpose of discussing the choice of the IOH. This, however, remains an untypical example how things work in practice.[887]

The lack of influence of creditors on the IOH appointment is another example of fettered Darwinism. Comparable to the points made about the preliminary creditors' committee, the policy aim proved futile as it is the court and not the creditors who determine the appointment of the key figure in insolvency proceedings.[888] This may serve as just another example for Germany's conservative approach to insolvency, which ended up in a desultory consequence of the flawed integration of creditors into the decision-making process. A more satisfactory result would have been reached by applying the so-called "Detmolder Modell" which, however, is still not common practice. With increasing demands for the involvement of creditors in the appointment process of the IOH, the procedure will need adjustments in order to attain a more perfect insolvency regime.

4.2.5. Blocking Potential

Besides the participation rights via creditors' meeting and creditors' committee, German law attaches importance to minority protection in the proceedings. The InsO therefore contains appropriate regulations in the insolvency plan procedure. It is argued that due to the urgent nature of the proceeding, a balance has to be found between minority protection and the possibility of confirming a plan without undue delay. Whether minority protection is imperative in insolvency proceedings will be discussed later on.[889]

4.2.5.1. Section 251 InsO - Protection of Minorities ("Minderheitenschutz")

In Germany, a majority vote for an insolvency plan is not yet sufficient legitimation to deprive an individual creditor of his assets. The level of

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[887] Frind, Der Einfluss der Glaeubiger bei der Auswahl des und der Aufsicht über den Insolvenzverwalter (n 852) 644.
[888] More on whether it should be the courts or the creditors deciding about the person of the IOH, see chapter 6
[889] See chapter 4.5.3.

protection, however, is not as far-reaching as for the majority of any given group. It is sufficient that the party involved is not placed in a less favourable position than would be the case without the plan.[890] Under the old section 251 InsO, a creditor could block the confirmation of the plan by arguing that his position would be worsened,[891] substantiating this together with his application.[892] The protection of minorities was to guarantee that a minority creditor would find himself confronted with the same situation, be it without the plan or with the plan, in spite of it having been accepted by the majority of creditors.[893] Although it needed substantiation, there was the chance that an individual creditor only sought for nuisance value, and could jeopardise the adoption of an otherwise most sensible plan with his objection under section 251 I InsO.[894] On introducing the regulation, the legislator was aware of the potential risk that a plan, with majority consent and after long negotiations might still not be confirmed due to the obstruction of a minority creditor.[895] The suggestion was that a clause should be inserted in the plan to compensate an individual creditor in such a case to avoid a worsening of his economic situation.[896]

The Federal Council ("Bundesrat") demanded an amendment with regard to the severity of the worsening of the economic position in asking for a considerable degradation ("nicht unerhebliche Schlechterstellung") to avoid obstruction from "trouble making" creditors.[897] The Government, however, did not adopt this recommendation arguing that the insolvency plan procedure did not encourage the withdrawal of assets held by an individual partner, and bearing in mind the constitutional obligation to protect the property.[898]

This regulation is another example of Germany's conservatism in insolvency law-making. Although the policy aim of the 1999 reforms had already turned its focus on fostering rescue, a loophole in the law still made it possible for

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[890] Bt-Drs. 12/2443 (n 304) 211.
[891] Old section 251 I 2 InsO.
[892] Old section 251 II InsO.
[893] Michael Merten, Die neue Insolvenzrechtsreform 2012 (ESUG) (HDS-Verlag Weil im Schoenbuch 2012)108.
[894] Schlegel Part 2 (n 872) 13.
[895] Bt-Drs. 12/2443 (n 304). 212.
[896] Ibid
[897] Ibid, p. 259
[898] Ibid, 268

antagonistic creditors to exercise their blocking potential, thereby revealing an unsound balance between the effectiveness of the insolvency plan proceeding and minority protection in favour of the latter. The insolvency plan procedure had another element of uncertainty which was not in line with the aim of an efficient restructuring process. The discrepancy between the overriding policy aim of creating an efficient and modern insolvency law and the outcome of highly risky obstruction in the proceedings by minority, troublesome creditors can be described as a further illustration of a restrained approach; regarding the idea of Darwinism, the regulations on minority protection were not adapted to the demands of a modern insolvency law.

The question could be asked in this context whether minority protection should indeed be paramount in a restructuring procedure. The scope of influence creditors have during the proceedings could be seen as satisfactory enough without the need of further protection once the plan is confirmed. All creditors are assured the right to involve themselves in the insolvency proceedings, all this raises the question why a majority decision can still be overruled even by a single dissenting voice. Is it not legitimate to expect from a minority to finally accept the majority vote? Bearing in mind the special situation surrounding an insolvency, it could be justifiable to develop a sense of duty to approve to a sustainable restructuring agreement.[899] Eidenmueller developed a concept of co-operation duties of creditors as he argues correctly that the pursuit of individual interests of the creditors would often result in a suboptimal state, namely the failure of the restructuring attempts, and their duties would include the approval of a sustainable restructuring agreement.[900] The idea behind this concept is that an individual creditor, especially a "hold-out creditor" should not be able to block a restructuring to pursue an individual interest as the blockage would affect the assets of the other involved parties as well.[901] This idea of "sacrifice" could be applied to the minority protection in general. It should be legitimate to include a "cram-down" like nature into the insolvency plan

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[899] Georg Bitter, 'Sanierung in der Insolvenz- Der Beitrag von Treue- und Aufopferungspflichten zum Sanierungserfolg' (2010) ZGR, 147,178.
[900] Horst Eidenmueller, *Unternehmenssanierung zwischen Markt und Gesetz: Mechanismen der Unternehmensreorganisation und Kooperationspflichten im Reorganisationsrecht* (Cologne Otto Schmidt 1999), 555.
[901] Bitter (n 899) 178.

proceedings, allowing the decision of the majority of the creditors and shareholders who voted for the insolvency plan to be binding for all creditors.

4.2.5.2. Section 253 InsO - Remedies ("Rechtsmittel")

Besides the minority protection, an individual creditor had the right to appeal against the court's order confirming the plan.[902] This possibility of an "immediate appeal" ("sofortige Beschwerde") implied as well the risk of an individual creditor blocking the whole plan, even if his appeal was only based on seeking nuisance value.[903] The appeal lodged by an individual creditor delayed the confirmation of the plan, at times even over a period of several months, reducing the opportunity to successfully restructure the company under an insolvency plan.[904] The German Notary Association ("Deutscher Notarverein", DN) drew wide attention to a newly established group of so-called "professional creditors" ("Berufsglaeubiger").[905] This was referring to creditors who made it a business take over claims from small creditors concurrently with assignment of insolvency debts in order to gain access to the creditors' committee enabling them to exploit the "nuisance value" ("Laestigkeitswert").[906]

Like section 251, 253 InsO also led to delays in the implementation or even to the failure of the plan. The above remarks made for section 251 InsO can be applied here as well.[907] The existence of a remedy, allowing an obstructive minority creditor to delay or even obstruct the whole restructuring does not match the overriding policy objectives and it had become clear already at this stage that a corrective would be inevitable.[908]

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[902] Old section 253 InsO.
[903] Schlegel Part 2 (n 872) 13.
[904] Bt. Drs. 17/5712 (n 294) 35.
[905] Deutscher Notarverein (DNV) 'Stellungnahme zum Gesetz zur weiteren Erleichterung der Sanierung von Unternehmen' (Berlin October 2010), 4 <http://rsw.beck.de/aktuell/gesetzgebung/gesetzgebungsvorhaben-zusaetzliche-materialien/erleichterung-der-unternehmenssanierung-(esug)>
[906] Ibid
[907] See chapter 4.2.5.1.
[908] Sax (n 870) 236: Satisfaction of undisputed claims The IP had pre-ESUG the obligation to satisfy all undisputed preferential claims ("Masseansprueche"), due or not due, even before the implementation of the insolvency plan. This satisfaction of the creditors had the disadvantaged that it tied up a lot of liquidity and often led to the failure of the plan.

4.3. Germany post ESUG

4.3.1. Introduction

One of the main aims of the ESUG was to strengthen the role of the creditors in the proceedings.[909] The primary objective of German insolvency law, i.e. the best possible settlement for creditors with outstanding claims as opposed to the preservation of an independent entity, remains the same.[910] It is argued that the preservation of an insolvent company cannot be an end in itself in a market economy system ("marktwirtschaftliche Ordnung").[911] The preservation of the entity would only be worthwhile, if the going concern value ("Fortfuehrungswert") exceeded the liquidation value ("Zerschlagungswert").[912]

The ESUG introduced the following changes with regard to creditors' participation: the consolidation of a preliminary creditors' committee, the introduction of certain thresholds for a compulsory creditors' committee, the possibility to influence the IOH's appointment by the creditors' committee and the change in definition with regard to the independence of the IOH. On the other hand, the ESUG contains certain changes to reduce the blocking potential of creditors to facilitate restructurings.[913]

The ESUG did not change the general approach by which creditors should have the possibility of protecting their interests. Competences could be used earlier and more intensively, but they were not extended.[914] The policy aim of strengthening the role of creditors without extending their rights could be seen as contradictory, or at least as only a desultory change, once more moulded by the nature of German law, its conservatism and "Darwinian fettered" approach.

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[909] See BT Drs. 17/5712 (n 294) A. Problem und Ziel ("Problem and Aim").
[910] BT Drs. 17/5712 (n 294) Explanation, general part, II. Aenderung der Insolvenzordnung, 17.
[911] Ibid
[912] Ibid
[913] Section 251 and 253 InsO.
[914] Ehrike Mueko (n 829) 74 1 b aa.

The following pages show in how far policy aims of enhancing creditors' involvement have been achieved.

4.3.2. Creditor Bodies

The ESUG did not introduce any changes with regard to the functioning of the creditors' meeting or the creditors' committee. The aim of enhancing creditors' influence was implemented by consolidating the appointment of a preliminary creditors' committee for the period between filing and opening of the proceedings, strictly speaking the "pre"-preliminary creditors' committee (Vor-vorlaeufiger Glaubigerausschuss),[915] not to be confused with the preliminary creditors' committee in an opened proceeding.[916]

4.3.2.1. Creditors' Committee

Whereas the preliminary committee allows non-creditors to sit on the committee, the pre-preliminary committee does not, unless they become creditors after all.[917] This was especially introduced with the purpose of avoiding the risk of hedge funds "buying" a creditor-position just before insolvency to be able to influence the proceedings, which was seen as potentially threatening the aspiration for restructuring.[918] There have to be at least four members in such a committee, whereas for a preliminary committee two are sufficient.[919]

4.3.2.2. Preliminary Creditors' Committee before the Opening of the Proceeding

The following exposition examines the preliminary creditors' committee before the opening of the proceeding.

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[915] Section 21 subs. 2 s. 1 no. 1a InsO.
[916] Section 67 subs. 1 InsO.
[917] Section 21 subs.2 S.1 No. 1a InsO.
[918] BT Drs. 17/7512 (n 294) ,6.
[919] BGH 11.11.1993, IX ZR 35/93.

4.3.2.2.1. Establishment

The InsO provides now that a preliminary creditors' committee could be appointed.[920] The possibility already existed under the old law, but had always been controversial; the new provision should institutionally anchor the earlier involvement of the creditors.[921] This more timely involvement should give the creditors' committee the possibility to exercise an influence on the IOH's appointment, which is dealt with in more detail below, as well as on the appointment of the trustee ("Sachwalter") in self-administration.[922]

The reason for this earlier possibility to establish a creditors' committee is the fact that the preliminary proceedings are crucial, as major decisions have to be taken during this interim phase; the first weeks are often decisive to prepare the grounds for a successful restructuring.[923] For a company to be restructured it is highly useful to have the creditors involved right from the beginning, as a restructuring without them is not possible anyway.[924]

Everyone involved in the legislative process supported the provision for the appointment of a pre-preliminary creditors' committee in general.[925] The BAK and the DRB[926] voiced their criticism that a determination of functions and competencies ("Funktions- und Kompetenzbestimmung") was missing. The aim of the new regulation was to foster creditors' participation, but the legislator failed to incorporate genuine participation rights ("echte Mitbestimmungsrechte"),[927] with the consequence that the preliminary IOH would operate in a legal vacuum as the law did not provide for clarification concerning the necessary consent from the creditors' committee in regard to

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[920] Section 21 sub section 2 No 1a InsO.
[921] BT Drs. 17/7512 (n 294) 34.
[922] See chapter 4.4.3 and 4.5.2.
[923] BT Drs. 17/7512 (n 294) (para 21 2 Nummer 1a).
[924] Ibid; see further chapter 3.3.4.
[925] Some involved parties criticised the position of the regulation. The regulation was imbedded under the security measures, although the pre-preliminary creditors' committee does not present such a security measure. Therefore it should have been regulated in section 67 InsO. (see BAK (n 504) 11,12; Deutscher Richterbund, 'Stellungnahme zum Gesetzesentwurf fuer ein Gesetz zur weiteren Erleichterung der Sanierung von Unternehmen' (Berlin March 2011), 6 <http://rsw.beck.de/aktuell/gesetzgebung/gesetzgebungsvorhaben-zusaetzliche-materialien/erleichterung-der-unternehmenssanierung-(esug)> (last visited 17.09.2015).Instead the legislator changed the heading of section 21 InsO from "security measures" to "interim measures" and left the codification of the pre preliminary creditors' committee in this section.
[926] German Judges Association ("Deutscher Richterbund").
[927] BAK (n 504) 12.

legal actions of the IOH.[928] This was another instance of a fettered Darwinian approach as the legislator had the chance with this comprehensive reforms to look at introducing genuine participation rights to achieve the policy objective of enhanced creditors' participation.

4.3.2.2.2. Thresholds

A controversial point was the thresholds for a compulsory preliminary creditors' committee and a preliminary committee on application.[929] Outside these thresholds it remains at the court's discretion to appoint such a committee. The Government Draft suggested the following thresholds, at least two of which had to be fulfilled:[930]

Figure five: Suggested Thresholds for a Compulsory Preliminary Creditors' Committee in Germany

Minimum of 2,000,000 million Euros balance sheet total
Minimum of 2,000,000 million Euros revenues during the last 12 months prior to the accounting date
Minimum of 10 employees on average during one year

These thresholds were modelled on the recommendation of the Commission of the EU "concerning the definition of micro, small and medium-sized enterprises."[931] They should serve to guarantee that creditors' participation became effective in companies with significant economic influence as also in the case of small and medium sized companies.[932] The Federal Council proposed in their comment to raise those values significantly.[933] They argued that setting up a committee carried the danger of unjustifiable procedural

[928] BAK (n 504) 12.
[929] Section 22a subsection 2 InsO.
[930] Section 22 a subsection 1 InsO.
[931] Commission Recommendation 2003/361/EC of 6 May 2003 concerning the definition of micro, small and medium-sized enterprises [Official Journal L 124 of 20.05.2003].
[932] BT-Drs. 17/5712 (n 294), 25; It is not seen as appropriate to appoint a preliminary creditors' committee if effort and time would be disproportionate to the low residual assets of the debtor, if the time involvement to appoint such a committee would result in the reduction of the debtors' assets or if the business is already discontinued, see section 22a subsection 3
[933] BT. Drs. 17/5712 (n 294) Annex 3, p. 51; BR Drs. 127/1 (n 507).

delays, being detrimental to the aim of the Draft. The time needed to hear the committee would run contrary to the necessity of short-term efforts during the ongoing business.[934] The installation of such a committee should therefore be reduced to major cases only. It was furthermore suggested that reference should be made to the thresholds for small companies limited by shares ("Kleine Kaptialgesellschaften").[935] For all other cases the appointment should be kept flexible and left up to the court's discretion.[936] In their counter-opinion the Government stated that the lower thresholds were justified as the urgency of the preliminary proceeding was reflected in the fact that the court would not have to appoint such a committee for cases of threatened adverse changes in the financial circumstances of the debtor.[937] They further argued that the court would additionally be able to direct other preliminary security measures. The Government emphasised that the strengthening of creditors' rights was of utmost importance and the chosen thresholds should guarantee an effective participation of creditors not only in major cases but in small and medium sized businesses as well.[938] A higher threshold is also not necessary if there is a threat of procedural delays as an appointment of a creditors' committee is not necessary if detrimental changes were to be expected.[939] The Federal Council interpreted the new regulation as a conceptual special feature in the proceedings regarding insolvencies of large businesses, with the Government gravitating more towards seeing the preliminary creditors' committee as the normal statutory case.[940] In consequence, the ESUG finally introduced the following thresholds:[941]

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[934] BT. Drs. 17/5712 (n 294) Annex 3, p. 51; BR Drs. 127/1 (n 507).

[935] Section 267 InsO: Umschreibung der Größenklassen: (1) Kleine Kapitalgesellschaften sind solche, die mindestens zwei der drei nachstehenden Merkmale nicht überschreiten: 4 840 000 Euro Bilanzsumme nach Abzug auf der Aktivseite ausgewiesenen Fehlbetrags (section 268 subsection 3 HGB); 9 680 000 Umsatzerloese in den zwoelf Monaten vor dem Abschlussstichtag; im Jahresdurchschnitt fuenfig Mitarbeiter. (Definition of size categories: (1) small capital companies are not to exceed at least two of the following characteristics: a) balance sheet total: 4 840 000 Euros after deducting losses on the asset side (section 268 subsection 3 HGB) b) sales revenues: 9 680 000 Euros for the twelve months prior to the balance sheet date c) annual average number of employees: 50).

[936] BT. Drs. 17/5712 (n 294).

[937] Section 22 a subsection 3 (first draft subsection 2), statement of the Bundesregierung BT Drs. 17/5712 (n 294) Annex 4, 67

[938] Ibid

[939] Heribert Hirte, 'Stellungnahme zum Regierungsentwurf eines Gesetzes zur Erweiterung der Sanierung von Unternehmen' (2011) 5; Section 22a subsection 2 alternative 3 InsO-E.

[940] Henning Bunte, Olaf von Kaufmann, 'Gesetz zur weiteren Erleichterung von Unternehmen (ESUG) Kontraere Positionen im Gesetzgebungsverfahren' (2011) DZWiR 359, 360.

[941] Critique: first draft "a majority of claims" was criticised as too lender friendly see Schlegel Part 1 (n 358) 417.

Figure six: Introduced Thresholds for a Compulsory Preliminary Creditors' Committee in Germany

Minimum of 4,840,000 million Euros balance sheet total
Minimum of 9,680,000 million Euros revenues during the last 12 months prior the accounting date
Minimum of 50 employees on average during one year

The first question now is whether the introduction of a threshold for the implementation of a preliminary creditors' committee represents another example of a fettered approach and secondly, whether the introduction of higher thresholds is a step in the right direction or whether this could be considered an additional illustration of Germany's conservative reform approach philosophy.

The general introduction of a threshold could be regarded as a restricted attempt to enhance creditor participation, as the creditors' committee is not compulsory for the majority of cases, leaving the decision about the appointment of an IOH still in the hands of the courts. However looking at it from a cost-benefit perspective[942], it makes sense to have a general threshold, as installing a creditors' committee is cost intensive and not appropriate in all insolvencies, especially bearing in mind that the costs are paid out of the insolvent's estate.

Basically accepting the necessity of thresholds opens up the second question as to whether the introduction of higher thresholds was a step in the right direction. Following the discussion above, it could be argued that lower thresholds would cause procedural delays. The amendment with increased thresholds, on the other hand, could bring about a two-tier society amongst creditors.[943] Creditors in insolvencies of certain business sizes are given an influence on the appointment of the IOH, whereas those of a business below

[942] More see Luecke Creditors' Committees (n 862).
[943] Bunte, Kaufmann (n 940) 361.

these figures are denied the same right.[944] Taking the factor of risk considerations, this kind of different legal treatment could additionally influence creditors to concentrate their activities even more on businesses exceeding the given thresholds at the expense of smaller companies.[945] Making a distinction here on the criterion of size might also restrict the IOH in his options for appropriate action, which should in any case depend on individual circumstances and not cut short by the simple question of size. The implementation of thresholds could therefore be seen as a regulation ignoring the actual needs of the parties involved,[946] setting another example of inconsistency when comparing the aim with the outcome and once again confirming Germany's conservative approach to insolvency laws.
Another outcome of the introduction of the higher threshold is the reduced influence of the creditors on the IOH's appointment. The instalment of the preliminary creditors' committee is linked to the influence on the IOH's appointment. In other words only if such a committee is installed, will the creditors have an influence, which is discussed in more depth below.[947]

4.3.2.2.3. Creditor List

If the debtor himself files for insolvency he has to submit a list of all creditors together with their claims.[948] Based on this list the court should be able to determine whether the establishment of a creditors' committee is compulsory or simply optional with regard to the thresholds discussed above. After much criticism, the original version calling for a "list of main creditors" was changed on finding it legally vague [949] and giving cause for discussion on which creditors to include or not.[950] In spite of the revised wording there was still the argument that the necessity of handing in such a list would cause delays in the procedure. Besides the already existant practice of attaching a debtor- and creditor - list together with the latest financial statements concerning the

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[944] Bunte, Kaufmann (n 940) 361.
[945] Ibid
[946] Ibid
[947] See chapter 4.4.3.
[948] Section 13 InsO.
[949] Original wording Discussion Draft (n 502) 13 ("Verzeichnis der wesentlichen Glauebiger und deren Forderungen" (list of main creditors and their claims").
[950] BAK (n 504) 7.

insolvency filing, the law demanded now the identification of special categories of creditors including the extent of their claim.[951] It is not self-evident that the insolvent debtor always has such a list at his disposal, the preparation of which could be time-consuming and therefore contradictory to the aim for an efficient and swift proceeding.

With the reforms, the legislator had a good opportunity to correct imperfect regulations and adapt to changes in the insolvency environment which had taken place over recent years. Instead of using this possibility courageously, the introduction of requirements laid down in section 13 InsO represented an illustration of a contradicted Darwinian approach when comparing the intended policy aim to the actual outcome. Instead of starting afresh, the legislator has introduced even more burdensome regulations. The underlying aim to improve the economic framework for an early restructuring of companies in distress,[952] is fettered with this new regulation as the requirement for such a list could potentially delay the proceedings, which is a proven reason for the failure of restructuring attempts.[953] Even the change from a "should" to a "may" regulation does not really alter the restriction of this approach as there is still the uncertainty about the court finally accepting the provided list.

4.3.3. Influence on IOH Appointment

The major change with regard to enhancing creditors' participation is the new possibility for the preliminary creditors' committee to participate in appointing the IOH[954] and also to reject an unwanted appointment.[955] The same rule applies concerning the appointment of the trustee ("Sachwalter").[956]

As analysed earlier on, creditors had a say in selecting the IOH only in rejecting the court's appointment and replace him with somebody of their own choice voted on in their first meeting, normally too late for avoiding an unwanted delay

[951] More details see section 13 subsection 1 InsO.
[952] Bt. Drs.17/7512 (n 294).
[953] See chapter 4.3.2.2.3.
[954] Section 56a InsO.
[955] Section 56a subs. 3 InsO.
[956] Section 276a InsO.

in the further proceedings.[957] The ESUG changed this by giving the preliminary creditors' committee the right to participate in the choice of the IOH.[958] The committee would be heard before his actual appointment with the court only making sure that the nominee fulfilled all legal requirements and had been voted for by the majority of the creditors.[959] The court could bypass this decision only if the nominee proved to be unsuitable for the position. Any alternative appointment must be based on the profile formulated by the creditors' committee.[960] The question of whether the decision is better placed in the hands of the creditors or left to the courts is discussed in more detail below.[961] The lively argument on this subject can ultimately be reduced to the fact that insolvency judges stand to lose a significant part of their power with this change.[962]

4.3.3.1. Section 56 a InsO

The regulation concerning creditors' participation in the IOH's appointment[963] was still slightly amended during the legislative process. A few changes were made with regard to the proposal of the creditors. The "general proposal"[964] laid down in the discussion draft was changed to a "unanimous proposal".[965] The requirement for a majority of total claims ("Summenmehrheit")[966], was criticised as this could have the potential to undermine the independence of the IOH. The demand for only a simple majority of claims had brought about negative experiences in the past, which then led to extending this rule to the majority of individual creditors ("Kopfmehrheit") as far back as 2001.[967] This solution turned out to be unsatisfactory as well; even though the weight of the main creditors had been neutralised, there was an increased risk that other creditors necessary for a successful restructuring would refuse to give their

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[957] See chapter 4.2.4.
[958] Section 56 a InsO (originally in the Discussion Draft (n 502) section 56 subsection b), the content was taken on into another section in the interest of clarity on the basis of the decision-recommendation of the Law Commission.
[959] Sax (n 870) 237.
[960] Schlegel Part 1 (n 358) 417.
[961] See chapter 4.5.2.1., 4.5.2.2.
[962] Hirte, Stellungnahme (n 939).
[963] Section 56 a InsO.
[964] See section 56 b InsO; Discussion Draft (n 502) 2.
[965] Ibid ; Bt. Drs. 12/5712 (n 294) 8.
[966] Section 56 b InsO; Discussion Draft (n 502) 27.
[967] DAV (n 503) 3.

agreement.[968] It was finally suggested that an arrangement between the groups of creditors beforehand should be required.[969]

The legal committee of the Federal Council demanded the cancellation of section 56 subsection 3[970] of the Discussion Draft considering that the obligation for the court to appoint the IOH suggested by the creditors could be incompatible with the principle of judicial independence ("Grundsatz der richterlichen Unabhaengigkeit"), with particular emphasis on the neutral supervisory function of the insolvency court.[971] It was argued that the courts should not be restricted in their freedom of decision as the situation pre ESUG had proven to be sufficient,[972] especially in major cases with courts necessarily respecting and taking proposals of creditors into account. Insolvency judges would gladly consider any useful information to appoint the "right" IOH, but interests of creditors could be contradictory, thus leaving a neutral court in a better position to judge the performance and suitability of the IOH, especially bearing in mind that creditors will pursue their individual interest in the proceedings.[973]

The Gravenbrucher Kreis suggested requiring the court to appoint the candidate decided on unanimously or, alternatively, decide in favour of one out of maximum of three potential candidates proposed by the creditors' committee, following a vote by a simple majority.[974] The Discussion Draft,[975]

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[968] DAV (n 503) 3.
[969] Ibid, 3.Critical see BAK (n 504) 25, 26; Frank Frind., 'Die Glauebigermitbestimmung bei der Verwalterauswahl und das "Zeitkorridor-Problem"' (2011) ZInsO 757,761.
[970] Section 56 a subsection 2 InsO.
[971] BR-Drs. 127/1 (n 507) 1,9.; this suggestion was brought into the Bundesrat by Bundesland Bayern, which was a favoured option as well of Verband Insolvenzverwalter Deutschland (VID) *Stellungnahme zum Entwurf eines Gesetzes zur weiteren Erleichterung der Sanierung von Unternehmen (ESUG)* (2010); http://rsw.beck.de/aktuell/gesetzgebung/gesetzgebungsvorhaben-zusaetzliche-materialien/erleichterung-der-unternehmenssanierung-(esug) (last visited 17.09.2015); INDat-Report 9/2010,7; see as well Erif Eralp 'email response of 'Die Linke' party on request of the author (07.April 2014).
[972] BAK, (n 504) 16.
[973] Ibid, 17
[974] Gravenbrucher Kreis, 'Ergaenzenden Stellungnahme zum Entwurf eines Gesetzes zur weiteren Erleichterung der Sanierung von Unternehmen' (ESUG) (2010); http://rsw.beck.de/aktuell/gesetzgebung/gesetzgebungsvorhaben-zusaetzliche-materialien/erleichterung-der-unternehmenssanierung-(esug) (last visited 17.09.2015); see further on this point: Elisabeth Winckelmeier-Becker, 'letter to the Parliamentary Secretary of State ("Parlamentarischer Staatssekretaer") Max Stadler Vorbereitung des koaltionsinternen Berichterstattungsgespraechs zum ESUG (Berlin, 02. August 2011, unpublished policy material provided via email from the CDU on request of the author) 7; Max Stadler, 'response to the letter from Winckelmeier-Becker (02. August 2011) Stellungnahme des Bundesministeriums der Justiz zu den Fragen von MdB Winkelmeier-Becker zum Regierungsentwurf ESUG (BT-Drs. 17/5712) (01.September 2011, unpublished policy material provided via email from the CDU on request of the author) 11.
[975] See section 56 b InsO-E, Discussion Draft (n 502) 38.

however, amended this even more drastically in demanding an unanimous proposal, which was adopted in the end. It was argued that a deletion of this section would completely prevent the participation of creditors.[976]

The Discussion Draft had suggested that the preliminary creditors' committee or the main creditors recommend the IOH. Interestingly, there were no further discussions after the changes made in the Discussion Draft, allowing only the preliminary creditors' committee to suggest the IOH and not the main creditors, meaning that creditors' participation would take place only where a preliminary creditors' committee is appointed, generally limited to large insolvency cases. The overall idea of extended creditors' participation in the preliminary proceeding was changed drastically with this minor alteration. An exertion of influence on the selection of the IOH is, of course, limited by the thresholds set, so that the court will continue to decide on the appointment of the IOH for the majority of cases.

With this change, the legislator obviously gave with one hand and took away with the other. There is indeed an improvement of creditors' participation in comparison to the situation pre ESUG. Nevertheless, instead of deciding on a resolute approach, the legislator settled once again for a lightweight solution. The policy aim for more creditor participation is not reflected in the outcome resulting from this change, as in the majority of cases creditors will not take an active part in choosing the IOH.

4.3.3.2. Time-Consuming Set-Up

The main issue discussed in this context concerned the timely set-up of a preliminary creditors' committee to be able to suggest the potential IOH before his actual appointment was announced. An experienced judge estimated that it would take at least one week for the preliminary creditors' committee to be established and to select and decide on their candidate as preliminary IOH.[977] The legislator argued that no general delays were to be expected since the

[976] Frind, Die Glauebigermitbestimmung (n 969) 771.
[977] Frind Zeitkorridor (n 969) 757.

court would have sufficient information about the circle of creditors.[978] However, looking at a practical scenario in an emergency situation relevant to the continuation of a business, there is only the preliminary IOH to take necessary security measures or initiate meetings to inform the employees about the situation.[979] The obligatory hearing of creditors by the court before appointing the IOH can only be foregone if there is an apparent deterioration of the financial situation ("offensichtliche Verschlechterung der Vermoegenslage"), and not in all cases where the business is continued, as the existing regulation would otherwise be altogether obsolete.[980] In consequence, a narrow interpretation is necessary and the court would demand specific facts before deciding to appoint the preliminary IOH without hearing the creditors first, which is not normally the case at the beginning of the proceedings.[981] The arguments of the legislator would prove futile and the courts would need to hear the creditors first. The consultation period lasting at least a week would result in valuable time being lost, certainly not serving to foster the prospects of a restructuring.[982] The debtor having to provide a list of all creditors involved in filing for insolvency on his part could be a delaying factor as well.

The German Notary Association ("Deutsche Richterbund") speaks of a process in "baby-steps" ("Trippelschritten"), meaning that this procedure is very time consuming in practice and comes to the assumption that the courts would in many cases need to waive the hearing of a preliminary creditors' committee in order not to risk a worsening situation for the debtor.[983]

Is this again an example of a Legislative inconsistency? If one argues with the policy aim of fostering creditors' participation then the outcome could be seen as consistent with the outcome as with the establishment of the creditors' committee already in the preliminary proceedings, the influence takes part at a crucial time of the proceedings.

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[978] Discussion Draft (n 502) 24.
[979] BAK (n 504) 23.
[980] Ibid, 24
[981] ibid
[982] Ibid
[983] Deutscher Richterbund (n 925).

However, if the overarching purpose of the facilitating of restructurings is taken the answer to the question would be yes. Delays in proceedings hamper restructuring attempts and the chosen new procedure has to be regarded as inconsistent with the actual legislative intention. In order to have a better adaptation in the Darwinian sense the procedure around the appointment of the preliminary creditors' committee should have been designed in a less complicated and more practical way. What is explained above about the establishment of a preliminary creditors' committee and the possibility of suggesting the IOH is far too time-consuming to fit the aim of facilitating early restructurings.

The original plan, to let the major creditors decide should have been pursued. The regulations around the appointment of the preliminary creditors' committee and the appointment of the IOH is yet another illustration of an over-regulation in the German sense for flourishes and pensiveness ("deutscher Tief- und Schnoerkelsinn").[984] By trying to make the procedure fair and just, thinking of all questions around such appointments, it becomes yet again bureaucratic and burdensome.

Another major change is the relaxed definition of independence with regard to the appointed IOH, to be discussed separately in chapter six.[985]

4.3.4. Blocking Potential

The blocking potential outlined above on the part of creditors was seen as the "insolvency plan Achilles' heel"[986] or also "birth defect of the InsO"[987] the minority protection under section 251 Inso as well as the available remedies under section 253 InsO contributed largely to the insignificance of the insolvency plan procedure.[988] One major aim of the ESUG was to facilitate restructurings in general. A practical problem in implementing an insolvency plan was the possibility for stakeholders to obstruct the plan by the measures

[984] Nietzsche, See Eidenmueller in Paulus (n 468) 1345.
[985] Section 56a InsO, the independence of the IP is discussed in more detail in chapter 6.
[986] Schlegel Part 1 (n 358) 417.
[987] Ibid
[988] More on the insolvency plan procedure, see chapter 2.3.5.

discussed above.[989] Economically viable restructurings supported by a very large majority must not be allowed to fail due to the obstruction of only a single individual.[990] The ESUG aimed to introduce some changes to guarantee the protection of minority rights on the one hand, but to also prevent unjustified procedural delays on the other.[991]

4.3.4.1. Section 251 InsO - Protection of Minorities ("Minderheitenschutz")

The new section on the protection of minorities outlines the adjustment to the new law providing the possibility to include the rights of shareholders in the insolvency plan.[992] The minority protection was extended to the shareholders, ensuring that they do not lose the liquidation value of their legal status and are not treated less favourably through the insolvency plan compared to a straight liquidation. This also guarantees that the constitutional requirement of article 14 of the German Constitution is observed.[993] There need be no particular concern regarding constraints to or loss of shareholder rights as they will stand to lose their protection anyhow with the opening of insolvency proceedings.[994]

A change introduced by the ESUG is the necessity to substantiate the application by the date of voting at the latest ("Abstimmungstermin").[995] There is no possibility of making up for it at a later stage. A simple declaration registered with the court is no longer an option.[996] The second change was the introduction of a severability clause for compensation ("salvatorische Entschaedigungsklausel").[997] This clause serves to prevent the potential of disadvantaged positions and precludes reasoning to reject the plan.[998] Another modification specifies that claims have to be brought forward to

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[989] See chapter 4.2.5.
[990] Bt. Drs. 17/5712 (n 294) 35.
[991] Klaus Wimmer, 'Erste Erfahrungen mit der Insolvenzordnung' (1999) ZInsO, 556, 558.
[992] BT Drs. 17/5712 (n 294) 34.
[993] BT Drs. 17/5712 (n 294) 34.
[994] Ibid,.34,35
[995] New section 251 I 1 InsO; 17/5712 (n 294) 35.
[996] BT Drs. 17/5712 (n 294) 35.
[997] New Section 251 III 1 InsO; BT Drs 17/5712 (n 294) 35.
[998] Ibid

ordinary courts ("ordentliche Gerichte"),[999] outside the insolvency proceeding, thereby preventing harmful delays.[1000]

It was furthermore suggested that a specific provision should be added to clarify that these rules should only affect those shareholders holding rights being infringed,[1001] leaving no uncertainty for extra discussion.[1002] The Government did not follow this proposition arguing that the structure of the provision was explicit enough in allowing only those shareholders to vote whose rights are infringed, making an additional clarification unnecessary.[1003] Pre ESUG it was unclear whether a complainant would need to put in a formal complaint ("formelle Beschwerde"), in other words, whether it was even possible to complain without having to be involved in voting on the insolvency plan or having even already voted in favour of the plan.[1004] In future, any complaint is admissible only if the complainant officially declares his disagreement in writing, this binds him to vote against the plan.[1005]

The changes made with regard to minority protection are a clear improvement compared to the situation pre ESUG. The minority protection is still in place, but the balance was changed more in favour of an effective procedure at the expense of minority protection. Setting a strict deadline for the applications, specifying the necessity of formal complaints and the essential feature of a compensation clause now serve to avert nearly all possibilities of obstructing the insolvency plan proceedings.

In answer to whether the legislator achieved the envisaged policy aims by implementing these changes, it can be stated that the avoidance of procedural delays is a positive factor in facilitating the proceedings. The introduction of a compulsory compensation clause prevents a possible disadvantaged position

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[999] New Section 251 III 2 InsO.
[1000] BT Drs 17/5712 (n 294) 35.
[1001] BT-Drs. 17/5712 (n 294) 57.
[1002] Ibid; BR Stellungnahme BT Drs. 679/11 (n 509), 14. Zu Artikel 1 Nummer 35.
[1003] BT-Drs. 17/5712 (n 294) 69.
[1004] Wimmer (n 991) 558.
[1005] Ibid

and it could consequently be argued that the obstruction potential as explained above[1006] in fact no longer exists.[1007]

However, echoing the point made earlier,[1008] it remains an open question whether minority protection is still needed at this stage of the proceedings at all. In the spirit of altruism ("Aufopferungsgedanke") it is valid to argue that the minority should accept the majority voting in favour of a sound restructuring agreement.[1009] The opportunity of the creditors during the proceedings could be seen as sufficient to allow no further remedies once the insolvency plan is approved. A "hold-out" creditor could still take advantage of this minority protection rule which could still hinder the restructuring process.[1010] A cram-down like effect would be needed to prevent these individuals to obstructing viable restructuring attempts, from which they would benefit ultimately.[1011]

4.3.4.2. Section 253 InsO - Remedies ("Rechtsmittel")

The ESUG introduced certain changes with regard to potential remedies assisting creditors against court orders of the court confirming or rejecting the insolvency plan. All amendments to section 253 InsO are aimed to avoid delaying that the effective date of an insolvency plan extensively by remedies opposing the confirmation of the plan.[1012]

The potential claimant has to exploit all procedural possibilities, while any appeal presupposes the existence of a complaint ("Vorliegen einer Beschwerde"), meaning that the appeal requires the plan to infringe on the rights of the appellant.[1013]

[1006] See chapter 4.2.5.
[1007] See as well Wimmer (n 991) 559.
[1008] See chapter 4.2.5.1.
[1009] Bitter (n 899).
[1010] Flechter Comment Protective Umbrella Proceedings (n 81) 25.
[1011] Philipp Schaefer, Andre Frischemeier, 'Corporate finance by way of debt equity swaps in light of new amendments to the German insolvency statute' (2012) J.I.B.L.R. 195,201.
[1012] BT Drs. 17/5712 (n 294) 35; Section 253 InsO was extended to the shareholders as their need protection as well as their rights might be affected by the plan. It was, like with section 251 InsO, suggested to add a clarifying provision in the sense that it should made clear that these provisions should only apply for shareholders, which rights are infringed. (BR 57/5712, 57) This clarification in the wording of the law should avoid discussions. (17/5712; BR Stellungnahme (n 294) 58: 14. Zu Artikel 1 Nummer 35).The Bundesregierung did not follow this proposition as it would be clear from the structure of the provision that shareholders are only allowed to be part of the voting of the plan if their rights are infringed and therefore the clarifying provision would be unnecessary. (BT-Drs. 17/5712, (n 294) 69).
[1013] Bt. Drs. 17/5712 (n 294) Section 253

Furthermore, the appellant has to substantiate a significant economic impairment ("wesentliche wirtschaftliche Beeintrachtigung").[1014] The insolvency plan can provide for compensation of parties having their position worsened due to the plan as such. Provided financing of this compensation is secured, there is no sufficient reason to substantiate a significant economic impairment on the basis of which a confirmation of the plan could be rejected.[1015] Section 253 II 3 InsO introduced a material value for the admissibility of any potential appeal. Accordingly, the level for a claim of significant economic impairment was set at a minimum of 10% above the amount which the appellant would have received if it had not come to an implementation of the plan.[1016] The introduction of this material value represents an especially useful instrument preventing appeals from parties acquiring a debt for the single purpose of gaining from obstructing the plan.[1017]

The court is bound to reject any appeal application if the execution interest ("Vollzugsinteresse") of the parties involved outbalances the interest of the appellant to suspend confirmation of the plan.[1018] Responsibility for this decision lies with the judge and cannot carried out by the clerks of the court ("Rechtspfleger").[1019]

Taking up the recommendation of the German Association of Notaries ("Deutscher Notarverein" "DNV") the legislator introduced a regulation analogous to the release proceedings of section 246a of the German Stock Corporation Act ("Freigabeverfahren nach dem Aktiengesetz").[1020] This last-minute change can be found in section 253 subsection 4 InsO; on application of the IOH, the regional court is now able to reject a complaint if the imminent effectiveness of the insolvency plan seems to need priority.[1021] This change highlights that the legitimate interest of the appellant in the proceedings

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[1014] Bt. Drs. 17/5712 (n 294) Section 253
[1015] Ibid
[1016] Ibid
[1017] Ibid
[1018] Ibid, Section 253, p. 35 Zu Nummer 37
[1019] Rechtspflegergesetz, Artikel 2, Änderung des § 18 Absatz 1 (RPflG).
[1020] DNV (n 905); Bundesministerium der Justiz, 'Stellungnahme des Bundesministeriums der Justiz zu den Pruefungsantraegen der Berichterstatter der Koalitionsfraktionen im Gespraech am 22.September 2011 (unpublished policy material provided via email from the BMJ on request of the author), 7.
[1021] Reinhard Willemsen/, Janine Rechel, *Kommentar zum ESUG – Die Aenderung der InsO* (Deutscher Fachverlag GmbH Frankfurt am Main 2012), 4.

("Rechtsschutzinteresse des Rechtsmittelfuehrers") has to be balanced against the enforcement interest ("Vollzugsinteresse") of the remaining parties involved.[1022] This change is beneficial as it further reduced the blocking potential of the creditors and the regional court ("Landgericht") has the potential to refuse the application if the implementation of the insolvency plan appears to be a top priority. The prioritisation of the enforcement interest of the insolvency plan is a tight step into the direction to achieve a perfect insolvency regime as an earlier implementation of the plan enhances the chances of a restructuring and hence nurtures a rescue culture.

4.4. England

4.4.1. Different Forms of Creditors

English insolvency law differentiates between secured, unsecured and preferential creditors. As the word indicates, creditors with a form of security are called secured creditors, most commonly banks. They hold claims against the debtor which are either fixed on determined assets or "floating" over a diversity of assets, or a combination of both fixed and floating.[1023]

As already analysed in chapter three, England has a system of floating charge holders. Before the changes introduced with the EA the floating charge holder held a very strong position in insolvency proceedings by having the right to appoint an administrative receiver. They lost this right due to the quasi-abolition of administrative receivership.[1024]

In general, creditors are ranked by order of priority. Preferential creditors hold a favoured position by statute so, for example, employees in regard to specific payments.[1025] Until September 2003, also the Crown enjoyed a preferential

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[1022] BT-Drs. 17/5712 (n 294) 36.
[1023] Office for Fair Trading (OFT) *The market for Corporate Insolvency Practitioners, A market study* (2010) 14; www.oft.gov.uk/OFTwork/market-work/
[1024] See chapter 3.3.2.
[1025] OFT (n 1023), 3. the preferential status of the Crown/ HMRC was abolished by the Enterprise Act 2002, s. chapter 3.

status concerning unpaid taxes, which was abolished through the EA to make more funds available for unsecured creditors.[1026]

Unsecured creditors are creditors who hold no form of security at all. Ranking behind secured and preferential creditors, they can only expect to receive any amount left over. The various types of unsecured creditors include larger and frequently involved entities, namely HM Revenue and Customs, major real estate owners[1027] and all kinds of smaller traders, consumers and employees.[1028] It is obvious that unsecured creditors have the weakest position in insolvency proceedings and it could be argued that they are therefore in need of special attention and protection.

As already indicated, this research work is not intending to focus on employees due to the lack of changes through the ESUG. It puts its emphasis instead on participation rights and obstruction potential on the part of creditors in insolvency proceedings.[1029]

4.4.2. Creditor Bodies/ Influence on IOH Appointment

In England, creditor bodies consist of the creditors' meeting and the creditors' committee. These are the two instruments open to creditors through which to influence insolvency proceedings.

4.4.2.1. Creditors' Meeting

The role of the creditors' meeting varies depending on the procedure chosen. The prevailing objective, however, is that creditors are given an opportunity to protect their position by attending these meetings and the possibility to vote on matters concerning their interests.[1030] The objective here is to concentrate on major rescue tools, administration, CVA and SoA as the research question

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[1026] Levy, French, (n 607) 1117.
[1027] OFT (n 1023) 1.13.
[1028] Vanessa Finch, 'Corporate rescue: who is interested?' (2012) JBL 190,197.
[1029] The comparison of the treatment of employees will be a potential topic for further research
[1030] http://www.mw-w.com/a-guide-to-creditors-meetings.html

is set to focus on restructuring regimes, not on general insolvency proceedings and especially not on liquidations.

4.4.2.1.1. Administration

The administrator will send an invitation for the initial creditors' meeting to all creditors whose address and claim he is aware of.[1031] In theory, all creditors are eligible to attend the meeting called for. An appropriate proposal has to be sent to all creditors and other parties as soon as reasonably practicable, at the latest within eight weeks,[1032] and a creditors' meeting arranged within 10 weeks of the administration order to present recommendations for achieving the set objectives.[1033] Creditors' and members' meetings have to take place separately with at least 28 days notice to give time for any necessary consideration.[1034] Depending on the extent of unsettled debts and existing assets, the administrator can demonstrate how far unsecured creditors' interests are affected in between on the one hand getting paid in full, provided there are sufficient assets available, or losing all outstanding accounts on the other.[1035] From his side, the administrator can call for a meeting at any time, which he is obliged to arrange if requested by creditors speaking for 10% in value of outstanding loans or if so directed by the court.[1036]

The approval of proposals made by the administrator requires a simple majority vote by value of attending creditors.[1037] If rejected, the administrator has to refer matters back to the court, which has discretionary power including the possibility of deciding for a winding-up order.[1038] Approval in the creditors' meeting, opens the possibility of installing a creditors' committee to assist the administrator.[1039] If the administrator wants to reduce the rights of the unsecured creditors, he cannot include this directly into the proposal, as the creditors' meeting only has the right to accept or reject the proposal, but not

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[1031] IA 1986, Sch B1, para 50 IA 86.
[1032] IA 1986, Sch B1, para 49, Weisgard (n 686) 279; rule 2.34 IR 86.
[1033] IA 1986, Sch B1, para 50.
[1034] Rule 1.9 IR 8, where the proposal is by the director, rule 1.11 where the proposal is by an administrator or liquidator.
[1035] Schedule B1 52 (1) (b).
[1036] Section 56 (1) IA 86; Rule 2.37 IR 86.
[1037] Rule 2.34, 2.35 IR 86.
[1038] IA 1986, Sch B1, para 55, Weisgard (n 686) 280.
[1039] Rule 2.50 IR 86.

make binding constitutive declarations infringing rights of creditors. The administrator would have to use a CVA or a SoA in order to be able to reduce rights of unsecured creditors.[1040]

4.4.2.1.2. Company Voluntary Arrangement

As noted above, the CVA is a formal procedure without the requirement to involve the court but, nevertheless, representing a binding arrangement between debtor and creditors.[1041] A proposal to the creditors is made by the company directors, the administrator or liquidator, supervised and implemented by an IOH. The grounds for calling a meeting are to present a relevant proposal, settle open questions and obtain the approval of the creditors.[1042]

All unsecured creditors are allowed to vote and the proposal is binding for all creditors provided that at least 75% of the creditors present at the meeting voted in approval.[1043]

4.4.2.1.3. Schemes of Arrangement

As highlighted in chapter three, the SoA represent a flexible procedure holding the potential of being used by companies in financial distress, in order to find a compromise with creditors aiming for restructuring.[1044] Due to the informal nature of the proceeding a creditors' meeting is not an essential and the SoA does not depend on the contribution of the creditors' committee.[1045]

4.4.2.1.4. Usage of Creditors' Meetings

According to underlying data provided by the Office of Fair Trading (OFT), creditors' meetings were held in 61% of all administrations.[1046] Looking at how these creditors' meetings were made up, it is worth mentioning that unsecured

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[1040] Bork, *Rescuing Companies* (n 22) 30, 14.18; para 49 (3) of Sch B1 IA 1986.
[1041] Flechter, *Law of Insolvency* (n 547) 477.
[1042] Weisgard (n 686) 129.
[1043] Rule 1.19 IR 86, more details see chapter 3.3.4.
[1044] See chapter 3.3.5.
[1045] Bork Rescuing Companies (n 22) 104.
[1046] OFT (n 1023) 4.46.

creditors rarely came to attend these meetings.[1047] The OFT market study shows that 80% of the cases in administration were agreed upon without any amendments or even rejection.

4.4.2.2. Creditors' Committees

4.4.2.2.1. Administration

Creditors' committees represent and protect creditors' interests as a whole.[1048] One of the main roles of a creditors' committee is to control and monitor the IOH's powers, to assist the IOH also in acting as a sounding board for him, sanction certain of his actions and fix his remuneration.[1049] Creditors' committees involved in liquidation procedures are named "liquidation committee".[1050] For restructuring procedures its role is widened to also deal with the approval and probable negotiation concerning reorganisation plans and corresponding proposals.[1051] The main point of emphasis here is on the function in rescue proceedings. A creditors' committee must consist of at least three and not more than five members,[1052] all being unsecured creditors of the insolvent debtor allowing creditors to vote only about the unsecured element of their claim.[1053] Pursuant to rule 2.50 of the IR 86, creditors' committees in administration are established by resolution of the creditors' meeting.[1054] The committee is duly constituted if at least 2 members are present or represented.[1055] Given the fact that only unsecured creditors are entitled to vote,[1056] members joining the creditors' committee will always be unsecured

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[1047] OFT (n 1023) 4.47; only in 1 out of 20 meetings
[1048] SIP 15, Annex A 1.1.
[1049] Part 2 Chapter 7, Section B rule 2.52 (1) IR 86; SIP 15 Annex A 1.1; 1.2 for post Enterprise Act administration; for pre Enterprise Act administration s. Original Part 2, Section B, Chapter 4, rule 2.34 (1) IR 86; for administrative receivership s. Part 3 Chapter 3 rule 3.18 IR 86.
[1050] Jay Lawrence Westbrook, Charles D. Booth, Christopher Paulus, Harry Rajak, The World Bank, *A Global View of Business Insolvency Systems, Law Justice, and Development Series*, (The World Bank Washington D.C. 2010) 79,80.
[1051] Ibid
[1052] Rule 2.50 (1) IR 86.
[1053] Rule 2.38, 2.40 IR 86.
[1054] S. Schedule B1 para 57, for post Enterprise Act administration; for pre Enterprise Act administration, s. Original Part 2, Section B, Chapter 4 rule 2.32 IR 86, section 26 Insolvency Act 1986; for administrative receivership s. rule 3.16 IR 86.
[1055] 2.54 IR 86.
[1056] 2.40 IR 86.

creditors. The English system does not provide for remuneration of members serving on the creditors' committee.[1057]

4.4.2.2.2. Company Voluntary Arrangement

There are no provisions made regarding a possible creditors' committee in CVAs, except for the duration of a moratorium.[1058] It might, however, be useful for the company to install such a committee, especially in cases with a single dominant creditor or group of creditors demanding a say in the proceedings.[1059] It might also be advisable in situations where seeking advice from creditors could prove valuable, for example, if company directors were aiming at varying the terms of the arrangement or, especially, in the event of a default.[1060] Functions of this committee will, of course differ from a regular creditors' committee. In the absence of legal provisions, the powers given such a committee must be defined individually since statutory powers of individual creditors cannot be limited.[1061]

4.4.2.2.3. Schemes of Arrangement

Due to the nature of the proceedings there is no requirement to install a creditors' committee.[1062]

4.4.2.3. Use of Creditors' Committees

Making up only 3% of all administration proceedings creditors' committees are not frequently used in England; and it can be concluded that interests of unsecured creditors are hardly ever represented at the beginning of an administration procedure.[1063]

The main reasons for the lack of attendance are the relatively small amounts that unsecured creditors have outstanding, leaving them with hardly any

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[1057] 2.66 IR 86, Members can only claim travel expenses in relation to their attendance at meetings, with the exception of meetings held within six weeks of a previous meeting summoned by the administrator.
[1058] Para 35 od Schedule A1.
[1059] Weisgard (n 686) 127.
[1060] Ibid
[1061] Ibid
[1062] See more on SoAs: chapter 3.3.5.
[1063] OFT (n 1023) 4.50.

influence on the proceedings. This, naturally, causes a lack of interest for the majority of unsecured creditors who simply do not see enough justification due to cost and time efforts necessary in order to make use of such a committee.[1064]

4.4.3. Influence on IOH's Appointment

Creditors, and here specifically secured creditors, exert a major influence on the appointment of the officeholder in administration procedures.[1065] It is common practice that banks, as the main secured creditors, have a panel of IOHs to choose from.[1066] From the perspective of an IOH, this inherent reliance implicates a strong dependence and responsiveness concerning requests on behalf of secured creditors.[1067]

Although in an administration procedure the IOH is appointed by the court, this does not imply that the court is choosing the person to be appointed, the authorisation to choose the IOH goes along with the authorisation to apply for administration[1068], namely it is for the company,[1069] the directors of the company, as well as one or more creditors.[1070] In addition, the supervisor has a right to apply in a CVA procedure.[1071] Initiation of proceedings by the debtor requires an advance notice to the floating charge holder in giving him the priority to appoint the IOH.[1072] It is often the case that the debtor will come to an understanding with the major banks but the debtor remains to be seen instrumental in actually appointing the IOH.[1073]

[1064] OFT (n 1023) 4.56.
[1065] OFT (n 1023) 4. Market Assessment 30.
[1066] OFT (n 1023); as well critically Finch, Who is interested. (n 1028) 196.
[1067] Ibid 196
[1068] Reinhard Bork, Jenny Wiese *Die Rechtsstellung des Insolvency Practitioners* (RWS Verlag Cologne 2011) 122.
[1069] Whereas the application of one director is not sufficient, see *Re Chelmsford City Football Club (1980) Ltd.* [1991] BCC 133.
[1070] Para 12 Schedule B 1 IA 86.
[1071] Ibid
[1072] See para, 26 (1) (b) Schedule B1, IA 1986; more information see Bork IP (n 1068) 122.
[1073] Ibid, 123.

4.4.4. Blocking potential

4.4.4.1. Administration

There are no minority protection rules for the creditors in an administration procedure. As discussed above, the creditors' meeting is only able to reject or approve the measures in an administration proceeding and it does not have the power to decide to infringe creditors' rights by declarations.[1074] Bork argues that this lack of constitutive power of the creditors' meeting avoids the necessity for further minority protection rules.[1075] If the creditors' meeting approved the plan there is no necessity for further blocking rules.

4.4.4.2. Company Voluntary Arrangement

Once it is implemented, creditors have the possibilty to challenge the CVA on grounds of unfair prejudice.[1076] There is no definition of "unfair prejudice"; it is a question of the individual case.[1077] A case of unfair prejudice presupposes a discriminatory treatment of an individual or a class of shareholders.[1078] The prejudice must emerge from the arrangement.[1079] "Unfairness" arises when creditors are treated differently.[1080] Unfair prejudice is given on finding the shareholder or creditor in a worse situation with the CVA than without, having compared the financial position before and with the opening of the CVA.[1081] In the *Powerhouse* case,[1082] for example, the situation of the landlords as one group of creditors was taken by comparing the CVA as such to the outcome of a liquidation procedure; with the landlords holding enforceable guarantees for the case of liquidation, it became clear that a CVA would have worsened their position.[1083]

[1074] See chapter .4.2.1.
[1075] Bork Rescuing Companies (n 22) 23.22.
[1076] Section 6 InsO Act 1986.
[1077] Rachel Mulligan, Nick Angel, 'Powerhouse CVA defeated!' (2007) CRI 110, 112.
[1078] ibid
[1079] Ibid, 112; *Cadbury Schweppes plc v Somji* [2001] 1 WLR 615, sub nom *Somji v Cadbury Schweppes plc* [2001] BCLC 498, CA).
[1080] Ibid
[1081] Keay and Walton (n 515) 160; *Re T & N Ltd* ([2004] EWHC 2361.
[1082] (1) Prudential Assurance Co Ltd & Ors (2) Luctor Ltd & Ors v (1) PRG Powerhouse Ltd & Ors (2) Anthony Murphy & Ors (2007), [2007] EWHC 1002, (Ch D).
[1083] Ibid

The CVA will not have any effect on the rights of preferential creditors, unless the proposal is specifically agreed upon. It must be said again, however, that the CVA is binding for all creditors entitled to vote at the meeting, even one not present.[1084]

4.4.4.3. Schemes of Arrangement

If creditors are not economically affected by the scheme, it is possible that a certain class of creditors could remain unconsidered; this would, however, only apply to an entire class, not to individual creditors.[1085] The court has to sanction the scheme after the vote of the creditors. Their discretion is unfettered; the scheme does not need to be the "best" or only scheme, but it has to be "fair".[1086] In *IMO*[1087] the court sanctioned the scheme and decided that it was not necessary to consult a class of creditor who were not affected in their rights and not having an economic interest in the debtor.[1088] It was held that the claims of the mezzanine lenders did not generate any rights in the scheme as they had no economic value.[1089]

The scheme, once approved, binds all creditors, as well the secured creditors; in other words it is not possible for dissenting creditors to block the scheme. It could be said that the scheme has a "cram down" effect[1090] as it is a forced inclusion of the dissenting creditors and shareholders, protected by the formation of the classes during the procedure.[1091]

4.5. Comparison

It is without a doubt that both countries have a long history of creditor participation in insolvency proceedings. Both, Germany and England offer participation through creditor bodies even with the same name: creditors'

[1084] Keay and Walton (n 614) 173.
[1085] *Re IMO (UK) ltd* [2009] EWHC 2114.
[1086] *Re Telewest Communication* [2004] BCC 342.
[1087] IMO (n 1085).
[1088] IMO (n 1085).
[1089] In *Re A Debtor (No 101 of 1999)* [2000] BPIR 998 the court held that unfair prejudice is not automatically given when creditors are treated differently in an IVA; same conclusion: *Inland Revenue Commissioners v Wimbledon Football Club* [2004] All ER (D) 437 May, [2004] EWHC 1020.
[1090] Pilkington (n 136) 13.
[1091] See chapter 4.4.4.3.

meetings and creditors' committees. As mentioned earlier, the objective of this comparison is to analyse similar and comparable aspects of creditors' participation, with the special focus on "before and after ESUG". The similarities and differences are highlighted and it is analysed whether the changes in Germany were influenced by the English system in being driven by forum shopping activities. If so, it is evaluated whether these changes worked to improve the situation in Germany and led to a more rescue-friendly regime and hence enhanced the insolvency landscape.

4.5.1. Creditor Bodies

In general, creditors' meetings in Germany and England pursue the same function in giving creditors the opportunity to protect their interests by attending and voting in these meetings. The major difference is that the creditors' meeting in Germany has "constitutive power"[1092], in other words they have an influence on the process, whereas in England the creditors' meeting, in an administration proceeding has no such powers, it only has the right to accept or refuse the measures suggested by the administrator. The possible different impacts of this difference are discussed below in connection with the blocking potential.

The differences between the two regimes as far as the creditors' committee is concerned are not part of the discussion here, as these are not derived from the changes through the ESUG.[1093] The influence of the creditors' committee on the IOH appointment and the installation of a preliminary creditors' committee are the changes in this context, which are discussed below.

4.5.2. Influence on the IOH's Appointment

As discussed above, the ESUG introduced several amendments with regard to the method of appointing the IOH.[1094] Pre ESUG, the IOH was appointed by the insolvency court, with little influence exerted by creditors. Post ESUG, the

[1092] Bork Rescuing Companies (n 22) 14.18.
[1093] On the differences see Luecke Creditors' Committees (n 862).
[1094] See chapter 4.3.3.

introduction of section 56a InsO allowed creditors to play a much more important role. In England, on the other hand, the secured creditors, especially the banks as main secured creditors have their say in choosing the IOH. This factor opens up certain different aspects to look into.

In Germany, provided that certain thresholds are met, the appointment of the IOH is decided on by the creditors' committee, set up in larger cases. The same applies to cases not meeting the thresholds set for which the court decides to have a creditors' committee established. For all other cases the appointment is still left entirely at the discretion of the court. In England, by comparison, that decision will always rest with the secured creditors. Due to the different set-up of the creditors' committee in Germany it works out that both countries leave decisions about the appointment to the secured creditors, provided, of course, that a creditors' committee has in fact been installed.

It is striking that the English method is much more simplistic and practical, the party filing together with major creditors being able to decide. In Germany, by contrast, certain bureaucratic obstacles have to be overcome first, such as handing over the list under section 13 InsO[1095] and the general necessity to install a preliminary creditors' committee before the IOH can be appointed.[1096]

The shift from an excessive influence held by the court to the increasing influence of creditors was clearly driven by forum shopping activities. One main reason why the German system was not regarded as very rescue-friendly was the uncertainty for the debtor and creditors about the person to be appointed as IOH.[1097] In introducing the Discussion Draft there is outright recognition that foreign investors considered Germany's legal system less appropriate for restructurings on the basis of proceedings being unpredictable for debtor and creditors due to their having little influence on choosing the IOH.[1098] All participants in insolvency proceedings have their individual interest of wanting a say in choosing the IOH. The creditors will claim their money; the

[1095] See chapter 4.3.2.2.3.
[1096] See chapter 4.3.2.2.1
[1097] BT Drs. 17/5712 (n 294) 17.
[1098] BT Drs. 17/5712 (n 294) A. Problem und Ziel, 1.

debtor will want to safeguard his business, the IOH will work for his remuneration and the administration of justice will oversee their process and their responsibility.[1099] In consequence, it is a vital question as to who finally decides to appoint the IOH.

4.5.2.1. Court Decision

Given a situation of such contradictory interests, especially in economically important areas, courts should be able to decide in complete neutrality, not being involved in pursuing any self-interest and not bound by instructions either.[1100] As far as creditors are concerned it could be argued that their information about IOHs might tend to be superficial and based on hearsay such as "this IOH shall be a good one".[1101] Compared to the average creditor, however, an experienced judge could be in a better position to assess the qualification and availability of IOHs.[1102] Especially in high profile insolvency plan cases, it has always been good custom in Germany for judges to consult with creditors, allowing them an important practical influence also before changes by the ESUG were implemented. There could be certain arguments concerning a potential interference with the independence of the judiciary a possible race to the bottom by lowering standards connected with decisions about the IOH now being handed over to less experienced parties.[1103]

Frind argues that a major asset of the German regime was the possibility for judges to balance individual interests and he argues that the judge should not simply be a "rubber-stamper" of a creditor's proposal, like in the English "out-of-court-appointment", where the proposal of the creditors on the application form is by signing converted into a court decision, which would be an isolated philosophy of a different legal system.[1104] It is correct that it is a different system, but this does not mean that the idea, to place the responsibility into

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[1099] Frank Frind, 'Unabhängigkeit – kein Wert mehr an sich? - Die Auswahl und berufliche Stellung des Insolvenzverwalters nach den neuen Regelungsentwürfen zur Änderung der InsO' (2010) NZI, 705, 705.
[1100] Ibid 709
[1101] Ibid 708
[1102] Ibid
[1103] Ibid
[1104] Frank Frind, 'Zum Diskussionsentwurf fuer ein "Gesetz zur weiteren Erleichterung der Sanierung von Unternehmen"' (2010) ZInsO, 1473, 1478.

the hands of the creditors might not be a viable way towards more rescue-friendliness in Germany as well. Question are raised whether changes driven by forum shopping activities were in fact beneficial to Germany under a legal system working differently. Possibly insufficiently deep consideration before deciding for this basically legal transplant.[1105] Commenting on this further in a detailed look at the different nature and development of insolvency courts or courts in general in Germany and England would go beyond the scope of this research. It is possible, however, to remark that the German method is moulded by its paternalistic system of commitment to justice ("Paternalistisches System der Justizfoermigkeit").[1106] The main mistake was and still is that reformed laws[1107] continue to hold on to the given judicial structure. Creditors' autonomy must falter under the inherent judicially dominated procedure, and seeing insolvency as an issue for the hour of court proceedings ("Stunde des gerichtlichen Verfahrens") must be regarded an historical error.[1108] Insolvency law has an economic aspect which is in striking contrast to the German commitment to justice.[1109] In other words, courts in Germany might historically have a different function in comparison to their counterparts in England, but this appears to generate the obvious unwillingness to bring about necessary changes to the existing structure. Legislation is not adapting to the environmental changes, which demand procedures with less interference by the courts. It remains to be said as well that the proponents of the court decision are all judges themselves.

4.5.2.2. Creditors' Decision

There are, of course, also good arguments for having creditors decide about the party to appoint as IOH. The change in Germany in giving creditors more influence could in consequence be a race to the top, a perfection of the law with regard to facilitating restructurings. The explanations given by Frind pertaining to the appointment of the IOH show the clearly varied interests at

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[1105] More see methodology 0.8.
[1106] Hans Haarmeyer, *Stellungnahme zum Gesetzesentwurf der Bundesregierung Entwurf eines Gesetzes zur weiteren Erleichterung der Sanierung von Unternehmen, BT Drs. 57/5712* (2010), 5; http://gsv.eu/sites/default/files/rege-esug_prof._haarmeyer.pdf (last visited 26.09.2015).
[1107] Here referred to the InsO.
[1108] Haarmeyer ESUG (n 1106) 5.
[1109] Ibid

stake, depending on the specific involvement of any party concerned.[1110] Interests of creditors and the debtor are in jeopardy, creditors bearing the risk of economic failure and the debtor at risk with his entire business have reasons to claim being given the right to influence the choice of the IOH as key person in forthcoming proceedings.

In practice, the decision in Germany will normally be made in consultation between the debtor and his advisors. These advisors, by nature professionally involved in all cases of major insolvencies and experienced with IOHs will probably have a better overview about the qualification and suitability of potential officeholders than the courts could offer.

Even arguing with Frind and acknowledging that roles of the courts differ between England and Germany, creditors will find themselves in the same situation in either country. In certain cases creditors might even be the same ones, bearing in mind the ever increasing internationalisation of businesses.

One should as well bear in mind that the intention of the change is the psychology behind being able to exert an influence on the key party in an insolvency proceeding. This in turn will effect earlier filing of an insolvency proceeding to further facilitate restructuring. The main creditors will normally be first in getting signals of financial difficulties or other potential grounds for insolvency, enabling them to make sure that debtors not delay filing for insolvency on the argument of not wanting to put their future and fade into the hands of any unknown party. Making creditors and the debtor get involved in choosing the IOH will do away with this uncertainty.

Putting the decision into the hands of creditors would seem to be the right decision and changes entailing greater influence on the IOH's appointment can be seen as a race to the top, resulting in a more perfect insolvency regime: a race to the top in the sense of a race to rescue. Although at first glance creditors' rights are strengthened, it still could be seen as an improvement for

[1110] See Frind Unabhaengigkeit (n 1099).

establishing a rescue culture, the creditors being able to influence an earlier filing of the debtor and hence increasing the chances for a successful restructuring.

In consequence the decision of the German legislator to put the decision on the appointment of the IOH into the hands of the creditors only in case a preliminary creditors' committee is installed is yet again another form of contradiction of the Darwinian Theory. They gave with the one hand in giving the creditors more power in the decision on the IOH, but, only if very high thresholds are fulfilled. As a result, only in the minority of cases is the decision making power with the creditors. Instead of making a fresh start and allowing in all cases the creditors decide on the IOH, the legislator chose a half-hearted approach as explained above. The Discussion Draft recommended that the main creditors should decide if no preliminary creditors' committee had been installed.[1111] Eliminating this had a huge impact on creditors' participation. This could be seen clearly as a step back; the legislator had the chance for a more drastic change, but stopped halfway.

4.5.3. Blocking Potential

There appears to be an overall trend to reduce the influence of dissenting creditors, acknowledging that time is a sensitive factor in all restructuring proceedings as discussed above.[1112]

In Germany the creditors' meeting in an insolvency plan proceeding has in addition to voting rights, a say on whether the company should be temporarily continued or shut down and on the acceptance of the plan.[1113] Bork speaks of "constitutive power" of the creditors' meeting.[1114] In England the creditors' meeting in an administration procedure has no such constitutive power; they only have the possibility to reject or accept the plan of the administrator. Bork argues, due to the lack of the constitutive power in England further blocking

[1111] Discussion Draft (n 502) 2.
[1112] Windsor, Mueller-Seils, Burg, M (n 691) 8.
[1113] See section 244ff. InsO, 157 InsO; see Beissenhirtz, Creditors' rights (n 106) 318.
[1114] Bork Rescuing Companies (n 22) 14.18.

possibilities are not necessary as the minority shareholders do not need additional protection.[1115] In other words he argues that due to the lack of constitutive power in England there is no majority decision and therefore the minority would not need protection. However, firstly it could be argued against this that the minority creditors have an influence on possible infringing measurements in the first place, whereas in England the creditors have no influential power at all. Secondly, this argument only applies for the administration procedure. Within a CVA procedure, individual creditors can be excluded if their claims have no financial value. Once the CVA is approved, there is the possibility for a creditor to sue on the grounds of unfair prejudice[1116] whereas in a scheme of arrangement procedure, once approved, the scheme binds all creditors, with no further remedy available. [1117]

Overall it can be concluded, that there is still more blocking potential available for dissenting creditors in Germany, especially comparing it to the SoA procedure. Practice shows that it is exactly the "cram down" nature of the SoA proceeding which makes it attractive.

The German legislator should think of abolishing remedies completely for an approved plan.[1118] Certain co-operation duties for creditors are essential for a flexible and efficient restructuring procedure. An individual creditor should not be able to use his position and hence bargaining power to block an otherwise sustainable restructuring agreement. It is legitimate to have a cram-down like nature proceeding, binding for all creditors for the sake of a successful restructuring.

A clear reference that the reduction of the blocking potential in Germany can be traced back to forum shopping activities cannot be found in the policy documents. However, looking at the context, especially as well with regard to the reduction of obstruction potential with regard to DESs, it suggests itself that the German legislator was inspired by the English system.

[1115] Bork Rescuing Companies (n 22) 14.18.
[1116] See chapter 4.4.4.2.
[1117] See chapter 4.4.4.3.
[1118] See chapter 4.2.5 and 4.5.3.

The reduction of the obstruction potential is to be seen as a race to the top. The German experience pre ESUG demonstrated the poor adaptation to the practical needs. Reducing the possibilities for obstructive creditors to intervene makes it more likely that an insolvency plan will be implemented, which in return means a higher restructuring rate, benefitting the rescue culture of Germany's insolvency landscape, which is in line with one of the main aims of the reforms. However, there is still more potential to adapt the rules more perfectly in the sense explained above. Minority protection at the stage of the proceedings, after an approved plan could be seen as superfluous and the changes could be seen as not far reaching enough.

4.6. Mini Conclusion

The changes with regard to creditors' participation have not resulted in a substantial increase of creditors' influence, only if certain thresholds are exceeded creditors get the chance to get involved via the preliminary-creditors' committee. This is now manifest in law, even though the instalment of a preliminary creditors' committee was already possible pre ESUG and frequently used in larger cases.[1119] Overall, the policy aim of the ESUG to promote creditors' participation is not reflected in the outcome. Instead of making the reforms a fresh start, the German legislation ended up with a compromised and fettered approach: a lightweight solution; the opportunity for a courageous change was missed. The legislation for a compulsory creditors' committee in certain cases could well be looked at favourably as the influence of creditors was improved but, nevertheless, it stayed far from perfect in regard to the hurdles above discussed on the way to added participation. Starting with the list of creditors detailing their claims in the case of a debtor filing for insolvency,[1120] along with procedures for appointing the preliminary creditors' committee,[1121] and ending with the set-up of thresholds, all these elements act to hinder participation for the majority of cases. Bearing in mind the overarching aim of fostering rescue, the new regulations might even lead to

[1119] See chapter 4.2.3.2.
[1120] See chapter 4.3.2.2.3.
[1121] See chapter 4.3.2.2.1.

procedural delays and in consequence to a less perfect outcome than achieved before the changes were implemented.

Including creditors in the process of choosing the IOH was certainly a step in the right direction on the way to a more perfect insolvency regime. As evaluated above, however, it is only a fettered approach seen in the Darwinian sense. The challenges to overcome existing hurdles in practice will most likely lead to further adaptation in the future.

With regard to the reduction of the blocking potential of dissenting creditors it could be argued yet again that a right step was taken into the direction of a more perfect insolvency regime in Germany. However, the German legislator should have taken it even a step further. The SoA procedure in particular should serve as an example with its cram-down like nature. This procedure is especially valuable for situations where minority creditors, with often a very strong negotiation position but only a small amount of debt, are trying to use their bargaining power. The German legislator should have followed this path by trying to find a regulation which would lead to an effective insolvency plan, binding for all creditors once approved. Yet again, for a successful restructuring procedure, there should be a way to "force" minority creditors to certain co-operation duties, such as the duty of approval to a viable restructuring agreement.[1122]

[1122] Horst Eidenmueller, *Unternehmenssanierung zwischen Markt und Gesetz* (n 900).

Chapter Five

Influence of the Debtor

"We would tend to regard it [debtor-in-possession] as leaving an alcoholic in charge of a pub."[1123]

5.1. Introduction

The intention behind this chapter is to evaluate the method by which England and Germany are trying to integrate the debtor into the insolvency proceedings, putting the focus on changes made by the ESUG. Circumstances pre- and post- ESUG are analysed and correlated with comparable in England. It is examined, whether the reform changes in Germany were driven by forum shopping activities, with the aim of finding out whether these changes led to a more perfect insolvency landscape in line with the Darwinian approach of this thesis.

The critique in this chapter is focusing on the so-called self-administration ("Eigenverwaltung")[1124] in view of amendments introduced by the ESUG. Strictly speaking the ESUG introduced two new different variations of the debtor-in-possession procedure, the actual self-administration procedure under section 270a InsO and the newly introduced protective umbrella proceeding under section 270 b InsO. This chapter concentrates on section 270 a InsO, the actual debtor-in-possession version, while the latter, the so-called protective umbrella proceeding, is discussed in greater detail in chapter eight, considering its importance and relevance in connection with pre-insolvency procedures.

The debtor, of course, makes up the focal point of insolvency, being both object and subject of the proceedings.[1125] At stake is nothing less than the future of the debtor as the insolvency proceedings decide about the success

[1123] Gabriel Moss, 'Chapter 11-An English Lawyers Perspective' (1998)11 Ins. Int. 17, 18.
[1124] To the Terminology "self-administration" see Introduction 0.7.
[1125] Pape, Uhlenbruck, Voigt-Salus (n 302) 189, chapter 15 Rn. 1.

or failure of a potential restructuring and in consequence therefore about the fate of the debtor himself. As highlighted above, leaving the debtor in possession is one indicator of a debtor-friendly regime.[1126] Involving the debtor in the proceedings is a clear evidence that his integration gives an incentive for an earlier filing for insolvency. Given the incentive of being involved in the process by seeking help early bears the potential to influence the entire insolvency procedure itself.[1127] A large number of companies actually fail to be rescued because they seek help late, so obviously the earlier a debtor looks for support, the greater the chances for a successful restructuring, consequently strengthening the regime towards a more rescue-friendly regime. The central point of discussion in this context is how the debtor company's management can be encouraged not to postpone seeking for help at an early stage in order to tackle the financial challenges of the company before it is too late.

In times of financial difficulties two questions arise with regard to the leadership, supervision and responsibility of the company: the timing of a management or control replacement in times of a crisis and the question of who should control and manage the ailing company. These questions are categorised as a form of Corporate Governance in a company on the verge of insolvency, the so called "Bankruptcy Governance".[1128] The "Bankruptcy Governance" regimes of England and Germany will be looked at in the following.

5.2. Germany pre- ESUG

The debtor has different disclosure and cooperation rights[1129], which in comparison to other regulatory areas are still treated with low priority.[1130] As

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[1126] See introduction 0.5.5.
[1127] See as well Cork Archive, Insolvency Principles and Philosophies, 5.6.a) "To diagnose and treat an insolvency situation at an early rather than a late stage in its existence", http://law.kingston.ac.uk/research/centre-insolvency-law-policy/muir-hunter-museum/cork-project.
[1128] Horst Eidenmueller, 'Die Eigenverwaltung im System des Restrukturierungsrechts' (2011) ZHR, 11 see as well John Tribe and Jingchen Zhao 'Companies Act 2006 schemes of arrangement in comparative perspective' 1 JIBFL 15.
[1129] See sections 97ff InsO.
[1130] Pape, Uhlenbruck, Voigt-Salus (n 302) 189, chapter 15 Rn. 1.

discussed in chapter two[1131], the right of management and disposition ("Verwaltungs- und Verfuegungsbefugnis") in general insolvency proceedings passes over to an independent IOH,[1132] in other words, the existing management is replaced, with the result of the existing management losing all influence on the future of the company. An alternative possibility of retaining the existing management during an insolvency process was introduced by the InsO in 1999.[1133] This procedure is called self-administration and could be seen as the main option for the debtor to have a say in the insolvency proceedings. Although the Government decided to introduce this possibility, it is worth mentioning the explanatory notes of the Government Draft highlighting that self-administration should be regarded an exception and the appointment of an IOH the norm.[1134] A management unable to avoid insolvency would usually not be suitable to optimally realise the insolvent's estate and put the interest of creditors ahead of their own.[1135]

5.2.1. Self-Administration

In a case of self-administration, the debtor will stay in possession and a court-appointed trustee ("Sachwalter") joins in to monitor the process.[1136] The creditors' committee decides upon keeping the debtor in possession, thereby expressing the autonomy of the economically affected party ("Autonomie der wirtschaftlich Betroffenen").[1137] Similarly to any other insolvency proceedings, the general aim of the InsO to satisfy creditors as a whole can also be said for self-administration, serving to confirm that both restructurings and liquidations could be conducted by these means as well.[1138]

Basically acting in the same way that an IOH would, the debtor retains the power of administration and disposal over the insolvent's estate. He does, however, not operate on his own principle of individual autonomy

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[1131] See chapter 2.3.4.
[1132] See section 80 InsO.
[1133] Sections 270-285 InsO; see further chapter 2.3.6.
[1134] BT Drs. 12/2443 (n 304) 224.
[1135] Ibid, 224,225
[1136] Sections 270 to 285 InsO.
[1137] BT Drs. 12/2443 (n 304) 86.
[1138] Ingeborg Haas *Das neue Insolvenzrecht* (Haufe aktuell Freiburg 2012) 73, however in practice self-administration is hardly ever used in liquidations due to its nature.

("Privatautonomie"), but taking on the function of a neutral administrative officer ("Amtswalter").[1139] All actions have to be conducted reflecting the interests of creditors as a whole.[1140] The company management keeps its competencies especially in the areas concerning completion of legal transactions and participation in the work council. In this context, powers given to the trustee are not comparable to those an IOH would have.[1141] Along with the right of separation[1142], the debtor keeps his rights about the realisation of assets and is left in a position to dispute a registered claim.[1143] Moreover, the debtor maintains all responsibility for the distribution of the insolvent's estate.[1144]

Instead of an IOH a trustee holding only restricted rights is appointed. The trustee comes in to verify the debtor's economic situation and to monitor management in general.[1145] Besides these monitoring duties his main dealings concern the enforcement of liabilities[1146] and appeals.[1147] Similar to the office holder the trustee must also be independent from the debtor and creditors alike and is required to have all necessary knowledge and expertise.[1148] The trustee operates under supervision of the court[1149] and is liable for any breach of his duty.[1150]

Under the system in Germany, reasons for keeping the debtor in possession are the debtor's ability to play a vital role with his knowledge, avoiding the period of adjustment for a potential IOH, minimising of costs and the incentive given to encourage filing for insolvency at an early stage.[1151] It is frequently argued that leaving the debtor in possession is like "putting the fox in charge

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[1139] Thomas Zerres 'Eigenverwaltung nach der Insolvenzordnung' (2001) .6 <http://www.jurawelt.com/sunrise/media/mediafiles/13557/eigenverwaltungnachderinso.pdf>
[1140] Ibid
[1141] Section 279 InsO, Haas (n 1138) 73.
[1142] See chapter 4.2.1.
[1143] Section 282 InsO and section 283 InsO, Haas (n 1138) 73.
[1144] Section 283 subsection 1 no.1.
[1145] Section 274 subsection 2 InsO.
[1146] Under section 92 and 93 InsO.
[1147] under section 129 to 147 InsO, Haas (n 1138) 73.
[1148] Section 56 InsO.
[1149] Section 58 InsO.
[1150] Section 274 subsection 1 in connection with section 60 InsO; More duties s Haas (n 1138) 76.
[1151] Pape *in: Kübler, B.; Prütting, H. Kommentar zur Insolvenzordnung* (RWS Verlag Cologne 2005) section 270 para 2

of the henhouse" or "leaving the alcoholic in charge of the pub"[1152], as financial distress is often attributable to management errors.[1153] Insolvency experts especially reacted aversely to keeping existing management in charge, fearing that creditors could be denied payment for years on end, incidentally the most often critiqued aspect of US Chapter 11.[1154] However, it is not unusual to substitute the management of the company.[1155] This is often done by replacing the former management with an experienced restructuring specialist. [1156]

The shareholder structure remains unchanged for cases of self-administration and shareholders also retain the right to reinstall the old management in the event of it meanwhile having been replaced by restructuring experts. It is advisable that the shareholders transfer their shares to a trustee, together with the right to sell these at a later stage. This would counteract critics arguing that self-administration is used by debtors merely with the intention to restructure the company at the expense of creditors.[1157]

Keeping the debtor in possession could encourage management to file for insolvency at an early stage, allowing them to retain at least partial control of the company,[1158] and sending out a positive signal for employees and suppliers alike. This could, however, also be used as a counter argument, if the financial difficulties can be attributed to mismanagement.[1159] It is advantageous that in a self-administration procedure, the plan can be prepared way in advance and the main parameter could be discussed with the main creditors.[1160] With fees for a trustee amounting to only 60% compared to employing an IOH the self-administration procedure is less cost – intensive, which could be the crucial factor in opening proceedings at all.[1161]

[1152] Moss (n 1123) 19.
[1153] Buchalik, *Faktoren EV* (n 451) 295.
[1154] Gerard McCormack, *Control and corporate rescue - an Anglo-American evaluation* (2007) I.C.L.Q. 515.
[1155] Ibid
[1156] Michael Frege, 'Grundlagen und Grenzen der Sanierungsberatung' (2006) NZI 548.
[1157] Buchalik, Faktoren EV (n 451) 296.
[1158] Haas (n 1138) 74.
[1159] Ibid
[1160] Buchalik, Faktoren EV (n 451) 296.
[1161] Haas (n 1138) 73.

Pre ESUG, the DIP proceedings were only possible when the process would not cause delay or other disadvantages for the creditors.[1162] In other words, even mere suspicion was enough to reject such an application, making the debtor-in-possession an exception only and not the rule by any means. Under the old regime, the approval of creditors was needed for cases where a creditor filed for insolvency with the debtor, on the other hand, applying for self-administration.[1163] At the same time, the principle of *ex proprio motu investigation* ("Amtsermittlungsgrundsatz") was imposed on the courts, obliging them to start investigations on their own part.[1164] For the decision-making process the court would take various indications into account, such as, for example, previous convictions for property or insolvency offences. The court would always base its decision on the resulting assessment as the determining factor. A positive approval of an application for self-administration would finally depend on whether the approval would result in a threat for the creditors ("Glauebigergefaehrdung") or would lead to delays in the procedure ("Vefahrensverzoegerung").[1165] Furthermore, the actual reason for the insolvency incurred would have an impact on the court's decision as well.[1166]

There is no special statutory rule regarding the DIP in a provisional insolvency proceeding; the general rules are applicable and the appointment of a preliminary office holder is allowed.[1167]

A point of discussion concerns the question of imposing a general administration and transfer ban ("allgemeines Verwaltungs- und Verfuegungsverbot") under section 21 subsection 2 Number 2 InsO. It was argued that this should be possible to prevent a deterioration of the insolvent's estate.[1168] On the other hand, such a ban would be obstructive to self-administration. The giving up the administration of the business makes it unlikely for the court to still agree to self-administration as the necessary re-

[1162] Old section 270 subsection 2 No.3 InsO.
[1163] Old section 270 subsection 2 No. 2 InsO.
[1164] Merten (n 893) 132.
[1165] Zerres (n 1139) 6.
[1166] Ibid
[1167] Merten (n 893) 137.
[1168] Zerres (n 1139) 4.

familiarisation by the debtor would delay the proceedings. The consequence should be to appoint only a "weak" office holder ("schwacher Insolvenzverwalter").[1169]

In case of imminent illiquidity ("drohende Zahlungsunfaehigkeit")[1170] the debtor has the possibility of filing for insolvency and to apply for self-administration at the same time. Under the old regime the court had the possibility of rejecting self-administration and ordering the opening of general insolvency proceedings instead; in other words, the debtor could never be certain that the court would rule in his favour.[1171]

5.2.2. The old Self-Administration Procedure-an example of Germany's Conservatism?

The old self-administration procedure used to be an example of Germany's conservative attitude towards insolvency law. At first glance the introduction of self-administration seemed a good illustration for the adaptation to a changing insolvency environment, leaving the debtor in charge and creating an incentive for earlier filing and fostering restructurings respectively. Looked at again in actual practice, however, the "trimmed" procedure led to a reluctance to filing for self-administration.[1172] Although created on the model of US Chapter 11, there are substantial differences between these two procedures. Viewing the hurdles described above and due to the insertion of several restrictions, McCormack speaks of a "stripped down debtor-in-possession procedure" in comparison to the US counterpart.[1173] Instead of becoming the norm, the restrictions imposed keep self-administration as still only the exception. The possibility for the courts to reject an application and the obstruction potential in the hands of creditors went on to impose uncertainty on the debtor, resulting

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[1169] More see chapter 4.2.4.; 4.3.3.

[1170] Section 18 subsection 2 InsO defines that a debtor is likely to become insolvent, if he presumably will not be able to satisfy the existing duties of payment at the due date („Der Schuldner droht zahlungsunfähig zu werden, wenn er voraussichtlich nicht in der Lage sein wird, die bestehenden Zahlungspflichten im Zeitpunkt der Faelligkeit zu erfüllen.").

[1171] Prominent cases pre ESUG are *Kirch Media, Phillip Holzmann* and *Babcock Borsig AG*; see more details in Schmidt, Uhlenbruck (n 417) 165; Especially the case of Babcock Borsig, which was one of the largest companies in Germany in the last years filing for insolvency, is a positive example of a DIP case. In this case, the company was restructured by "using the DIP in an exemplary manner". Quote of the former prime minister of North Rhine-Westphalia Wolfgang Clement in Steffan. (n 466) 82

[1172] See figure seven

[1173] McCormack, *Control and corporate rescue* (n 1154) 523.

in a reluctance to apply for self-administration. The policy intention to encourage early filing was cancelled out by the inefficiency of regulations actually implemented.

Interestingly enough, the Discussion Draft for the InsO suggested the self-administration procedure should become the norm,[1174] but the final changes resulted only in a half-hearted approach, narrowing it down to exceptional cases as explained above.[1175] The original intention had, of course, been to establish self-administration as the rule. This shows for yet another time how conservative the attitude towards courageous changes really is. In the end, this resulted in rejecting the wider use of the procedure. So the policy aim to encourage early filing and foster company rescue was not in accordance with the outcome, giving another example of a contradiction to the Darwinian Theory. Later the ESUG picked up on the original proposal for the material conditions for the order of self-administration, changed during the legislative history of the InsO, predictable already on the arguments outlined above.

5.3. Germany post ESUG

The fettered approach is reflected in the hesitant attitude to use self-administration in actual practice. Following its introduction by the InsO the debtor- in possession procedure was not used very frequently. In the years 1999 to 2012, 2,708 self-administration applications were approved out of a total of 284.293 proceedings opened, [1176] representing only 1.00 % of all proceedings.

[1174] See original Section 320 subsection 2 no. 3 and explanatory notes p. B 290.

[1175] See chapter 5.2.1.

[1176] Institut für Mittelstandsforschung, www.ifm-bonn.org; Es nimmt daher kein Wunder, dass in den ersten Jahren nach Inkrafttreten der InsO Beschlüsse, mit denen die Eigenverwaltung des Schuldners angeordnet wurden, zu kuriosen Ausnahmeerscheinungen gehört haben. So wurde aus Brandenburg davon berichtet, dass auf die ausdrückliche Frage des Gerichts, ob im Falle der Anordnung der Eigenverwaltung die Rechte der Gläubiger gefährdet seien, der Gutachter es unterlassen habe, hierauf zu antworten. Das Gericht hat dann die Eigenverwaltung angeordnet, was indes zu einem nach gerade tumultuarischen Verfahrensablauf geführt haben soll. Ähnliches ist aus dem Bezirk eines westfälischen Insolvenzgerichts berichtet worden. Im Übrigen war es aber ruhig um das Rechtsinstitut der Eigenverwaltung. Im Jahre 1999 hat das AG Darmstadt einen Beschluss 10 veröffentlicht, mit dem die Anordnung der Eigenverwaltung wegen deren extraordinären Charakters abgelehnt wurde. (Not surprisingly, the DIP led to curious exceptional phenomena in the first years following the entry into force of according InsO decisions. The federal state of Brandenburg reported details about an expert refraining from answering an explicit question by the court pertaining to creditor rights becoming exposed to risks in the case of self-administration. The court consequently ordered the self-administration, which then led to almost tumultuous conditions during the course of the proceedings. Similar circumstances were reported from a district of the Westphalian insolvency court. Apart from that talks concerning the institution of self-administration fell silent. In

Figure seven: Company Insolvencies, Opened Proceedings and Self-Administration in Germany 1999-2012

Year	Filings	Opened regular proceeding	Quote of opened proceedings	Self-administration/ Numbers of SAs orders	SA per 1.000 opened proceedings
1999	26.476	9.564	36,1	204	21,3
2000	28.235	11.673	41,3	132	11,3
2001	32.278	14.646	45,4	240	16,4
2002	37.579	21.513	57,2	253	11,8
2003	39.320	23.060	58,6	184	8,0
2004	39.213	23.897	60,9	173	7,2
2005	36.843	23.247	63,1	147	6,3
2006	34.137	23.293	68,2	159	6,8
2007	29.160	20.491	70,3	147	7,2
2008	29.291	21.359	72,9	160	7,5
2009	32.687	24.315	74,4	157	6,5
2010	31.998	23.531	73,5	214	9,1
2011	30.099	22.393	74,4	192	8,6
2012	30.099	21.311	70,8	346	16,2
1999-2012	457.415	284.293		2.708	

Source: IFM Bonn, www.ifm-bonn.org

The Centre for Small and Medium Sized Business Research ("Institute fuer Mittelstandsforschung") speaks of a curious exception ("kuriose Ausnahmeerscheinung"). The main reasons given for modest use were insufficient knowledge on the part of debtors and creditors about the procedure, lack of familiarity with the IOH and in part the lack of business

1999, the district court of Darmstadt published a decision rejecting the ordering for a self-administration on grounds of its extraordinary character.)

management skills.[1177] An additional reason for the infrequent use was the particular reservation of the courts to approve self-administration giving rise to uncertainty for debtors about a corresponding approval.[1178] This is a reflection of the paradoxical German approach. The policy aspiration for an early filing via more debtor influence was diminished by the constraints of regulations creating the reality of hesitancy to make use of self-administration, which is reflected in the above figures.

The 2012 reforms should remove hurdles, allowing debtors and creditors alike to be involved in selecting the trustee and all parties to be given more planning security to incentivise early filing, enhancing the prospects for successful restructuring.[1179] A major objective of the ESUG was to facilitate restructurings and the de-stigmatisation of insolvency,[1180] the reforms including changes to the existing self-administration procedure in order to strengthen the existing system with the aim of more frequent usage.[1181] The aspiration hence was to create a more rescue-friendly regime; an important indicator as noted above with regard to a debtor-friendly regime is the degree of influence of the debtor in the proceedings.

5.3.1. Self-Administration-the Norm

The preconditions for the court to order self-administration were apparently "modestly"[1182] reduced. The ESUG picked up a suggestion in the Government Draft for the InsO 1999[1183], as self-administration had proven itself in practice and strict requirements set until now could therefore be relaxed slightly.[1184] Whereas pre ESUG self-administration was regarded the exception, it is seen as the rule now and can only be rejected in circumstances which would lead

[1177] Georg Paffenholz und Peter Kranzusch, 'Insolvenzplanvorhaben und Eigenverwaltung insolventer Unternehmen nach den Moeglichkeiten des Insolvenzrechts' (2007), 6; http://www.ifm-bonn.org/uploads/tx_ifmstudies/IfM-Materialien-186.pdf (last visited 19.09.2015)
[1178] Merten (n 893) 130.
[1179] Ibid
[1180] Hoelzle ESUG (n 806)
3) 130.
[1181] Bt. Drs. 17/5712 (n 294)
[1182] Ibid
[1183] Section 331 subsection 2 No.3
[1184] Bt. Drs. 17/5712 (n 294) 38

to disadvantages for creditors by using this procedure.[1185] So unless there are foreseeable disadvantages for the creditors, the court will have to order self-administration provided the debtor made an appropriate application.[1186] In contrast to the old regime, the rejection of an application is now only possible if precise circumstances are known which could result in disadvantages; mere subjective concerns are no longer relevant.[1187] Uncertainties about potential disadvantages for creditors will no more be to the detriment of the debtor.[1188] The law does not differentiate any longer between whether the debtor or a creditor files for insolvency. However, for an efficient DIP regime, a secured perspective for the debtor should be given once he applied for the DIP; in other words it would be necessary that the insolvency proceedings would be opened without any preliminary proceeding and without any further preconditions.[1189] The obstruction potential for a creditor in the case of a creditor filing was abolished which will potentially lead to a more frequent use of self-administration.[1190]

The ESUG abolished the potential risk for the debtor that the court would open insolvency proceedings and dismiss self-administration in the case of filing for insolvency at the stage of imminent illiquidity. If the court dismisses his application for self-administration, the debtor is now given the possibility to withdraw the application for the opening of insolvency proceedings. [1191] This rule does not take effect if the debtor has already reached the stage of illiquidity or over-indebtedness.[1192] The court will have to explain a dismissal especially in the case of approval by the preliminary creditors' committee.[1193]

[1185] Andreas Spahlinger, INSOL World 2012, 10
[1186] Section 270 InsO
[1187] Haas (n 1138) 4.3.1.
[1188] Bt. Drs. 17/5712 (n 294) 38.
[1189] Eidenmueller, EV im System des Restrukturierungsrechts (n 1128) 31.
[1190] Bt.-Drs. 17/5712 (n 294) 40.
[1191] Section 270a Abs.2 InsO
[1192] Ibid
[1193] Section 270 Abs. 4 InsO

5.3.2. Influence of the Creditors' Committee

If a preliminary creditors' committee is appointed it has to be given the opportunity to be heard, unless the appointment does not lead to an obvious change in the financial position of the debtor.[1194] If a preliminary creditors' committee is not installed, the court will decide on its best judgment.[1195] Interestingly, the Discussion Draft broadened the opportunity to be heard to the "main creditors" in case of a lack of a preliminary creditors' committee.[1196] During the reform process this was changed to just a power of influence by the preliminary creditors' committee, if one is installed. This small change has the same effect as the amendment with regard to the influence of the preliminary creditors' committee on the appointment of the IOH, analysed in chapter four.[1197] The policy aim for more creditor participation was undermined with this change, as in the majority of cases the court will decide without the opportunity of the creditors to influence this decision. For the shaping of the self-administration process it would have been advantageous to have left the original wording of the Discussion Draft and leave the main creditors in charge of the decision. The creditors are best placed to decide upon the appropriateness of self-administration, whereas it can be argued that the court normally would be overstrained to estimate whether the there is a notable deterioration in the financial position of the debtor or whether a restructuring seems to be hopeless.[1198]

Section 270 a Abs.1 InsO extends self-administration to preliminary insolvency proceedings. These rules should prevent advantages of self-administration getting lost with the appointment of a preliminary insolvency administrator.[1199]

[1194] Section 270 Abs.3 InsO.
[1195] Willemsen, Rechel (n 1021) 280.
[1196] Discussion Draft (n 502) 10.
[1197] See chapter 4.3.3.
[1198] DAV (n 503) 5.
[1199] BT-Drs. 17/5712 (n 294) 39; Merten (n 893) 137.

5.3.3. Right of Appeal for the Debtor?

It was suggested from various sides that it should be possible for the debtor to appeal the decision of the court. This was later not included in the reform because it was argued that the possibility of reviewing the decision of the court already existed, either by application for self-administration in the first creditors' meeting[1200] or by requesting an annulment.[1201] The creation of a right to appeal would bear the risk of contradictory decisions if a decision of the appellate court were made after the decision of the first creditors' meeting.[1202] It could be argued that a lack of possibility to appeal against the decision of the court allows no control over the decision, which could again be seen as a "half-hearted" attempt to strengthen self-administration as the rejection of self-administration is not reviewable.[1203]

5.3.4. Predictability of Adaptation

Looked at from a Darwinian perspective, the necessity of changes to the old self-administration regulations were predictable. As highlighted above, the Discussion Draft of the InsO originally used the same phrasing as the Government Draft of the ESUG.[1204] This demonstrates that the reforms in 1999 were not far reaching enough to meet the demands of the business environment. The lightweight changes in 1999 inevitably entailed cumulative changes. An adaptation was needed due to the imperfect state of the regulations in view of the needs of the insolvency market, which showed up yet another instance of Germany's conservatism towards reformation of existing insolvency laws. When introducing this new procedure in 1999, the Government missed the opportunity to adapt the regulations to the needs of the insolvency landscape, chipping away again with peripheral changes instead of starting afresh and introducing a "genuine" self-administration procedure.

[1200] Section 271 InsO; BT-Drs. 17/5712 (n 294) 39.
[1201] Section 272 subsection 1 No.1 InsO, BT-Drs. 17/5712 (n 294) 39.
[1202] Ibid
[1203] Gerhard Pape, 'Glaeubiger – und Schuldnerantraege im Regelinsolvenzverfahren' (2011) ZInsO 2154, 2157.
[1204] See original Section 320 subsection 2 no. 3 and explanatory notes p. B 290.

5.3.5. Practical Experience

First surveys with regard to the practical experience of the ESUG documented the respondents thinking self-administration was in general positive for the continuation of the company; the earlier inclusion of the creditors and the influence on the choice of the trustee would be the main factors of success.[1205]

Since the introduction of the new self-administration regime, the number of cases has risen. In 2012, 346 self-administration procedures were ordered by the courts. In no other year since the introduction were there more than 253 orders.[1206] A new study revealed that the proportion of self-administrations under section 270 a InsO has risen slightly in 2012 by 1.5%, the first year under the new regime, and in 2013 by 2.3%.[1207]

The rising use of self-administration reflects that the changes through the ESUG are a positive step in the right direction towards a more frequent use of this rescue-friendly procedure.

However, there is still some room for improvement, especially with regard to creditors' involvement as highlighted above; in most of the cases it is still the court deciding on self-administration.[1208] Furthermore the lack of a right of appeal by the debtor could be seen as improvable. The most striking drawback is that the order for self-administration is still dependent on certain conditions, namely the existence of a ground for insolvency ("Insolvenzgrund") and further preconditions.[1209] The IDW for example suggested allowing self-administration automatically without any discretionary powers of the insolvency court if the debtor presents an insolvency plan within the law including a certification by an independent expert, which testifies that a restructuring would not be

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[1205] Roland Berger, ESUG – Studie 2012 – Erste Praxiserfahrungen mit der neuen Insolvenzordnung (2012) 19, 28 <http://noerr.com/Mailings/Twitter/ESUG-Studie_2012_FINAL.pdf > (last visited 18.09.2015).
[1206] IFM, http://www.ifm-bonn.org/fileadmin/data/redaktion/statistik/gruendungen-und-unternehmensschliessungen/dokumente/Eigenverwaltung_D_1999-2012.pdf, the year 2012 is even not totally representable as the ESUG only came into force on the 01.03.2012.
[1207] Roland Berger, Noerr ESUG-Studie (2014) 13; http://www.noerr.com/~/media/Noerr/PressAndPublications/Brochures/RB_Noerr_ESUG-Studie_2014_final%20pdf.pdf (last visited 10.09.2014).
[1208] See chapter 4.5.2.
[1209] Eidenmueller, EV im System des Restrukturierungsrechts, (n 1128) 37.

obviously hopeless.[1210] This was not adopted by the legislator and is therefore again only going halfway towards an effective DIP regime. The fact that the debtor can withdraw his insolvency application if DIP is not granted is only a scant comfort, bearing in mind the negative publicity along with a loss in value for the company.[1211]

The changes can be seen as a step into the right direction, but the hurdles described above are another instance of German's conservative approach towards spirited reforms. The legislator once again did not use the chance for a fresh start, failing to change the DIP regime in a manner that it is perfectly adapted to encourage insolvent companies to file for self-administration. Furthermore, the changes must be seen in correlation with the introduction of the protective umbrella proceeding,[1212] as it is argued that the changes to the self-administration procedure are a compromise not having introduced a genuine pre-insolvency procedure as discussed in more detail in chapter eight.[1213]

5.4. England

In England, the debtor's participation is wholly dependent on the procedure chosen for the case in question. At first glance, this would seem surprising as English law does not provide for the equivalent of a DIP procedure, at least looked at from substantive provisions.[1214] The following paragraphs examine how debtors are included in the different proceedings. Fletcher summarises "that UK insolvency law has been unable to embrace the "American way" of corporate rescue, with debtor-in- possession as its core principle, but has instead opted for a "rescue" model in which creditors' interests continue to assert a dominant influence."[1215] The American debtor in possession could be

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[1210] IDW, *Stellungnahme zum Diskussionsentwurf fuer ein Gesetz zur weiteren Erleichterung der Sanierung von Unternehmen*,(2010) 11; http://rsw.beck.de/aktuell/gesetzgebung/gesetzgebungsvorhaben-zusaetzliche-materialien/erleichterung-der-unternehmenssanierung-(esug) (last visited 17.09.2015).
[1211] Eidenmueller, EV im System des Restrukturierungsrechts, (n 1128) 36.
[1212] See chapter 8
[1213] See chapter 8.
[1214] See chapter 3.3.
[1215] Ian F Flechter 'UK corporate rescue: recent developments – changes to administrative receivership, administration, and company voluntary arrangement – the Insolvency Act 2000, the white Paper 2001, and the Enterprise Act 2002' (2004) E.B.O.L.R. 120.

seen as the flagship of all DIP proceedings. The debtor does not have to be insolvent to get the benefit of Chapter 11, which is similar to the SoA proceeding. The directors have a fiduciary duty to the company. In the case of a solvent company this duty is owned to the shareholders in the first place, whereas closer to insolvency, creditors' interests become more important.[1216] The debtor has a double function in the proceedings; on the one hand he is debtor, but on the other hand he is a self-managed legal entity with all of the rights and obligations of a trustee.[1217] However, it has to be considered that in practice the existing management is replaced and the control is in the hands of the dominant DIP-financers, in other words the DIP becomes a secured party in possession.[1218] Or in the words of Baird and Rasmussen: "The board may be in the saddle, but the whip is in the creditors' hands".[1219] The protection under the "umbrella" of US Chapter 11 with an automatic stay is already available at an early stage which is the reason why it is, looking at it from a timeline perspective, most comparable with the SoA procedure.[1220]

Keeping the DIP was never seriously discussed in England as a viable option and leaving the responsibility with the persons who allowed the business to become insolvent seemed counterproductive. The Cork Committee made a considered decision not to implement a DIP procedure on the model of US Chapter 11, stating historical, social and structural reasons.[1221] Lord Justice Millet argued specifically about the potential lack of acceptance amongst English creditors.[1222] This might be taken to explain why company managers were held responsible for failures incurred in the UK, as opposed to the US, for example, where normally the economy blamed, thereby accepting the DIP as a natural component of insolvency law.[1223] Whereas the English regime will tend to focus on professional autonomy and discretion, the US, by comparison,

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[1216] Gerard McCormack *Corporate rescue law-an anglo-american perspective*, (Edward Elgar Cheltenham 2008), 80.
[1217] Eidenmueller, EV im System des Restrukturierungsrechts, (n 1128) 19.
[1218] So called SPIP; see Eidenmueller, EV im System des Restrukturierungsrechts, (n 1128) 19.
[1219] Douglas G Baird, Bob Rasmussen, 'Chapter 11 at Twilight' Vanderbilt Law and Economics Research Paper No. 03-18; U Chicago Law & Economics, Olin Working Paper No. 201 http://papers.ssrn.com/sol3/papers.cfm?abstract_id=455960##; Eidenmueller, EV im System des Restrukturierungsrechts, (n 1128) 19.
[1220] See as well chapter 8
[1221] Lord Justice Millett (as he then was), Moss (n 1123) 19.
[1222] Ibid
[1223] Carruthers (n 54) 509.

upholds a high degree of confidence in the existing management.[1224] However the development in the USA of an increased role for creditors in Chapter 11 shows that in a DIP procedure it is not the management, but the main creditors who influence the proceedings.[1225]

5.4.1. Administration

Due to the law not providing a possibility of leaving the debtor in possession in the administration procedure, the management is always replaced by an administrator. Paragraph 59, Schedule B1 of the IA 86 defines the general powers the administrator is entrusted with; he may "do everything necessary or expedient for the management of the affairs, business and property of the company".[1226] In other words, the powers given to the debtor's management by the article of association and the CA 2006 can be exercised only by the consent of the administrator.[1227] The effect is that the directors are more or less completely deprived of their powers, taking on the duty to co-operate with the administrator.[1228]

5.4.2. Company Voluntary Arrangement

In a CVA procedure the existing management is not replaced by an IOH. Management maintaining control over the day-to-day business is one of the essential features of a CVA.[1229] Though not explicitly named a DIP procedure, with the management staying in charge it factually becomes a DIP through the backdoor. As Tribe phrases it "the CVA is, to adopt American corporate

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[1224] Carruthers (n 54) 509.bid

[1225] Whether or not this development is to be seen as positive or negative is discussed controversially, see for example: Elizabeth Warren, Jay Lawrence Westbrook, 'Secured Party in Possession' (2003) 22 American Bankruptcy Institute Journal 12; Baird, Rasmussen (n 1219); Lynne M LoPucki, 'The Nature of the Bankrupt Firm: A Response to Baird and Rasmussen's The End of Bankruptcy' (2003) 56 Stanford Law Review 645; Skeel (n 262)

[1226] General Powers. (1)The administrator of a company may do anything necessary or expedient for the management of the affairs, business and property of the company.
(2)A provision of this Schedule which expressly permits the administrator to do a specified thing is without prejudice to the generality of sub-paragraph (1).
(3)A person who deals with the administrator of a company in good faith and for value need not inquire whether the administrator is acting within his powers.].

[1227] Goode (n 58) 11-87; *Mills v Sports Direct* [2010] 2 BCLC 143

[1228] Ibid; section 235 Insolvency Act 235; John Tribe, 'The Role of Directors in Receivership: Who should bring actions for loss suffered by the company and defend any counterclaim?' (2001) R.A.L.Q 335.

[1229] Weisgard (n 686) 25.

bankruptcy law parlance, a debtor-in- possession type procedure".[1230] With the DIP procedure the management is not displaced, but a nominee will be appointed to act as a mediator and facilitator between the company and its directors, not only serving as advocate for the directors of the company.[1231] In general, the nominee will be a licensed IOH.[1232] The nominee will take on the task to prepare a report[1233] within 28 days of having been given notice. The report has to be prepared with independent objectivity[1234] and a critical eye, evaluating whether the company's proposal was produced in accordance with the rules.[1235] This was reinforced in *Re Greystoke*[1236] where it is stated that the nominee must be satisfied that the position relating to assets and liabilities fully reflects the information given to the creditors and the corresponding proposal has a chance of being implemented without unavoidable manifest unfairness. The nominee has to state his opinion about the moratorium obtained[1237] having a reasonable prospect[1238] of being implemented and the company presumably still holding adequate funds to be able to carry on with the business.[1239]

5.4.3. Schemes of Arrangement

The nature of the SoA procedure implies the management staying in possession, with the procedure being used to find a compromise between debtors and creditors and not representing an official insolvency procedure.[1240] The independent person involved, takes on a more advisory and supervisory function and not the otherwise existing duties of the management as would be the case in an administration procedure. Such an

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[1230] Tribe, Tudor Orthodoxy (n 683) 482; see as well David Milman, 'Strategies for regulating managerial performance in the "twilight zone" – familiar dilemmas: new considerations' (2004) Journal of Business Law, 493, 512; Flechter *UK corporate rescue*: (n 1215) 127

[1231] Weisgard (n 686) 62.

[1232] McCormack, 'Rescuing small businesses: designing an "efficient" legal regime' (2009) J.B.L. 299, 301.

[1233] Section 2 Insolvency Act 1986

[1234] See *Re Colt Telecom Group plc* [2002] EWHC 2815

[1235] *Re A Debtor* (N0 222 of 1990) [1993] BCLC 233; expectation of the judge "considered opinion of the sort which one would expect of a professional accountant and a licensed IP to bear upon the nature of the proposal"

[1236] [1996] BCLC 429

[1237] IA 86, Sch A 1, para 6(2)

[1238] Test applies as in *Re Harris Simons Construction Ltd* [1989] 1 WLR 368, 919880 5 BCC 11; Weisgard (n 686) 57.

[1239] Ibid, Weisgard (n 686) 61.

[1240] See chapter 3.

independent person is called a "scheme supervisor", who will normally be an IOH or an expert with knowledge of the market the debtor operates.[1241]

The SoA procedure is in its nature closest to the Chapter 11 procedure in the US; aiming at restructuring the debtor and available before the actual state of insolvency.[1242] The trend goes towards "ex ante solutions" rather than "ex poste" reactions to financial difficulties.[1243] The SoA procedure can therefore be seen as the restructuring tool of the future as it alleviates the "ex ante-solution".[1244] This view is supported by the trend of foreign companies in financial difficulties using the SoA procedure in England due to its attractiveness and flexibility.[1245]

5.5. Comparison

Considering the analysis above, one could gain the impression that Germany is more debtor-friendly than England due to the possibility of leaving the debtor in possession, especially post ESUG, which introduced the DIP as the rule now and not merely as the exception.[1246]

However, looking a bit further, the English regime has virtually two DIP procedures, the CVA and the SoA. The comparison at this point needs to be exercised with caution as only the CVA and the SoA effectively leave the debtor in charge. The adminstration procedure as one of the main restructuring proceedings replaces the management by a licensed IOH. In Germany, furthermore, self-administration is in general only used in combination with the insolvency plan procedure and not with the general insolvency procedure. The challenge at this point is that it is not possible to compare the situations directly where the debtor stays in charge, especially due to the different nature of the proceedings. The surrounding factors influencing the participation of the debtor can not be filtered out without distorting the overall picture. It can be

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[1241] Pilkington (n 136) 4
[1242] Tribe Companies Act schemes of arrangement (n 750) 390; see chapter 3.3.5.
[1243] Vanessa Finch, 'The Recasting of Insolvency Law' (2005) 68 MLR 713.
[1244] Tribe Companies Act schemes of arrangement (n 750) 390.
[1245] See chapter 3.3.6.
[1246] See chapter 5.3.1.

highlighted, however, that both countries involve the debtor in the proceedings up to a certain extent by using varying mechanisms. The comparison at this point therefore is done in a more abstract way, asking the question whether it is in general advisable to leave the debtor in charge in an insolvency proceeding. The second interesting question in this context is whether the changes made through the ESUG were driven by forum shopping activities. This point of analysis is more satisfactory and makes it worthwhile to compare the DIP regimes in the end.

At first glance, changes in the self-administration procedure do not appear to have been caused by forum shopping activities, as there is no such regime in England. Having said this, there is a way of arguing that the relevant changes were influenced by the English insolvency regime. During the reform discussions there were voices demanding an independent pre-insolvency restructuring procedure similar to the CVA and the SoA.[1247] The ESUG did not follow these suggestions and the German insolvency regime is still lacking an independent pre insolvency restructuring procedure such as the CVA or the SoA in England.[1248] Instead, the ESUG led to the introduction of a protective umbrella proceeding, discussed in depth in chapter eight. It is therefore argued that strenghtening the already existing self-adminstration was a compromise measure trying to encourage early filing without having to introduce a separate independent pre- insolvency restructuring procedure.

In other words, the extended self-administration rights were inspired by forum shopping activities. The overarching aim of the ESUG to encourage early filing to increase the chances of restructuring could be achieved by different means, for example by having a separate pre-insolvency restructuring method such as the CVA, or by a well functioning DIP regime. The prominent forum shopping cases *Schefenacker* and *Deutsche Nickel*[1249] both used CVAs to restructure the company. The German reaction, however, was not to introduce a completely new procedure, but to go down a compromise path in intensifying

[1247] See chapter 8.4.
[1248] The protective umbrella procedure introduced by the ESUG is not a pre insolvency restructuring procedure, but more a pre-pack procedure, it will be discussed in more detail in chapter 8.
[1249] See appendix one

the DIP procedure and modifying the preliminary phase if applied for under section 270b InsO.[1250] The changes with regard to self-administration in Germany were inspired by forum shopping activities, settling for a compromise solution while being unwilling as yet to introduce a self-contained pre-insolvency proceeding.

This naturally only indicates another compromise made during the reform process, giving one more example of a contradiction to the Darwinian theory. As discussed in chapter eight, it is still a flaw in the German insolvency landscape not to offer a pre-insolvency proceeding comparable to the CVA and the SoA procedure.

Strengthening the self-administration procedure could be regarded a race to the bottom, as leaving the debtor in possession would be like "putting the fox in charge of the henhouse"[1251], especially if the financial problems incurred are management- made. It is, however, generally acknowledged that the debtor can have a positive impact on the proceedings, knowing all the challenges the company is confronted with. Furthermore, the possibility of a DIP route will encourage an early filing in order to benefit from this procedure. Therefore leaving the DIP should be seen as a positive concept, a race to the top, especially if a race to the top is defined as a race to rescue. The influence of the debtor in the proceedings is correlated without a doubt with an earlier filing and hence enhances the chances of a restructuring.

5.6. Mini Conclusion

It can be concluded that the strengthening of the self-adminstration system and its more frequently used post-ESUG is a step towards to insolvency law perfection in the sense that there is now a better adapted insolvency landscape than before the introduction of the changes through the ESUG. The modest modifications in making self-administration the norm and removing uncertainties such as the risk of the debtor ending up with a rejected

[1250] Details see chapter 8
[1251] Buchalik, Faktoren EV (n 451) 295.

application as well as eliminating the obstruction potential of creditors represent an overall improvement. By facilitating the DIP regime, the debtor is encouraged to file for insolvency at an earlier stage, which in turn leads to a greater likelihood of a successful restructuring.

However the fact that there is still not an automatic order if the debtor applies for self-adminstration and it is still burdened with preconditions, indicates that the legislator stopped again half –way. A well functioning DIP procedure needs a secured prospect for the debtor that he obtains the benefit of the proceedings if he applies for them. Any insecurities hamper the decision making process. The slightest insecurity, will lead to doubts, necessary discussions and negotiations, which is time consuming and counterproductive at that stage and in the end hampers a timely restructuring.

Furthermore, these positive remarks on the amendments to self-administration must be put into the context surrounding the decision in Germany not to introduce a separate pre- insolvency restructuring procedure. Although the changes in the self-adminstration method can be regarded as producing a more perfect insolvency regime in the Darwinian sense, but seen in combination with the failed attempt to establish a stand-alone pre-insolvency proceedings, it could be considered a further instance of a thwarted approach towards more courageous changes. This desultory effort might in future lead to another necessary adjustment to satisfy the needs of the insolvency arena. The legislative aim to motivate an early filing is partly accomplished by the revised self-administration and the newly introduced protective umbrella procedure, but Germany's cautious conservatism held back a more enterprising approach to introduce a pre-insolvency method to encourage an even earlier filing with the aid of these procedures.[1252]

[1252] See chapter 8

Chapter Six

Independence of the Insolvency Office Holder

"Die Auswahl des Insolvenzverwalters- Eine Schicksalsfrage des Verfahrens"

(The choice of the insolvency office holder- A fateful question of the proceeding")
-Ernst Jaeger[1253]

6.1. Introduction

The purpose of this chapter is to investigate the role of the insolvency office holder (IOH) in Germany and England, looking at the changes through the ESUG. The focal point of discussion is the definition of the IOH's independence as the only change introduced by the ESUG in this context. The situation in Germany pre- and post- ESUG is evaluated and contrasted with the developments in England, analysing whether changes were driven by forum shopping activities and aiming to find out whether the insolvency landscape in Germany has improved in consequence.

The EIR offers a definition for the IOH, referring to "any person or body whose function is to administer or liquidate assets of which the debtor has been divested or to supervise the administration of his affairs."[1254] In England, job titles like liquidator, administrator, trustee and nominee fall within this definition whereas in Germany there is the "Insolvenzverwalter" or "Sachwalter".[1255]

The IOH plays a pivotal role in insolvency proceedings. Choosing a well-qualified IOH is significant and exerts a major influence on the outcome of the proceeding. The choice and appointment of the right candidate must be considered one of the most important questions of insolvency law.[1256] The

[1253] Ernst Jaeger, Friedrich Weber, *Konkursordnung* (eights edition, Walter de Gruyter 1973) 78 Anmerkung 7 Abs.2; Kein Einfluss auf Verwalterauswahl; Ernst Jaeger: „Die Auslese des Verwalters ist die Schicksalsfrage des Konkurses."
[1254] EIR (n 12) Article 2 (b); see as well Universiteit Leiden (n 107)15.
[1255] Ibid
[1256] Pape, Uhlenbruck, Voigt-Salus (n 302) 142.

Cork Report emphasised the importance of the IOH: "If they [those who administer the insolvency system] do not have the confidence and respect, not only of the courts and of creditors and debtors, but also of the general public, then complaints will multiply and, if remedial action is not taken, the system will fall into disrepute and disuse".[1257] The decisions taken by IOHs in the procedures stand to have a significant effect on the final outcome of any insolvency action.[1258]

The profession of IOHs underwent dramatic changes over the last few decades; phrasing it "from undertaker to life-saver"[1259] serves well to describe this development. Liquidating companies will require specific skills not at all comparable to those sought for restructuring a business. Rapidly changing market environments keep the profession in a constant state of flux and development, and IOHs are frequently obliged to act and make decisions under pressure.[1260] The position of an IOH is that of an intermediary, to some extent having to deal with strong organised interests.[1261] A variety of skills comes as a must to qualify: a clear business sense, good legal knowledge and certain specific personal attributes.[1262] The Leiden Report identified several key principles and best practices for IOHs.[1263] Evaluating all of these aspects would go beyond the scope of this research, which will concentrate on subjects relevant to the amendments introduced by the ESUG; in particular the question of the extent to which the IOH needs to be independent from both debtors and creditors.

The author is aware that it could be of considerable interest to also include the role of the insolvency courts in this context, as the role of the court and that of the IOH are in a sense interdependent. Under normal circumstances it could

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[1257] Cork Report (n 57).
[1258] OFT (n 1023), 3.51; decisions of the IOH include: whether to enter an insolvency procedure, which insolvency procedure is appropriate, whether to consider refinancing of the business by a third party lender, whether the procedure will aim to save the company outright, save some element of the company or wind up the company and distribute its assets, how to secure and recover the assets, whether to pursue any possible claims against the directors or any, debtors of the insolvent company, and how to protect and balance the interests of competing creditors. (s OFT (n 1023), 3.50).
[1259] Vallender Insolvenzkultur (n 5).
[1260] Uhlenbruck, 'Das Bild des Insolvenzverwalters (n 746) 2.
[1261] Horst Papke, 'Das Bild des Vergleichsverwalters' in Pourgin E, v. Wysocki K (eds) Wirtschaftspruefer im Dienst der Wirtschaft – Festschrift fuer Ernst Knorr Duesseldorf 1968)) 1.
[1262] Uhlenbruck, Das Bild des Insolvenzverwalters (n 746) 2.
[1263] Leiden (n 107).

be said that the more strongly the court exercises its role, the fewer powers are left for the IOH. The author will make this a matter of future research.

6.2. Germany pre-ESUG

Due to the nature of the German insolvency system, i.e. the single gateway insolvency procedure, the role of the IOH is not defined with the filing for insolvency. The IOH must pursue the overarching purpose of collective satisfaction of the creditors which might be achieved by way of liquidation or restructuring in various forms. In cases where self-administration is arranged, the IOH takes on the role of a supervisor ("Sachwalter"). The same requirements will apply to the IOH and the preliminary IOH.[1264]

The function of the IOH underwent several changes over the last decades; the early 20th century still saw the typical IOH being a general business lawyer with only around half of his time taken up by with insolvency administrations until a separate profession of IOHs developed by about 1985.[1265] Since the introduction of the InsO in 1999, the job profile of the IOH has been redefined and competition intensified.[1266] Significantly deeper business knowledge became necessary; as the new role of the IOH went on to include the continuation of companies' businesses for the purpose of restructuring and the preparation of insolvency plans.[1267] There are currently approximately 1750 IOHs registered in Germany, of whom 14% are female.[1268]

For the purpose of this research, the role of the IOH "pre-ESUG" is defined as post- InsO 1999, entering discussion on IOHs as regulated between 1999 and 2012. Where necessary for the analysis concerning the history and development of the role of the IOH, reference will be made to previous legislation.

[1264] See chapter 2.3.
[1265] Hans Haarmeyer, Wolfgang Wutzke, Karsten Foerster *Vergutung im Insolvenzverfahren (VegVO)* 1997, Einfuehrung recital 73.
[1266] Stappner (n 879) 259.
[1267] Ibid, 260
[1268] http://www.dettmer-rechtsanwaelte.de/fileadmin/freigaben/Downloads/Pressespiegel/INDat-Report_8-06.pdf

6.2.1. Appointment

The appointment of the IOH has already been evaluated in chapter four in connection with the new power given the creditors' committee and the reader is therefore referred back to chapter four.[1269]

6.2.2. Independence

The independence of the IOH is a basic prerequisite and an absolute necessity for the functioning of any insolvency procedure. Any sort of dependency would automatically endanger orderly conduct of insolvency proceedings. It is argued that absolute independence of the IOH is the guarantee for all parties that the insolvency proceedings are executed in a fair manner and that all parties are satisfied optimally.[1270]

Section 56 InsO, pre-ESUG provided that the IOH has to be fully independent of debtors and creditors alike. Independence should guarantee that the IOH is able to safeguard the interests of all creditors; he must not obtain any advantage out of his function.[1271] The concern about a potential dependency is sufficient to disqualify the IOH regardless whether advantages emerge for the IOH in person or for any other party involved in the insolvency proceedings. To guarantee the functioning of insolvency proceedings, the term "concern" needs to be interpreted extensively, and any present or past economic or factual interrelation between IOH and debtor or creditors being sufficient.[1272] In case of even a mere suspicion of any possible linkage, the courts are

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[1269] See chapter 4.3.3.

[1270] Christian Ahrendt, Deutscher Bundestag, 'Protokoll zur 136. Sitzung' (Berlin 27.October 2011) <http://dip21.bundestag.de/dip21/btp/17/17136.pdf> (last visited 19.09.2015).

[1271] Thorsten Graeber in 'Muenchener Kommentar zur Insolvenzordnung' (Vol 2, third edition Munich 2013) 56, recital.25; http://www.vid.de/de/qualitaet/fragebogen-unabhaengigkeit.html:
Mit der Beantwortung der nunmehr insgesamt 11 Fragen wird es sowohl den Mitgliedern des vorläufigen Gläubigerausschusses, als auch den mit der Bestellung des Verwalters befassten Insolvenzgerichten möglich sein, sich ein Bild über die Unabhängigkeit des Verwalters zu verschaffen. Allerdings ist es zwingend erforderlich, dass die Entscheidungsträger auf Seiten des vorläufigen Gläubigerausschusses und des Insolvenzgerichts die Beantwortung der 11 Fragen auch richtig zu werten wissen. Nicht jeder Berührungspunkt zu einem am Insolvenzverfahren Beteiligten darf ohne weiteres als Anhaltspunkt für die fehlende Unabhängigkeit gewertet werden. Hier ist ein kritischer aber auch sachbezogener Umgang mit dem Fragebogen und seinen Antworten gefragt. (Replies to now in total 11 questions enable both, members of the preliminary creditor's committee and insolvency courts concerned with appointing the administrator, to obtain a comprehensive view on the independence of candidates. It is however imperative that all key decision-makers properly classify the replies to all 11 questions. Not all connections with a participant in the insolvency proceedings can necessarily be interpreted as an indication for a lack of independence. This requires a critical and relevant handling of the questionnaire and answers thereto.)

[1272] Ibid

officially bound to undertake an active investigation.[1273] The IOH is obliged to reveal and report on his own initiative any possible facts about him being or having been connected with any party involved in the case, which could justify concern about his ability to fulfil all his duties without bias.[1274]

Section 56 InsO remains slightly vague in regard to this matter. An analogy could possibly be drawn with the definitions of independence for insolvency judges.[1275] The Federal Supreme Court decided that these sections should not be applicable for IOHs.[1276] The regulations are designed on an understanding of judicial office ("richterliches Amtsverstaendnis") which cannot be transferred to a self-employed person.[1277] The decisions should therefore be made on a case by case basis as situations vary and a rigid listing of pre-conditions ("Tatbestandsvoraussetzungen") is not possible.[1278]

6.2.2.1. Preparation of an Insolvency Plan

A controversial point already discussed before the changes through the ESUG was whether an IOH would still be regarded as independent if he prepared the insolvency plan before the actual filing for insolvency. There is an argument for using the extensive knowledge gained by the insolvency plan originator by making him the IOH.[1279] A mere preparation of the plan could be regarded a neutral act, as the opposing interests have to be assessed already at this stage.[1280]

Arguably, doubts could be raised about the independence of the person chosen by the debtor to prepare the insolvency plan. The preparation of an insolvency plan implies the conclusion of a contract between the debtor and

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[1273] Ibid
[1274] BGH Urteil vom 24.01.1991, IX ZR 250/89; the Association of Insolvency Practitioners in Germany ("Vereinigung Insolvenzverwalter Deutschlands" short "VID") developed a questionnaire for IOHs to sign prior an appointment.
[1275] Sections 41, 42 of the German Code of Civil Procedure ("Zivilprozessordnung, ZPO").
[1276] Dated 24.01.1991; Case explanations. Thorsten Graeber, 'Die Unabhaengigkeit des Insolvenzverwalters gegenueber Glaeubigern und Schuldnern' (2002) NZI 345.
[1277] Hanns Pruetting, 'Die Unabhaengigkeit des Insolvenzverwalters' (2002) ZIOH 1969.
[1278] Ibid
[1279] Graeber Mueko (n 1271) section 56 Rn 28 another controversial discussed issue in this context is the so called Poolverwaltung, this does not exist in England and is not analysed in the context of independence, as there is nothing to compare, but it will be of interest for further research.
[1280] Pruetting, (n 1277) 1972.

the potential IOH, the latter being entitled to a fee and in consequence having a vested interest in the insolvency proceedings.[1281] He could be inclined to act as stakeholder more for the debtor and possibly less so for the creditors, this in itself creating a conflict of interest.[1282] The potential conflict could be seen in the risk that he would have to verify whether his own fees could be challenged in a later proceeding or whether the debtor was already unable to pay its debts at the time of the assignment for consultation. There is furthermore the risk that consulting errors may remain undetected, which in turn could jeopardise inherent restructuring possibilities.[1283]

Another point to bear in mind in this connection is that section 45 subsection 2, number 2 of the Lawyers Professional Standards ("Bundesrechtsanwaltsordnung, BRAO") applies in case of the IOH being a general lawyer by profession. This section stipulates that lawyers are not permitted to take on the position of IOH in a case where they had previously been assigned to represent an opposing party[1284]. According to the established case law of the German Federal Constitutional Court ("Bundesverfassungsgericht")[1285] the profession of an IOH is an autonomous, not being a dependent derivative part of the general profession of a lawyer.[1286] The preparation of an insolvency plan with a view towards getting appointed as IOH must therefore be seen under the restrictions outlined in section 45 BRAO.[1287] Taking these as a standard could be criticised as not all IOH's are subject to the BRAO, although the majority are.

[1281] Pruetting, (n 1277) 1972.
[1282] Gerd Weiland, 'Stellungnahme zum Gesetz zur weiteren Erleichterung der Sanierung von Unternehmen' (2011) 4 Stellungnahme BR 121/11;Law Commission 127/1/11 (n 507) http://rsw.beck.de/aktuell/gesetzgebung/gesetzgebungsvorhaben-zusaetzliche-materialien/erleichterung-der-unternehmenssanierung-(esug) (last visited 17.09.2015).
[1283] BR Ausschuss BT-Drs. 121/11 (n 507).
[1284] (1) Der Rechtsanwalt darf nicht tätig werden: 3. wenn er gegen den Träger des von ihm verwalteten Vermögens vorgehen soll in Angelegenheiten, mit denen er als Insolvenzverwalter, Nachlaßverwalter, Testamentsvollstrecker, Betreuer oder in ähnlicher Funktion bereits befaßt war; (2) Dem Rechtsanwalt ist es untersagt: 1. in Angelegenheiten, mit denen er bereits als Rechtsanwalt gegen den Träger des zu verwaltenden Vermögens befaßt war, als Insolvenzverwalter, Nachlaßverwalter, Testamentsvollstrecker, Betreuer oder in ähnlicher Funktion tätig zu werden. ((1) The lawyer must refrain from acting: 3. if asked to act against the owner of assets managed by him in matters he already dealt with in the function of insolvency practitioner, administrator of estate or testament, supervisor or similar; (2) The lawyer is forbidden: 1. to act as insolvency practitioner, administrator of estate or testament, supervisor or similar, if he has already been involved in acting against the owner of assets to be managed.).
[1285] See eg 1BvR 135/00 and 1 BvR 1086/01
[1286] Verein Insolvenzverwalter Deutschland (VID) *Stellungnahme zum Gesetz zur weiteren Erleichterung der Sanierung von Unternehmen* (2011) 7, http://rsw.beck.de/aktuell/gesetzgebung/gesetzgebungsvorhaben-zusaetzliche-materialien/erleichterung-der-unternehmenssanierung-(esug) (last visited 17.09.2015).
[1287] Ibid 7.

Could the reluctance to use the knowledge of the insolvency plan originator be another example of Germany's conservatism? As highlighted at various instances, successful restructurings do not allow for delays, and a time-efficient handling is one of the key elements of success. Allowing the person having prepared the plan to also carry it through with all diligence at hand could help in preserving the value of the company. A quick and efficient restructuring requires a detailed knowledge of the company and the originator of the insolvency plan would in fact be well prepared for the job.

This issue would seem more to be one of sufficient professionalism and competence in handling without bias. How much worth is it to forego this advantage for the mere possibility of bias instead of putting more trust in the IOHs in Germany? Could it not be possible to install other safeguards outweighing doubts about leaving the originator to continue dealing with the plan by making use of the advantage to be drawn from his know-how? The categorical exclusion so far would seem to be another example of a possibly exaggerated vigilance. The insolvency landscape continues to demand efficient and state-of-the-art conditions in order to be able to accomplish a successful restructuring. Needless to say independence is a central value to be maintained, but the automatic exclusion of the originator might be too cautious, suggesting a more flexible approach by putting other safeguards in place.

6.2.2.2. Extrajudicial Advice

It is questionable whether the status of independence should be lost merely because of the IOH having provided extrajudicial advice. One could argue that this should rest on the form of advice given. Advice by way of an informal restructuring attempt will most likely exclude the candidate from still being independent. Under the regulations before the introduction of the InsO in 1999 the ethical code in place prevented a former consultant being appointed as IOH, whereas the new focus on restructuring instead of liquidation demands a

reorientation.[1288] The consultant could become regarded as especially suitable for restructurings, with the main aim of making the debtor profitable again at the earliest possible date. With the know-how gained such a restructuring would in all likelihood be more successful compared to the attempt by an external IOH. The time necessary for an external IOH to get familiar with the debtor's situation could on its own be a deciding factor with regard to success or failure of the rescue undertaken.[1289] The preoccupation with the debtor could well be judged problematic for an out-of-court restructuring attempt as the consultant would already have represented the interests of the debtor. From the viewpoint of other parties involved this could create the impression that the necessary independence cannot be expected.[1290] Furthermore, the observations made with regard to section 45 subsection 2 number 2 BRAO would also apply for informal restructuring attempts.[1291]

The above arguments with regard to the originator of the insolvency plan could be applied for extra-judicial advice as well. In practice, it remains unlikely that a consultant having given pre-insolvency advice would really be appointed as IOH. Again, there should be further consideration as to whether the current state of things might be too conservative and worth replacing by a more flexible approach in order to still benefit from the knowledge of the consultant.

6.3. Germany post ESUG

6.3.1. Appointment

The IOH is appointed by the insolvency court. The ESUG, however, changed the influence of creditors in the appointment of the IOH, which was a matter of discussion back in chapter four.[1292]

[1288] Norbert Hill, 'Die Unabhaengigkeit des Insolvenzverwalters' (2005) ZInsO, 1289, 1293.
[1289] Ibid
[1290] Ibid, 1294.
[1291] VID (n 1286) 7.
[1292] See chapter 4 role of creditors 4.3.3.

6.3.2. Independence

The ESUG did not challenge the fact that the independence of the IOH would still be an indispensable principle in the future. In its recommendation the Law Committee highlighted that the new participatory rights for specific cases should not lead to an IOH being appointed without the essential independence, as otherwise not only the function of the IOH, but also the general confidence and trust in the appropriate implementation of insolvency proceedings would be shattered.[1293] This principle should not only apply for the IOH, but also for the office of a trustee ("Sachwalter").[1294]

The definition of "independence" of the IOH was one of the most controversial topics discussed during the reform process. Whereas pre- ESUG section 56 InsO did not contain any further clarification with regard to the term independence, the reformed section 56 InsO now defines factors by which the general independence of the IOH is not put in doubt.

6.3.2.1. Proposal by Debtor or Creditor

It is now made clear that independence should not automatically be excluded on the basis of a candidate being proposed by either the debtor or a creditor.[1295] There was no discussion about the revision and it was agreed that this clarification helped to underline that the fact of a debtor or creditor proposing the IOH would not on its own imply bias.[1296] The Government argued that clarification was necessary as courts sporadically rejected a candidate just on this ground.[1297] It was furthermore left to the court to reject the appointment for reasons doubts about the independence.[1298] The Association of Insolvency Practitioners in Germany ("Vereinigung

[1293] Bt-Drs. 17/5712 (n 294) 26.
[1294] Section 276 a InsO.
[1295] Section 56 subsection 1 sentence 3 No.1 InsO; Original section 56 a No.1 InsO, the legislator decided to introduce a separate section for the independent and separated section 56 from 56 a E-InsO, 56 a InsO dealing with the appointment of the IOH.
[1296] Bt-Drs. 17/5712 (n 294) Weiland (n 1282) 4.
[1297] Bt-Drs. 17/5712 (n 294) 26.
[1298] Weiland (n 1282) 4.

Insolvenzverwalter Deutschlands" for short "VID") included exactly the same wording already back in 2006 in their professional ethics.[1299]

The original wording of a further clarification with regard to independence stated that "independence is not automatically excluded if a person was operating for the debtor, without having influenced the management".[1300] This first version was criticised as being too vague and unspecific. Each consultative function would lead to an influence on the management. The normal consultancy work pre-insolvency includes automatic help with an out-of-court settlement, which always goes along with a corresponding management function. For that reason the wording was taken as impractical and counter-productive.[1301] The Discussion Draft was therefore changed making the provision to insert a new No.2 and No.3 into section 56 InsO, to be dealt with in the following.

6.3.2.2. Advice of Generic Nature

The amended section 56 subsection 1 clause 3 number 2 InsO[1302] was written to clarify that independence should not generally be excluded for a candidate having advised the debtor about the process of an insolvency proceeding and its implications in general terms before the filing.[1303] The reason for this clarification was to give local IOHs the guarantee of not being disqualified just because they had provided a debtor with general information about the process of insolvency proceedings as such, along with restructuring possibilities or implications for the debtor's capacity, before an actual filing for insolvency was decided on.[1304] This revised version raised concern in the Federal Council commission, resulting in a demand for the removal of this subsection. The commission argued that it would be very difficult for the court to determine whether the proposed IOH had just advised the debtor generically or whether the consultation went beyond this and could have left an impact on

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[1299] Berufsgrundsaetze para 4 III a); http://www.vid.de/de/qualitaet/berufsgrundsaetze.html (last visited 15.09.2015).
[1300] Discussion Draft (n 502) 1 5. A) 2.
[1301] BAK (n 504) 19, 20.
[1302] Discussion Draft (n 502) section 56 a No. 2 Inso, see fn 87.
[1303] Section 56 subsection 1 sentence 3 No.2 InsO.
[1304] BT-Drs. 17/5712 (n 294) changes to section 56; recommendation of Rechtsausschuss (the Law Committee) 127/1/11 and the Statement of the Federal Council ("Bundesrat") 121/11; Weiland (n 1282) 4.

his independence.[1305] Using such a vague legal concept was seen as impracticable.[1306] The German Association of Insolvency Judges ("Bundesarbeitskreis Insolvenzgerichte, BAK") shared the view held by the Federal Council that the interpretation of the term "generic advice" would lead to disputes in practice.[1307] It was thought moreover that this regulation would largely privilege leading firms of IOHs. The position as IOH is of personal nature and the case of a debtor receiving advice under subsection 2 from an associate would not exclude a so far uninvolved partner being appointed as IOH.[1308] The BAK therefore postulated a regulation similar to section 45 sub section BRAO:[1309] to reject an appointment if another partner or employee[1310] had previously worked with the debtor in an advisory position.[1311]

Does the amendment defining "independence" now represent just another case of Germany's conservative approach towards reforming insolvency law? With the reform, the legislator stood every chance to start afresh and eliminate the existing defects in defining "independence". What came about, however, was a mere clarification. Giving advice of a generic nature was not excluded pre-ESUG as the definition of "independence" was looked at from a broader point of view. It is still left to the courts to verify whether the advice given was only of a generic nature or more specific indeed, exactly as they were obliged pre-ESUG. There can at least be no argument that this change was an illustration of the Darwinian Theory as the outcome brought only a simple clarification.

6.3.2.3. Preparation of an Insolvency Plan/ Extrajudicial Advice

Section 56 No.3 InsO included another modification that independence was not to generally be excluded if the candidate had prepared an insolvency plan under mutual agreement between debtor and his creditors.[1312] The advantage

[1305] Empfehlung Ausschuss BT Drs. (n 507) 127/1/11; see as well Weiland (n 1282) 4.
[1306] Weiland (n 1282) 4.
[1307] BAK (n 504) 3. Art 1 para 56 InsO.
[1308] Ibid; Deutscher Richterbund (n 925) 5; Oliver Sporre, Protokoll zur 55. Sitzung, 32; http://dip21.bundestag.de/dip21/btp/17/17055.pdf
[1309] Berufsordnung der Rechtsanwaelte; http://www.brak.de/fuer-anwaelte/berufsrecht/ (last visited 15.09.2015).
[1310] S. section 45 subsection 1 and 2 BRAO.
[1311] BAK (n 504) 3, Art 1 para 56 InsO.
[1312] Bt. Drs. 17/5712 (n 294) 26.

in appointing the insolvency plan originator as IOH relates back to the extensive knowledge he built up about the debtor in those particular cases. Where the court is familiar with the IOH, his professional business methods and personal integrity, an appointment should at least be considered.[1313]

6.3.2.4. Concerns during the Legislative Process

Both, section 56 subsection 1 clause 3 number 2 and 3 InsO raised the following concerns during the legislative process:

Advice of generic nature in the sense of number 2 and the preparation of an insolvency plan under number 3 imply that the debtor had a contract with the potential IOH, being entitled to a fee and therefore had a vested interest in the insolvency proceedings.[1314] Having acted as stakeholder for the debtor and at the same time not for the creditors, would indicate a definite conflict of interest.[1315] Every consultative activity in the run up to an insolvency filing would have an influence on the management of the debtor;[1316] very probably so in the case of number 3, where an insolvency plan was prepared. The conflict was to be seen in the risk of the potential IOH having to verify whether his own fees could be challenged in a later proceeding or whether the company was already unable to pay its debt at the time of the assignment for consultation. Clearly, independence should be regarded a fundamental pillar of the InsO; trusting in the integrity of the IOH comes as a prerequisite for a successful restructuring.[1317] Niering compares the preparation of an insolvency plan with the preparation for a tailor-made suit. Similarly to a tailor knowing exactly any weak point of a customer the originator of an insolvency plan designs it for the debtor; the tailor-made "suit" should exclusively fit the debtor and not the creditors.[1318] Lischka, Member of the German Parliament speaks of breaking a taboo, as the prior occupation of the IOH cannot guarantee the necessary independence, comparing this situation with

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[1313] Bt. Drs. 17/5712 (n 294) 26.
[1314] BR-Drs 127/1/11 (n 507) Zu Artikel 1 Nummer 8 Buchstabe a (§ 56 Absatz 1Satz 3 Nummer 2, 3InsO)
[1315] Weiland (n 1282) 4, Stellungnahme BR 121/11 (n 507); Hilgers, Protokoll der 55.Sitzung (n 1457) 10, Nierig Protokoll der 55.Sitzung (n 1457) 17.
[1316] BAK (n 504) 13.
[1317] Niering, 'Protokoll der 55. Sitzung (n 1457) 17.
[1318] Niering, Protokoll der 55. Sitzung (n 1457) 17.

employing the wolf to guard a flock of sheep. [1319] There would be no credible explanation the IOH could give about any infringement uncovered, potentially having been part of them.[1320] There could furthermore be the risk that the IOH having acted as consultant to the debtor before his appointment failed to recognise possible consulting errors, which in turn would jeopardise all restructuring possibilities.[1321] In contrast, an IOH not having been engaged previously, could be better qualified to verify and possibly discard or modify a draft plan. This kind of flexibility could also serve to enhance the chances of restructuring.[1322]

Hirte, on the other hand, argues that the purpose of the enforcement of rights in an insolvency proceeding must lie in the protection of the interests of the creditors as a whole. Regulations about independence at any cost would not be of such interest. The question of independence should be put into the hands of the parties concerned, meaning the creditors.[1323] From the standpoint of the law, a generic control of abuse would be sufficient, for example in the form of allowing "not too intensive prior involvement" (nicht zu intensive Vorbefassung").[1324]

It should be borne in mind that independence is required for a purpose, and this being the realisation of the creditors' interests. If the creditors think that the cake will be bigger, then this is more important than to know afterwards if the cake would have be in fact a bit smaller or bigger.[1325]

Number 2 was finally adopted, whereas number 3 was cancelled during the legislative procedure.

[1319] Member of the SPD (Social Democrats); see as well Erif Eralp 'email response of 'Die Linke' party on request of the author (07.April 2014).
[1320] Burkhard Lischka, Deutscher Bundestag, 136. Sitzung (n 1270).
[1321] BT-Drs.121/11 (n 507).
[1322] Weiland (n 1282) 5.
[1323] Hirte, Stellungnahme (n 939) 8.
[1324] Hirte und Rendels, INDat-Report Heft 3/2011, 64, 65.
[1325] Hirte, Protokoll zur 55. Sitzung (n 1457) 14.

Number 3 was deleted so as to eliminate even the *slightest appearance*[1326] of a partiality of the IOH.[1327] The original intention behind the inclusion of this subsection was that it was thought to lead to greater predictability. However, this could as well be realised without this subsection, as the parties were in a position to nominate the plan originator in accordance with section 56a InsO. The cancellation of number 3 would not automatically imply that the party having prepared the insolvency plan was to always be excluded from the appointment as IOH, leaving it to the court to judge on the independence from case to case depending on the facts available.[1328]

6.3.2.5. Removal of Number 3 – Darwin contradicted

The removal of Number 3 could be regarded a further contradiction with Darwin's Theory. With the ESUG reforms, the legislator had many possibilities at hand for introducing changes for improving the insolvency landscape in Germany and making it more competitive in the same go. As highlighted above, effective time management comes as a major key to a successful restructuring.[1329] A party familiar with the debtor's situation is much more likely to conduct his work efficiently in this respect. The picture of a tailor-made suit which Niering uses[1330] is correct, but could equally be taken for an argument to nominate the originator, as this describes exactly why he should be considered the best qualified person to assess the restructuring possibilities and speed up the implementation of the plan. The aversion to making use of such prior knowledge for the benefit of a successful restructuring is to be seen as an additional case of Germany's conservatism. As the tailor knows the exact measurements of his client, the originator knows the key data of the debtor. Removing number 3 could again be taken as a missed opportunity to change the insolvency landscape for the better. The advantages stemming from allowing the originator of the plan to act as IOH would certainly outweigh the potential threat of him not being fully independent. The wording of no. 3 was quite conservative already in just emphasising that the originator should

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[1326] Highlighted by the author
[1327] Beschlussempfehlung Rechtsauschuss, BT-Drs. 17/7511 (n 508) 47.
[1328] Graeber Mueko (n 1276) para 56 Rn. 30.
[1329] See introduction 0.5.5.
[1330] See footnote 1313.

not be excluded right from the outset, and not to be interpreted as meaning that there were no cases where bias could have been assumed.[1331] Given normal circumstances, the originator of an insolvency plan will be a competent professional person, in general doing his work by adhering to all the standards set for his profession. His exclusion on grounds of bias would certainly be more the exception than the rule. It would be a genuine rarity, the IOHs in Germany are most respectable, and a wholesale mistrust would simply be unjustified.[1332] Paulus suggests stricter control mechanisms and sanctions for an IOH with prior involvement. The mere fact of a contract between the debtor and the potential IOH would not automatically lead to the latter's bias and even the appearance of possible partiality should not prevent losing sight of the main aim to achieve the optimal realisation of the creditors' interests ("Verwirklichung der Glaeubigerinteressen").[1333]

The justification for deleting no. 3 so as to eliminate even the appearance of partiality on the part of the IOH exactly reflects Germany's exaggerated cautiousness; the mere possibility becoming the norm at the expense of all the advantages a permission to appoint the originator of a plan as IOH would offer, especially bearing in mind that partiality is the exception rather than the norm. IOHs with prior involvement should be allowed to prepare the plan and be supervised more rigidly by certain control and sanction mechanisms. Even if there were an appearance of bias, it could be argued that the approach was too formal ("formal juristisch") and therefore not really representing the interests in question. It is all about substantive collision of interests ("materielle Interessenskollision") and bearing in mind the main aim is the realisation of the creditors' interests, it should be left for the creditors to decide about this matter; regulation about independence at any price would not at all help with this main objective.[1334] In other words, the legislator would seem to regard independence as an end in itself, looking at it from a formal perspective,

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[1331] See on this point: Elisabeth Winckelmeier-Becker, 'letter to the ("parlamentarischer Staatssekretaer") (n 974); Stadler, 'response to the letter from Winckelmeier-Becker' (n 974) 11.
[1332] Christopher Paulus, *Insolvenzverwalter und Glaeubigerorgane* (2008) NZI 705,707.
[1333] Ibid
[1334] Hirte, Stellungnahme (n 939) 8.

instead of giving more consideration to the interests of the parties involved in the effort for an optimal outcome.

Even though the Federal Council stressed the point that the deletion would not necessarily imply that the originator would be categorically excluded from the appointment as IOH, the reality will most likely be that a court is reluctant to do so. Had the original wording remained, it would still have meant that the courts would have had to make the final decision on independence individually case by case.

6.3.2.6. Influence of Creditors on the Appointment

It is further argued that the binding nature of the decision of the creditors' committee discussed earlier[1335] with regard to the appointment of the IOH, could seriously impair his independence.[1336] It would be a sort of cronyism with the IOH at the mercy of the main creditors, automatically losing his autonomy.[1337] On the other hand, the creditors' committee being set up to form a representative body which has to agree unanimously could well offer a chance to find the best suitable IOH in conjunction with the creditors.[1338]

There might, of course, be the appearance of bias, but it should be borne in mind that independence is required for a purpose, and this is the realisation of the creditors' interests. [1339] The arguments above with regard to the originator of the insolvency plan could be used correspondingly and in combination with that point. The independence is not an end in itself. Yet again it has to be highlighted that the profession of IOH is highly regarded; IOHs are aware of the need to act and autonomously in the proceedings. The IOH merely being a stooge of the main creditors is quite unlikely as he would not be able to build up a respectable reputation.

[1335] See chapter 4.3.3.
[1336] VID (n 1286) 9.
[1337] Lischka, Deutscher Bundestag 136. Sitzung (n 1270).
[1338] Winkelmeier-Becker 136. Sitzung (n 1270)
[1339] See point below 6.5.2.

6.4. England

There are appoximately 1800 licensed IOHs in England[1340], 79 per cent male, with the interesting trend of more women now entering the insolvency industry; already half of the IOHs under the age of 35 are female.[1341] An IOH can take on a variety of different roles in relation to corporate insolvencies: acting as liquidator, administrative receiver, administrator or as a nominee or supervisor of the debtor in case of a CVA.[1342]

With the focus on liquidation before the Cork era, the IOH was mainly occupied in selling the assets of the company to be distributed to the creditors after the deduction of costs incurred.[1343] The ensuing developments changed the first aim to the rescue of insolvent companies,[1344] with the focus shifting towards advising the debtor by collecting evidence and data, making business judgments so as to be able to implement rescue strategies, managing the business as a going concern, co-ordinating negotiations and protecting rights.[1345]

For the purpose of this research, the current role of IOHs is used as a point of reference, prior changes being taken into account where necessary.

6.4.1. Appointment

The appointment of the IOH will be dependent on the process chosen for any individual insolvency. In a case of administration, the IOH is either appointed by the court or possibly out-of-court on the initiative of a qualified floating charge holder or by the debtor with written consent of all secured creditors.[1346] For a CVA procedure, the nominee or supervisor is appointed by the court, not having to be a qualified IOH, but requiring a membership in a RPB. The SoA,

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[1340] See OFT (n 1023) 1.32.
[1341] R 3, 'A study in the economic significance of the insolvency recovery and turnaround profession - Value of the Insolvency industry'
<http://www.r3.org.uk/media/documents/publications/professional/The_value_of_the_insolvency_industry_->
[1342] Only for post EA 2002.
[1343] Vanessa Finch, 'Insolvency Practitioners: The avenue of accountability (2012) J.B.L. 645, 645.
[1344] Changed role after introduction of the IA 86 and again after EA 2002 due to changed role of administrator.
[1345] Finch Insolvency Practitioners (n 1343) 645.
[1346] Section 22, 35 IA 1986.

strictly speaking not an insolvency procedure,[1347] has no requirement for the appointment of an IOH, even though the restructuring plan will normally be prepared with the help of an external professional, most probably an IOH. In actual practice the appointment is mainly influenced by the secured creditors as they are able to formally veto the directors' choice of the IOH.[1348] This factual influence of secured creditors is helping non-panel IOH firms to secure appointments for large insolvencies.[1349] The IOH landscape surrounding larger insolvencies is mainly dominated by the "Big Four" accountancy firms[1350] or panel IOH firms as they are also called.[1351]

6.4.2. Independence

"Independence" is not used as a legal term in connection with IOHs in England. The word "independence" in this context is mentioned only once in the Insolvency Licensing regulations and guidance notes of the Institute of Chartered Accountants in England and Wales (ICAEW)[1352], which postulates the "professional integrity and independence of IOHs."[1353] In the Code of Ethics,[1354] the main noteworthy characteristics are integrity, objectivity, professional competence and due care, confidentiality and professional behaviour.[1355] The idea of "objectivity" comes nearest to the principle of "independence", being defined as that "An Insolvency Practitioner should not allow bias, conflict of interest or undue influence of others to override professional or business judgements."[1356] In this context, the term

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[1347] See chapter 3.3.5.
[1348] OFT (n 1023) Chapter 4, 4.5.
[1349] Ibid, para 4.13, 4.14.
[1350] Namely Ernest&Young, KPMG, Deloitte& Touche, PwC
[1351] OFT (n 1023) 4.13, 4.14.
[1352] a Recognised Professional Body under section 391 of the Insolvency Act 1986.
[1353] See Rules 3.5 and 3.6 Insolvency Licensing regulations and guidance notes, ICAEW, 2012; 3.5: "A licence holder must at all times conduct insolvency work with integrity and objectivity."; 3.6.: "A licence holder must take steps to prevent individuals who are not insolvency practitioners from being able to exert undue influence over the acceptance of an appointment or the way in which an appointment is conducted."
[1354] ICAEW, Code of Ethics for Insolvency Practitioners, 2009.
[1355] Ibid, Part I, 4.
[1356] ICAEW, Code of Ethics (n 1354) Part I, 4.b).

"independence" seems to be used interchangeably with "objectivity".[1357] The discussion in each country is similar, but following a different legal concept.[1358]

Lord Hoffmann highlighted the importance of independence in the case *Re Ipcon Fashions Ltd,*[1359] where it was decided that a director of a company could not be the liquidator of his own company. The Insolvency Practitioners Regulation is silent about the necessity of being independent, so there is no "hard law" demanding the independence of the IOH. However, the Joint Code of Ethics[1360] as "soft law" stipulates that the IOH must take reasonable steps to identify any threats to the fundamental principles.[1361] The examples listed in the Code of Ethics make it clear that for the IOH must be independent of personal relationships or financial commitments which might undermine his objectivity, including the necessity of being attentive towards a potential conflict of interests[1362] and a possible impact on professional personal relationships.[1363] The IOH himself would be obliged to introduce possible safeguards to "reduce the inherent threat to an acceptable level".[1364] For circumstances in which no reasonable safeguards could be put in place to eliminate the threat (so- called "Significant Professional Relationship"), the IOH should not accept the insolvency appointment.[1365] The decision to sever the relationship on the basis of his bias is largely left to the candidate for office without an independent assessment, making it indeed quite subjective. The OFT report recommends the reform of regulations to "encourage a competitive and independent IOH profession as the current regulation would only fulfill this partially as the IOH industry would essentially serve the interests of secured creditors.[1366]

[1357] See for example Hamish Anderson, 'Insolvency Practitioners: Professional Independence and Conflict of Interest' in Clarke A (ed), *Current Issues in Insolvency Law* (Sweet &Maxwell London1991) and Marc Norman Wellard, 'UK pre-pack reforms: pause for thought in Australia?' (2011) Australian Insolvency Journal, 23(2), pp. 15

[1358] To the pitfalls of legal comparative analysis see as well Luecke, H. *Independence of Insolvency Practitioners- An example of Congruity of Legal Concepts and the Predicament of Comparative Analysis* 2013, Australian Insolvency Law Bulletin, forthcoming.

[1359] (1989) 5 BCC 773.

[1360] ICAEW, Code of Ethics (n 1354).

[1361] Insolvency Practitioners Association (IPA) *Guide to Professional Conduct and Ethics; http://www.insolvency-practitioners.org.uk/regulation-and-guidance/ethics-code*(last visited 26.09.2015).

[1362] Ibid, para 31

[1363] Ibid, para 41, 44, see as well Anderson (n 1357).

[1364] Ibid, para 45

[1365] Ibid, para 47

[1366] OFT (n 1023) 1.34, 6.17-6.20.

6.4.3.Preparation of Pre-Packs

The Code of Ethics lists circumstances of previous or existing insolvency engagements which would exclude the appointment as IOH,[1367] not enumerating, however, the preparation of a pre-pack, prior legal advice or out-of-court restructuring attempts. The question arises, whether the preparation of a pre-pack or giving extra-judical advice would still be consistent with the necessary objectivity of the IOH.

For the case of a pre-pack this would imply that an otherwise existing lack of independence is accepted, provided it can be compensated by appropriately well-measured safeguards.[1368] SIP 16 does not explicitly exclude the administrator in a pre-pack sale on the ground of having already been involved prior to his appointment. The IOH will, however, be obliged to disclose the extent of his involvement ahead of finally being appointed.[1369] The task of re-evaluating assets is regarded an inadequate safeguard to eliminate the potential threat to the objectivity of the IOH, whereby any possible bias or conflict of interest could be ruled out.[1370]

It can be argued, that it makes sense that the person having prepared the pre-pack should also be the one executing it. Pre-packs have to be agreed upon quickly in order to preserve the value of a company. In-depth knowledge of the company is therefore of vital importance. The IOH has to be very conscious about his obligation to reveal the deal to the creditors,[1371] even though it seemed that the agreement had been concluded "behind closed doors", which could be regarded as another safeguard in place.

[1367] ICAEW, Code of Ethics (n 1354) Para 51: "(W)here the assets and business of an insolvent company are sold by an Insolvency Practitioner shortly after appointment on pre-agreed terms, this could lead to an actual or perceived threat to objectivity. The sale may also be seen as a threat to objectivity by creditors or others not involved in the prior agreement. The threat to objectivity may be eliminated or reduced to an acceptable level by safeguards such as obtaining an independent valuation of the assets or business being sold, or the consideration of other potential purchasers."
[1368] See as well Wellard (n 1357) 5.
[1369] SIP 16, para 9.
[1370] Wellard (n 1357) 5.
[1371] Ian Corfield, 'Administration: Do they work and for whom?' (2013) 24 (8) T.P.A. & A 85, 85.

The fact of being chosen by the secured creditors makes the IOH somewhat dependent with a possible likelihood of being responsive to the secured creditors' wishes; it goes without saying that a number of large IOH firms will have substantial relationships with secured creditors.[1372] It could be argued that a dependence with regard to the appointment will presumably impact the IOH's independence in the course of proceedings. This argument, however, loses its significance when it is considered that it is the creditors who bear the economic risk of failure, and it is understandable that they should be given the right to decide on the IOHs appointment.[1373]

6.5. Comparison

In the following it is evaluated whether the changes effected with regard to the independence of the IOH were driven by forum shopping activities and whether these changes actually led to an improved insolvency landscape in Germany.

6.5.1. Appointment

Pre-ESUG, the appointment of the IOH rested entirely in the hands of the insolvency courts. Now post-ESUG, it is still for the court to appoint the IOH, leaving no possibility for an out-of-court appointment, though an amendment with regard to the selection of the IOH was introduced after all.[1374] On a creditors' committee, in current practice mainly made up of secured creditors and non-creditors, being installed[1375], there is the possibility of proposing an IOH, whose appointment can generally not be refused if voted on unanimously.[1376] In England, the appointment can vary depending on the procedure. No matter which version is used, however, the secured creditors will have the greatest influence on the choice of the IOH in all proceedings. This change was critically analysed back in chapter four.[1377]

[1372] OFT (n 1023).
[1373] Ibid
[1374] See chapter 4.3.3.
[1375] More see Luecke Creditors' Committees (n 862).
[1376] Ibid
[1377] See chapter 4.

6.5.2. Independence

The word "independence" as a term of art in connection with IOHs is not used in England. Independence is, nevertheless, considered especially under the fundamental principle "objectivity". The content of these comparable principles is evaluated in the following.

Both jurisdictions highlight the importance of the IOH for any insolvency proceeding, putting emphasis on the right choice, independence (or objectivity) and qualification of an IOH. England and Germany have safeguards in place to avoid threats to these objectives, a major difference being that objectivity is self-regulated by the RPBs, and therefore only "soft" law in England. In Germany, on the other hand, independence is regulated by the InsO, in consequence being "hard" law. Both kinds of regulations have their advantages and disadvantages. The soft law solution is advantageous as it is flexible and based on first-hand experience and specific knowledge. However, it could be argued that it lacks objectivity. It could be argued that self-regulation comes close to no regulation. At least a counterbalance is needed in form of oversight of the profession.

Hard law is more objective as it is made by an independent body and the remedies are enforceable. It could be argued that self-regulation especially works in mature professions, and the IOH profession in England could be seen as such.

The independence of the IOH was already an indispensable principle pre-ESUG and the ESUG did not change this. The new section 56 InsO now defines factors which do not put the independence of the IOH in general in doubt, whereas the former section contained no further clarification at all. The question is whether these changes were driven by forum shopping activities.

Section 56 subsection 1 clause 3 number 1 is just a clarification.[1378]

[1378] See chapter 6.3.2.1.

6.5.3. Generic Advice

Section 56 subsection 1 clause 3 No. 2 InsO clarifies that giving advice of generic nature is no obstacle for remaining independent.

There are no information in the ESUG policy documents whether this change can be traced back to forum shopping activities, however, it is not precluded as the same holds true in England.

It could be argued that this particular amendment is part of "a race to the top" widening the possibility for insolvency law firms to give advice on general questions concerning the insolvency process and its implications. Before concluding, however, that any advice of generic nature would present no problem as to the question of independence, it needs to be considered how difficult it is in practice to draw the line between simple advice of generic nature and more extensive advice threatening the loss of independence. The use of such a vague term could therefore be regarded impractical.[1379] Broadening the definition of independence could lead to a "race to the bottom" by actually lowering the standards for the definition of independence. As emphasised before, true independence is an indispensable asset in itself, which needs to be protected carefully. But are we in fact confronted with an extension of the definition? In repeating remarks made earlier[1380], no real changes were brought about in consequence, advice of generic nature not having been a reason for exclusion pre-ESUG and remaining a matter for the courts to decide on even now. The change having taken place could better be categorised as a mere clarification and therefore not an example of a "race to the top" nor the opposite. Nevertheless, the clarification as such might bring some better understanding and by some is already seen as a "race to the top", but it will in all likelihood not change the German insolvency landscape for the better. However, the change is not really a race to the top as it will not enhance the rescue culture in Germany due to its pure clarification character.

[1379] See chapter 6.3.2.2.
[1380] See chapter 6.3.2.2.

6.5.4. Preparation of an Insolvency Plan

Special attention should be drawn to the third intended modification, to be found in the Government Draft, only to be deleted during the legislative process. Section 56 subsection 1 number 3 InsO allowed the independence not to be put in question automatically for a party who has prepared an insolvency plan.

The inclusion of this change in the Discussion Draft and the discussions around this topic could be traced back to forum shopping activities as there seems to be general consensus in England that the party having drawn up the pre-pack is not excluded from acting as IOH in the following proceeding.[1381]

This decision not to change the status quo in this context could be regarded a "race to the top". There is enough argument on independence being affected in allowing the originator of a plan to accept the IOH appointment. In line with the above analysis it could be argued that a potential bias and conflict of interest should be judged with all possible caution in order to uphold independence as a fundamental principle. The appearance of potential bias should be ruled out by not allowing the originator of an insolvency plan to act as IOH for the same debtor. There are certain arguments speaking for the plan originator being biased, having agreed to a contract with the debtor and being entitled to a fee and thus acting as stakeholder on behalf of his client. There might well be the risk of possible consulting errors made being left unrecognised and evoking the picture of "asking the wolf to guard a flock of sheep".

Considering the above stated circumstances brings to the fore again that independence should not be looked at as an end in itself. There is room to assume that the supporters of the deletion of no. 3 were trying to embrace exactly this idea by enforcing to include regulations about independence at any price. One should be mindful that independence is included for a specific

[1381] See chapter 6.4.3.

reason, with the overarching aim being the realisation of the creditors' interests. Hirte's picture of the cake for the creditors[1382] serves well to capture the right answer in a nutshell. The creditors should be allowed to decide on appointing the IOH with an eye on the size of the cake falling to them in the end; independence should not be regarded an end in itself, at least not as a rule but rather as an exception. The original suggestion not to exclude the originator in general, but to leave it up to the courts would be sufficient. The proponents of the cancellation of No.3 were too formalistic in their approach, instead of looking at it from a substantive law perspective. Leaving the originator in charge has considerable advantages, certainly outweighing the potential threat to independence. A time-effective handling fosters successful restructurings, made possible due to the extensive previous knowledge the originator brings along. In removing no. 3 this advantage has been lost, which must be seen as a "race to the bottom". Allowing the originator to be the subsequent IOH helps to boost a race to rescue due to his expertise and the possibility of him acting faster which improves the chances of a successful restructuring as discussed above. It is not argued that independence is an indispensable feature, and the original wording would have protected this fundamental pillar sufficiently. It was only highlighted that the originator should not be excluded right from the outset, not implying that a party is appointed without the necessary reflection on independence.

6.6. Mini Conclusion

It can be concluded that the amendments with regard to the IOH's independence will not lead to a major change in German's insolvency landscape. The changes made are clarifications primarily and respecting the status quo except in nuances. The wording of section 56 InsO pre-ESUG was vague and muddled by uncertainties with regard to the interpretation of "independance". However, the wording now has at least brought some clarification which might help with the interpretation. The German legislator had the chance to change the insolvency landscape in this respect for the

[1382] Hirte, Protokoll zur 55. Sitzung (n 1457) 14.

better and nearly did so, but finally failed specifically to endorse the appointment of the originator of the insolvency plan as the IOH. This would have been a big step into more rescue-friendliness. However, this restrained approach will not withstand the competiton for example with England, where this topic is addressed more practically and realistically. This fettered approach will lead to the necessity of more adaptation as the competition has still distinct modifications better adapted to the economic reality. It must be said yet again that deleting this provision No.3 is another example of Germany's conservative approach towards changes in the insolvency landscape. The legislator argues that "the mere possibility" should be excluded, this clearly demonstrates German's cautious approach. A mere possibility of bias prevents now in general unibased originators of the plan to act as IOHs. Speaking in general, the IOHs have a high ethical standard and are clearly able to stay professional in their approach.The arguments of the legislator that the originator of an insolvency plan could still be appointed as IOH despite the removal of No.3 might be correct, but it remains questionable how the courts will react to this in practice. Experience has shown that the courts would be most likely to adopt the easier way, by appointing a different IOH in order not to get into bothersome discussions of the topic of "independence".

Chapter Seven

Debt–to-Equity-Swap

"The debt-to-equity swap- a key tool for an attractive restructuring procedure"[1383]

7.1.Introduction

This chapter is to evaluate the DES as a restructuring tool. Firstly, circumstances in both Germany pre- and post-ESUG and England are analysed, before comparing and contrasting the situation with regard to the DES in the two jurisdictions. It is evaluated whether the changes post-ESUG were possibly driven by forum shopping activities in helping to improve the insolvency landscape in Germany, the very crux of this thesis.

A DES is a transfer of debt against equity capital. In this way, the balance sheet can be restructured in that the participating creditors acquire equity capital in a reorganised finance structure in return for reducing or renouncing their claim against the company.[1384] In other words, the creditors accept shares instead of getting their claims paid. The DES can generally be described a company law tool, the regulation of which has to be adapted to the characteristics of insolvency law;[1385] in other words, company and insolvency law have to be harmonised.

The DES can be particularly effective in an insolvency situation by reducing or cancelling out excessive indebtedness with an input of fresh capital coming into the company in the form of new equity through the swap of debt against equity, allowing trading to continue. For companies in temporary difficulties this represents the chance for a financial restructuring ("bilanzielle Restrukturierung").[1386] With the availability of fresh capital, equity ratios will

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[1383] Discussion Draft (n 502) 33.
[1384] Clowry K, 'Debt-to-Equity Conversion in the UK and Europe' (2010) 2 European Company Law 51, 53.
[1385] Haas (n 1138) 3.2.1.
[1386] Ann-Katrin Schleusner, 'Der Debt-Equity-Swap',1 <http://www.jura.uni-hamburg.de/ufo/ausgabe-03-2009/ann-kathrin-schleusener-der-debt-equity-swap.html>

improve and the company will become more attractive for potential investors as well as for suppliers and customers.[1387] Creditors, business partners and employees would regain confidence, with the new shareholders bringing additional expertise into the company and being likely to be open for innovative projects.[1388] There is a positive effect on liquidity as interest costs and repayment of obligations are reduced, giving the company new and valuble flexibility.[1389] It has certain advantages compared with a transferred restructuring.[1390] One striking one is the fact that with an asset deal all business assets pass to the new company, but following the still predominant legal opinion in Germany, existing contracts do not.[1391] In situations where the assets of a company are an existing contract a DES might be the better option.

On the other hand, a DES is accompanied by certain disadvantages.The debtor company has to be well aware that a new shareholder will drive the negotiations concerning the type of equity available in return for his claim and the issuing of new shares will dilute the value for the existing shareholders.[1392]

The tax implications accompanying a DES are not part of this research.[1393]

7.2. Germany pre-ESUG

7.2.1. Technical Implementation

A DES was possible pre - ESUG, though not specifically codified in the InsO. It can be carried out in various forms, the basic approach being a so-called cut in capital ("Kapitalschnitt") to be followed by a capital increase later on.The simplified capital decrease ("vereinfachte Kapitalherabsetzung")[1394] corresponds to the amount of subscribed, or nominal capital ("Stamm-bzw

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[1387] http://www.bristows.com/articles/debt-equity-swaps-all-the-rage.
[1388] Schleusner (n 1386) 1.
[1389] Ibid
[1390] More on "transferred restructuring see chapter 2
[1391] Moritz Brinkmann, 'Wege aus der Insolvenz eines Unternehmens – oder die Gesellschaft als Sanierungshindernis' (2011) WM, 97, 98.
[1392] Ibid
[1393] In a DES scenario, the swap results in a profit amounting to the ratio of the waiver. The question is if this profit is tax-privileged and whether potential capitalisation of losses carried forward are preserves under section 8 c subsection 1a Corporation Tax Act ("Koerperschaftssteuergesetz" KStG).
[1394] Sections 58, 58 a GmbHG for Private Limited Companies ("Gesellschaft mit beschraenkter Haftung",; GmbH) and sections 222ff and 229ff AktG for Public Limited Companies ("Aktiengesellschaft", AG).

Grundkapital") used up. Subsequently, the capital contribution is made by way of a non-cash contribution ("Sacheinlage"), excluding possible pre-emptive rights ("Bezugsrechte") held by present shareholders.[1395]

The contribution is made by either a transfer of receivables ("Forderungsuebertragung"), to offset or through a waiver agreement ("Erlassvertrag").[1396] All these capital measures require the assent of a qualified majority[1397] in a general meeting of the existing shareholders, provided the company constitution does not regulate this differently. This would apply to both the capital reduction and to the capital increase.[1398] At the same time, the general meeting will have to agree upon the exclusion of pre-emption rights in order to clear the path for the new shareholders.[1399]

7.2.2. Obstacles

7.2.2.1. Shareholders' Approval

Pre-ESUG, there were several hurdles to overcome before a DES was accepted. Infringements of shareholder rights were not allowed; so it took the consent of the existing shareholders whose rights had to remain unaffected even in the case of an insolvency plan restructuring. Changes of these rights needed the consent of the shareholders in accordance with the company law provisions and could not be substituted by an insolvency court's order to approve the insolvency plan.[1400] No other parties were allowed to infringe shareholders' rights or substitute their consent, in other words, if the shareholders did not consent, debtors would not be able to swap their debt for equity even if the shares had become worthless, as the right to sell remained with the shareholders.[1401] The obstruction potential was one of the main reasons why the DES was not used more frequently in practice. Investors and old shareholders often follow different aims in that investors look for a

[1395] Merten (n 893) 77.
[1396] Hagemann (n 29) 35.
[1397] 75% of the votes
[1398] Meyer (n 16) 847.
[1399] Ibid
[1400] Beissenhirtz, Restructuring Corporate Debt in Germany (n 479).
[1401] Ibid

profitable sale of the company in a few years' time, whereas the shareholders would be more interested in continuing running the company as a going concern.[1402] A DES preceding an exclusion of subscription rights would lead to obstructing shareholders.[1403]

7.2.2.1.2. Justification of the Infringement of Shareholders' Rights

Even pre-ESUG there were attempts to justify the infringement of shareholders' rights in a DES procedure. Relevant literature pursued an insolvency based approach to legitimise such infringement by arguing that the IOH would have a legal claim for the assignment of the shares ("schuldrechtlicher Anspruch auf Abtretung der Gesellschaftsanteile") on their being worthless[1404] or insisting that the possibility of intervention came as a result of the insolvency distribution sequence ("insolvenzrechtliche Verteilungsreihenfolge").[1405] Looking at the intention of the legislator, however, made it clear that it was no editorial mistake, but a deliberate decision not to infringe shareholders' rights. As far back as 1985 the Insolvency Commission recommended a procedure with the possibility of restructuring without the consent and against the will of the shareholders,[1406] though this suggestion was not implemented in the InsO 1999.[1407] They suggested the possibility of excluding shareholders if their shares were worthless.[1408] The Commission already realised as early as in 1985 that allowing infringement of shareholders' rights when the shares are worth nothing would foster restructurings with regard to the necessary changes in the legal structure of the company as the old shareholders are not participating any more. Furthermore the inclusion of new liable equity ("Haftungskapital") would be facilitated if shareholders with worthless shares were excluded.[1409] The recommendation of the Commission even went a step further and suggested the possibility of excluding shareholders for an important cause.[1410] These suggestions were not

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[1402] Schleusner (n 1386) 3; Franken (n 64) 653.
[1403] Ibid
[1404] Braun, Roemermann, InsO, para 217 recital 41
[1405] Bitter (n 899) 195.
[1406] Erster Bericht der Kommission fuer Insolvenzrecht (n 303) 16,42, Hagemann (n 29) 52
[1407] Hagemann (n 29) 35.
[1408] Erster Bericht der Kommission fuer Insolvenzrecht (n 303) 282.
[1409] Ibid
[1410] Ibid 283.

implemented in the InsO 1999 because of the argument that imposed sacrifices of assets ("Vermoegensopfer") should be avoided and forced interventions into the private order ("private Gueteordnung") could not be accepted.[1411]

Next to the insolvency based one, there was the attempt to justify the infringement with a company law based approach, arguing that the obligation of the shareholders to co-operate would arise from a fiduciary duty ("Treuepflicht").[1412] The so-called *Girmes*-case[1413] imposed such a fiduciary duty on minority shareholders, obliging them to vote in favour of a debt-to-equity swap.[1414] However, a general restructuring duty or a general duty to participate could not be deduced from this case,[1415] especially as the case was dealing with a fiduciary duty between the shareholders and not between the shareholders and a third party, which would be the case in a DES.[1416]

7.2.2.1.3. An Instance of Darwin contradicted?

Not allowing the substitution of shareholders' votes in a DES could be seen as divergence from the Darwinian Theory. A DES should be encouraged in certain restructuring cases, but due to the practical obstacle as explained above it is virtually non-existent in practice. The necessity for the consent of the shareholders was the breeding ground for "predatory shareholders" ("raueberische Aktionaere").[1417] It came about that shareholders would demand compensation for abstaining from this blocking potential and there was even talk about a blackmail potential in the hands of the shareholder ("Erpressungspotenzial der Gesellschafter").[1418] In case of success, the

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[1411] Erster Bericht der Kommission fuer Insolvenzrecht (n 303) 282; Hagemann (n29) 35.
[1412] Ibid 53
[1413] BGH, 20.03.1995 - II ZR 205/94.
[1414] Beissenhirtz Restructuring Corporate Debt in Germany (n 479) 4. Another mean to achieve at least the effects of a debt-equity swap in certain cases, provided there is a group structure in place with a holding company holding the corporate debt, is to establish a sub-holding company between the HolCo and the OpCo (MidCo). In the next step the creditors of HoldCo 'swap' their claims against shares in MidCo, thereafter HoldCo being liquidated and MidCo becoming the "new" HoldCo. Hence, although there are alternative means to get the creditors into the equity position, it is apparent that these means only work under particular circumstances.
[1415] Karsten Schmidt, *Gesellschaftsrecht* (4, Auflage Heymanns Cologne 2002) 135, Rouven Redeker, 'Kontrollerwerb in Krisengesellschaften: Chancen und Risiken des Debt-Equity-Swap' (2007) BB, 673 675.
[1416] Brinkmann (n 1391) 99, Bitter (n 899) 172.
[1417] Marcus Lutter, 'Zur Abwehr raeuberischer Aktionaere, in Festschrift 40 Jahre der Betrieb' (1988) DB 193, 193.
[1418] Eberhard Braun, 'Haftung und Insolvenz' in Ganter, Gottwald, Lwowski *Festschrift fuer Gero Fischer zum 65. Geburtstag* (C.H.Beck Munich 2008), see as well Hagemann (n 29) 49.

shareholder would benefit from a possible restructuring profit, not having contributed to the restructuring and even having tried to block it.[1419] This blocking potential in the hands of opposing shareholders is not in line with the objective of an effective restructuring procedure,[1420] especially bearing in mind that the creditors become factual owners of the debtor company, the shares being only "empty shells" typically worthless in an insolvency scenario.[1421] The blocking possibility of an individual shareholder, even one without a commercially valuable claim, becomes an illustration of a restrained and cautious approach and no adequate solution, especially bearing in mind that the creditors should be regarded the economic owners of the debtor in a scenario of excessive indebtedness.[1422] Bearing in mind that the DES is an essential restructuring tool, having a DES system in place which contains these obstacles does not support the aim of developing a rescue culture. The Law Commission saw the necessity for adaption to have a better debt-equity regime even pre-InsO, which the legislator did not recognise though it was obvious even then that this adaptation had to come in order for the legal system to be more competitive with regard to DESs.

7.2.2.2. Valuation of the Contribution ("Bewertung der Sacheinlage")

The second challenge faced was the difficulties in valuing the contribution of the creditors. The main question is how to distribute the value between the old and the new creditors, in other words the correct approach to find the "real" proportion of the debt capital which should be swapped into the future equity capital.[1423] There are two potential solutions for this evaluation, the company law and the insolvency solution.

[1419] Hagemann (n 29) 49.
[1420] See chapter 4.2.5.
[1421] Schaefer (n 1011) 97.
[1422] Horst Eidenmueller, 'Gesellschafterstellung und Insolvenzplan' (2001) ZGR 680.
[1423] Horst Eidenmueller, 'Andreas Engert Reformperspektiven einer Umwandlung von Fremd- in Eigenkapital (Debt-Equity-Swap) im Insolvenzplanverfahren' (2009) ZIP 2001, 541, 545.

7.2.2.2.1. Company Law Solution

The capital increase is done by distribution in kind and in practice not the nominal value, but the economic value of the claim is taken.[1424] The value of the debt capital which should be swapped depends on whether the company should be continued or liquidated. The aim of an insolvency plan procedure is in general the restructuring of the company and therefore the going concern value is taken. In other words the company law solution looks at the proportion between the potential going concern value of the company and the economic value of the debt capital to be swapped.[1425] This solution secures participation on a going concern basis for the existing shareholders, which takes the present proportion of the value of their share under the premise on a going concern of the company.[1426] This solution might be fair at first glance, however, one consequence is that the creditors would get less in an insolvency proceeding than they would be entitled to corresponding to their claim. The company law solution enhances the incentives for the shareholders as compared to an insolvency scenario their shares would be potentially worse less after insolvency distribution rules they would be last to be satisfied.[1427] Using going concern values in an insolvency scenario would involve significant risks.[1428] Even the suggested obtaining of an expert would burden the procedure with extra costs and would probably bring little clarity about the real value.[1429]

7.2.2.2.2. Insolvency Law Solution

The insolvency law solution avoids this result by applying strict insolvency distribution rules which would lead to a satisfaction of the creditors first and the shareholders would only get the remainder.[1430] Using the insolvency solution would improve the incentives for the creditors. The shareholders

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[1424] Section 255 II AktG; Ibid, 543.
[1425] Eidenmueller, Engert (n 1423) 545.
[1426] Ibid, 544
[1427] Ibid, 544
[1428] Ibid, 643
[1429] Meyer (n 16) 849.
[1430] General distribution rules see section 39,53, 199 InsO and for insolvency plan sections 245 subsection 2 No. 2; 247 subsection 2 No. 2 InsO.

would on the other hand try to avoid insolvency proceedings at any costs as they would lose their rights in the company without any compensation.[1431]

7.2.2.2.3. Company or Insolvency Law Solution?

It could be argued in favour of the company law solution that the outcome of a DES would be the same as if the company would be continued without the occurrence of insolvency.[1432]

No parties involved would be able to achieve a special benefit by filing for insolvency. This is advantageous for the shareholders and would therefore create an incentive for them to file for insolvency at an early stage, which enhances the chances of a successful restructuring and therefore nurtures a rescue culture.

The insolvency law solution is beneficial for the creditors and could cause the false incentive to aim for insolvency even if company value would be reduced in an insolvency scenario, which would be avoided with the company law solution. However, it has to be borne in mind that this advantage only applies when the company is on the verge of insolvency and not for the companies which are only in financial difficulties. It would set inaccurate incentives for the shareholders if they knew that they would probably get more for their shares in an insolvency scenario.[1433]

Therefore there are more reasons to follow the insolvency law solution as a different solution would reduce the obligations of the shareholders.[1434] The consistency between the normal and the plan proceedings does speak for the insolvency law solution as well. Insolvency has to be seen as the "moment of truth" for the shareholders and following the company law solution, incentivising the shareholder, does not seem to be the right approach. [1435]

[1431] Meyer (n 16) 849.
[1432] Eidenmueller, Engert (n 1423) 544.
[1433] Eidenmueller, Engert (n 1423) 545.
[1434] Ibid
[1435] Ibid

7.2.2.3. Differential Liability ("Differenzhaftung")

Along with the question about the value of the swapped claim, the question of the so-called differential liability comes into play. This principle requires a shareholder to balance the potential shortfall between his contribution and the nominal value of the share by a contribution in cash.[1436] A DES therefore carries the risk that an overvaluation of the contribution in kind could result in the shareholder being liable for the difference. Due to the uncertainty of a restructuring success this potential risk led to a less frequent use of the DES.[1437]

The principle of differential liability comes as yet another example of a fettered Darwinian approach; on top of needing shareholders' approval, the risk for the new shareholders of balancing a potential shortfall due to an overvaluation does not contribute to the use of an otherwise useful restructuring tool. This was another hurdle which had to be overcome towards a successful restructuring and hence another example of a constrained approach and contradictory to the aim of the legislator to foster restructurings. A simple exemption from the differential liability rules for DES would have had a massive positive impact on its usage.

7.2.2.4. Risk of Equity Substitution ("Eigenkapitalersatz")/ Restructuring Privilege

The DES was afflicted with the legal uncertainty about the swapped capital seen as equity substitution. Generally, a shareholder's liability is limited to the amount of capital contributed. However, the Equity Substitution Act ("Eigenkapitalersatzgesetz") states that a loan granted to a company in financial difficulties, should be treated as equity in case of insolvency.[1438] Shareholder loans are principally treated as debt, but under certain

[1436] Section 9 I 1GmbHG; 36a II3 AktG.
[1437] Brinkmann (n 1391) 101; Eidenmueller, Engert (n 1423) 550; Lars Westpfahl, Riaz K. Janjuah, 'Zur Modernisierung des deutschen Sanierungsrechts. Ein Beitrag zur aktuellen Diskussion über die Reformbedürftigkeit des deutschen Insolvenzrechts' (2008) ZWiR, Beilage 14.
[1438] § 30, 31 GmbHG

circumstances might also be taken for equity ("Eigenkapitalersetzendes Gesellschafterdarlehen").[1439]

These provisions do not apply for a new shareholder, privileged under section 32 a subsection 3 clause 3 GmbHG which includes the so-called restructuring privilege ("Sanierungsprivileg"). On the provision that the purchase of shares was made by a lender in times of crisis for the company to overcome these difficulties, it is restructuring privileged and the capital is not regarded an equity substitution.

A DES could only be a useful restructuring tool if it was restructuring privileged. The German Federal Supreme Court ("Bundesgerichtshof", BGH) defined the circumstances under which DESs are privileged in times of crisis.[1440] To recognise the restructuring purpose in the sense of section 32a III 3 GmbHG would require the restructuring intention ("Sanierungswille") together with the restructuring ability ("Sanierungsfaehigkeit"), having to be objectively determined.[1441] In other words, a restructuring concept drawn up by an independent third party would be needed to ascertain the restructuring possibility. Having a subjective as well as an objective element, it is not necessary that the company had already completed a successful restructuring in order to gain the privilege under section 32a III3 GmbHG. The restriction privilege also applies for a company facing insolvency, having presented an objective restructuring concept with a positive prognosis.[1442]

7.2.2.5. Changes through the Bond Act ("Schuldverschreibungsgesetz" SchVG)[1443]

The SchVG, applying to all bonds issued under German law introduced for the first time a flexible change of the terms and conditions of bonds by majority

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[1439] Ibid

[1440] BGH, Urt. v. 21. 11. 2005 - II ZR 277/03.

[1441] Ibid and more details see Rainer Himmelsbach, Jan Achsnik, 'Investments in Krisenunternehmen im Wege sanierungsprivilegierter debt-equity-swaps' (2006) NZI 562, the first instance saw it differently in just demanding the personal motivation to restructure the company and not the restructuring ability.

[1442] Ibid; Reason for the requirement of an objective element is the legitimate interest of the other creditors, as their chances of satisfaction of their claims should not only depend on the assessment of the investor. The IOH was allowed under certain circumstances to rescind settlements made within one year before the filing for insolvency.

[1443] Schuldverschreibungsgesetz (n 480).

decision.[1444] The previous Act restricted changes of bonds to the reduction of interest and deferment of the principal payment, regarded impracticable as a successful restructuring required more flexible measures, such as a DES.[1445] The new Act entrusts the bondholders with a more active role in restructurings, reducing the obstruction potential of minority creditors. The creditors' committee is given the possibility of agreeing upon various corporate actions with a qualified majority, also including a DES. The SchvG does not provide for a minority protection rule; the majority decision of the creditors is binding for all creditors.[1446]

These amendments could be taken as a positive example of an adaptation in Germany in the best Darwinian sense. The increased significance of the bond market demanded a change and the introduction of more flexible measures, including the possibility of a DES, which changed the landscape for the better.

7.3. Germany post- ESUG

The legislator considered the DES one of the key instruments for an attractive restructuring procedure, the supply of equity often being the pivotal element for success in an insolvency plan proceeding.[1447] One challenge of the old legislation was the condition of not infringing shareholder rights.[1448] Experience showed, however, that restructuring of companies frequently demanded exactly that.[1449] One of the main aims of the ESUG was therefore to enhance restructuring possibilities by allowing capital measures, such as a DES.[1450] The insolvency ground ("Insolvenzgrund") for excessive indebtedness ("Ueberschuldung") would be eliminated due to a reduction of interest cost and repayment of principal. As a countermove, creditors have the chance to participate in the future success of the company, and also the possibility of obtaining a say in the management.[1451]

[1444] Schuldverschreibungsgesetz (n 480) Para 1 I.
[1445] Lercara (n 487) 299.
[1446] Section 5 SchVG.
[1447] Discussion Draft (n 502) 33.
[1448] See chapter 7.2.2.1
[1449] Discussion Draft (n 502) 18.
[1450] Ibid
[1451] Discussion Draft (n 502) 18.

7.3.1. Elimination of Obstacles

7.3.1.1. Reduction of Shareholders' Rights

The ESUG introduced the possibility of reducing shareholders rights, at the same time enhancing the participation in an insolvency plan.[1452] Shareholders are now allowed a say in changes to their rights. They constitute their own separate voting group in the insolvency plan proceedings.[1453] The Discussion Draft declared that the changes would be corresponding with the practical needs.[1454] This in particular alludes to the weaknesses explained previously, examples of which are the forum shopping cases *Deutsche Nickel*[1455] and *Schefenacker*[1456]. Winckelmeier-Becker stated in a plenary meeting that creditors cannot be expected to bring in fresh money, with the shareholders getting away without responsibility, while the restructuring success at the same time would affect only those shares with no economic value left.[1457]

The new section 225a subsection 2 InsO opened the possibility of including the conversion from debt to equity in the constructive part of an insolvency plan.[1458] The existing shareholders would become participants in corresponding procedures, making an infringement of their rights possible under section 221 InsO.[1459] The existing blocking potential ceases to apply,[1460] as shareholders would form a group in the insolvency plan proceedings, subject to the obstruction prohibition under section 245 subsection 3 InsO.[1461] All details of the DES have to be provided in the insolvency plan.[1462] Technical requirements have not changed compared to the practice pre-ESUG. With reference to the different ways of dealing with the question of infringement of

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[1452] New section 225a InsO.
[1453] Discussion Draft (n 502) 18, more on obstruction potential, s chapter 9.
[1454] BT-Drs. 17/5712 (n 294) 31.
[1455] Appendix one
[1456] Ibid
[1457] Elisabeth Winkelmeier-Becker, Deutscher Bundestag, 'Protokoll zur 55. Sitzung', 5691 (Berlin 25. June 2011) http://dip21.bundestag.de/dip21/btp/17/17055.pdf (last visited 20.09.2015).
[1458] BT-Drs. 17/5712 (n 294) 31; Merten (n 893) 82.
[1459] See more details Merten (n 893) 84.
[1460] See chapter 4.3.4.
[1461] Meyer (n 16) 848; more to obstruction prohibition, see chapter 2.3.5.
[1462] ibid

shareholders' rights, the legislator opted for an insolvency based approach by introducing the participation rights as explained above.[1463]

Opening the possibility for a DES was unanimously supported. The Government Draft however, sparked off controversial discussions. The participation of shareholders in the plan gave cause for discussion as to whether the infringement of shareholder rights in an insolvency plan proceeding could be seen as an infringement of article 14 of the Constitution ("Grundgesetz" GG), referring to the constitutional requirement for the protection of property ("verfassungsrechtliche Gebot des Eigentumsschutzes").[1464] An interference with shares held by existing shareholders would not be possible without the payment of compensation; Article 14 GG allows forced intervention only for the protection of the creditors' interests of satisfaction ("Befriedigungsinteresse"). This is the reason why the existing shareholders are classified as a group in insolvency plan proceedings,[1465] all having to be treated equally. If existing shareholders rejected the plan in spite of their involvement being affirmed, the court would be able to declare their consent to the proposed insolvency plan on their behalf.[1466] This should replace the often time-consuming process of policy-forming on the part of existing shareholders under the old regime.[1467] It is argued, that there is no breach of constitutional rights as the opening of insolvency proceedings would limit the only legal position worth protecting to the residual value of the shares[1468], shareholders being classified as one group in an insolvency plan proceeding, and the procedure guaranteeing their participation. The constitutional requirement for the protection of property is any case guaranteed by the regulations in sections 245, 251 and 253 InsO.[1469]

[1463] Which means in other words that the infringement is only possible within an insolvency plan and a DES in an out of court restructuring would still faces the problems as pre ESUG.
[1464] Meyer (n 16) 848; Hagemann (n 29) 58, 59.
[1465] Ibid
[1466] Ibid
[1467] Ibid
[1468] Ibid
[1469] BT-Drs. 17/5712 (n 294) 35:"Das verfassungsrechtliche Gebot des Eigentumsschutzes in Artikel 14 des Grundgesetzes (GG) wird nicht verletzt. Nach Eröffnung eines Insolvenzverfahrens, das ohne einen Insolvenzplan zur Abwicklung des Rechtsträgers und zu dessen Löschung im Register führt, beschränkt sich die schützenswerte Rechtsposition des Anteilsinhabers auf den restlichen Vermögenswert, der dem Anteils- oder Mitgliedschaftsrechtauch im Insolvenzverfahren teilweise noch zukommt.Dass der Inhaber diesen Wert nicht gegen seinen Willen verliert, wird durch die Mitwirkung im Verfahren und den erwähnten Minderheitenschutz garantiert. Hinsichtlich der Gläubiger, deren Forderungen durch den Insolvenzplan in Anteile am Schuldner umgewandelt werden, kommt eine Verletzung von Artikel 14 GG bereits deshalb nicht in Betracht, weil eine Umwandlung nicht

These regulations make sure that an adequate compensation is paid in the case of the shares losing value.

The participation of shareholders in the plan is probably the only way forward in Germany without a breach of article 14 GG. The objective to reduce the obstruction potential of shareholders in a DES is therefore achieved at least for an insolvency plan proceeding. The aim of the legislator to increase the use of DESs by the possibility of infringing shareholders' rights is partially achieved. The fact that these new regulations only apply in an insolvency plan, but not in informal restructuring attempts is further proof of Germany's restricted approach towards reforms. The legislator had the chance to use the reforms for a fresh start and a real opportunity to change the rescue culture for the better, but stopped half-way in not including the majority of DES in practice into the new proceeding.

7.3.1.2. Requirement of Creditors' Consent

The new section 225 a II InsO states that a DES cannot be carried out against the will of the creditors concerned. However, the Discussion Draft[1470] included a fiction of consent ("Zustimmungsfiktion") giving the creditor a time limit of at least 2 weeks following an appropriate request after which consent would be presumed if no objection was received.[1471] The fiction of consent was to facilitate the procedure for the plan originator.[1472] However, concerns were raised about this provision with the argument that the right to disagree to the

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gegen den Willen der betroffenen Gläubiger möglich ist. (The protection of property set out in article 14 of the German basic constitutional law is not infringed. The opening of insolvency proceedings without an insolvency plan leads to the liquidation of the company and its deletion from the register, restricting the legal position of shareholders to the remaining assets partially still belonging to them also under insolvency proceedings. Ownership rights are covered by the participation of owners in the proceedings and being subject to the just mentioned minority protection. A violation of article 14, constitutional law can be ruled out for creditors with claims being converted into equity by way of the insolvency plan, which can not be carried out against the will of the creditors involved.)

[1470] Original version: Discussion Draft (n 502): "section 230 II InsO: „Die Zustimmung des Gläubigers, der keine persönliche Haftung übernehmen soll, gilt als erteilt, wenn 1. der Insolvenzverwalter oder der Schuldner ihm die geplante Maßnahme schriftlich erläutert und ihn dabei aufgefordert hat, binnen einer Frist von mindestens zwei Wochen seine Zustimmung zu erklären, und 2. der Gläubiger innerhalb der Frist nicht schriftlich geantwortet hat, obwohl er bei der Aufforderung auf die Rechtsfolge eines solchen Verhaltens hingewiesen worden ist." ("The consent of creditors not taking on personal liability is considered as given, if 1.) The insolvency administrator or the debtor explains the measures planned in writing, together with the request for a written approval within a minimum of two weeks, and 2.) If creditors fail to reply in writing within the time limit set, in spite of the written request having informed of the legal consequences of such conduct.").

[1471] ibid

[1472] Ibid, original section 230 II InsO, 35

DES should be an individual right of each creditor, which could not be replaced by a majority vote of the group.[1473]

The fiction of consent was removed and individual consent of all creditors is needed, as no single party should unwillingly be forced into a shareholder position,[1474] an exception being the case of a restructuring under the Bond Act.[1475] It was also suggested for the DES that a majority vote of the formed groups should be sufficient to overrule the minority in an insolvency plan procedure.[1476]

This could be seen as yet another instance of an exception to the Darwinian Theory. In view of the aim of the legislator to optimise restructuring possibilities and make the insolvency plan practicable, it could be argued that the necessity for an individual approval of all creditors might obstruct or at least hinder the restructuring attempt. Comparing the last minute changes to the original wording serves to demonstrate the conservative approach attitude again. The aim was to introduce amendments to the DES to really enhance possibilities for company restructurings. Demanding the individual consent of all creditors is hampering the actual intention and can only be considered a half-hearted attempt. The requirement will open the door for non-consenting creditors to obstruct or at least complicate a sensible restructuring effort which is beneficial overall.[1477] The legislator had the chance to cause a fresh start, but the cautious and conservative approach leads again to a frustration of a reform which conforms to the Darwinian Theory.

[1473] BT-Drs. 17/5712 (n 294) 31: Nach Absatz 2 Satz 2 darf kein Gläubiger gegen seinen Willen in eine Gesellschafterposition gedrängt werden. Unberührt hiervon bleibt die Möglichkeit eines Mehrheitsbeschlusses nach § 5 Absatz 3 Nummer 5 des Gesetzes überSchuldverschreibungen aus Gesamtemissionen (SchVG). = Eine Ausnahme besteht insoweit nur für Schuldverschreibungsinhaber: Nach § 5 Abs. 3 Nr. 5 des Gesetzes über Schuldverschreibungen aus Gesamtemissionen (SchVG) genügt hier ein Mehrheitsbeschluss, der auch die ablehnenden Schuldverschreibungsinhaber bindet. (Pursuant to paragraph 2 (2) no creditor may be pressured into a shareholder position against his will. This does not prejudice the possility of a majority decision according to article 5 (3) (5) of the German Bond Act. An exception applies only to bondholders, for which the just mentioned Bond Act requires a majority vote, automatically also binding on dissenting bondholder.).

[1474] Haas (n 1138) 79.

[1475] See chapter 2.3.8.

[1476] Weiland (n 1282) 210.

[1477] Weiland (n 1282) 7.

7.3.1.3. Valuation of the Consideration

The challenge of the valuation of the creditors' claim has not been fully met by the ESUG. In the Government Draft it says that with regard to the intrinsic value, it might be necessary to get an expert opinion. The intrinsic value is in an insolvency scenario regularly reduced and the real value will not correspond to the nominal value, but be substantially lower. The insolvency plan has to provide for value adjustments.[1478] It remains open, which evaluation standard applies, especially whether the new equity should be based on going concern values or liquidation values.[1479] In the Government Draft it says that in the valuation anticipated recovery rates could be taken into account.[1480] This would serve to indicate that valuation is better done with liquidation values in mind.[1481] The considerable risk of real values of claims tending downwards from at least substantially below nominal value to zero at worst would make a swap unattractive.[1482] The problem of valuation is still not resolved, but the above indicates that the Government intended to follow the "insolvency law solution" as discussed earlier on.[1483] It is surprising that the legislator did not include at least more criteria for the valuation of the claim which should be swapped into equity, which was demanded from the IDW.[1484] These uncertainties will again hamper the smooth implementation of the DES: another hurdle to overcome which the legislator should have considered more carefully.

7.3.1.4. Differential Liability

The ESUG has eliminated the obstacle of differential liability by limiting legal action against the correct valuation of claims for the duration of insolvency plan proceedings. In section 254 IV InsO differential liability is now excluded. The shareholders would not be held liable if a claim was overvalued, which was

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[1478] BT Drs. 17/5712 (n 294) 31.
[1479] Merten (n 893) 78.
[1480] BT Drs. 17/5712 (n 294) 31.
[1481] Heribert Hirte, Bela Knof, Sebastian Mock, 'Das Gesetz zur weiteren Erleichterung der Sanierung von Unternehmen Teil 1' (2011) DB, 632, 643.
[1482] Heribert Hirte, 'Das Gesetz zur weiteren Erleichterung der Sanierung von Unternehmen' (2011) DB 632, 643.
[1483] See chapter 7.2.2.2
[1484] IDW (n 1210) 4.4.

exactly in line with the legislator's aim to establish calculation certainty ("Kalkulationssicherheit").[1485]

Did the legislator reach this aim? At least he did for the existing creditors, which indeed makes it easier to get approval for the DES.

This provision was criticised on the ground that it would violate the protection of new creditors.[1486] The legislator countered that the creditors were included in the final voting process on the acceptance of the insolvency plan.[1487] This argument would, however, only hold true for the existing creditors with the new creditors left carrying the risk involved in an insufficiently capitalised debtor.[1488] Looking at the situation following the swap, it could be argued, however, that the financial situation of the debtor had improved massively due to a considerably reduced liability status and a formally higher equity capital. The new creditor would therefore not be exposed to a higher risk compared to the situation before the DES took place.[1489] The development of liquidity after the implementation of the plan will be fundamental for new creditors, although the valuation of the new claim should only indirectly influence company liquidity.[1490] This can be seen as a quite optimistic view.[1491]

These uncertainties and problems around the differential liability should have been resolved by giving more clarification with regard to the valuation of the claim. The uncertainties for new creditors would be reduced if the valuation was done in a more structured way. It was absolutely the right decision to abolish the differential liability for the existing creditors swapping their claims into equity as this was one of the reasons a DES was avoided in the first place. A new challenge occurs now for potential new creditors, which could be resolved by a more structured way to value the claim. This unfortunately and

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[1485] See chapter 7.2.2.3.
[1486] Meyer (n 16) 849.
[1487] BT-Drs. 57/5712 (n 294), 31.
[1488] Meyer (n 16) 849.
[1489] Meyer (n 16) 849.
[1490] BT Drs. 17/5712 (n 294) 31.
[1491] Ibid

surprisingly did not take place. This demonstrates another instance where a further adaptation in the Darwinian sense will be necessary in the future.

7.3.1.5. Equity Substitution ("Eigenkapitalersatz")/ Restructuring Privilege

The MoMIG introduced a change with regard to the restructuring privilege by inserting the new section 39 IV 4 InsO to clarify that shareholder loans given in times of a company crisis would no longer fall under the equity substitution regulations. There is no change in requiring the acquisition of shares having to be made for restructuring purposes, based on both restructuring intention ("Sanierungsabsicht") and restructuring ability ("Sanierungsfaehigkeit").[1492] Shareholder loans given in times of crisis are in consequence always subordinated, meaning that in an insolvency scenario they are last when it comes to the distribution of the insolvent's assets, which practically means that they would not get anything back on the occurrence of insolvency. [1493] In other words, the obstacle of substituted equity in a DES is eliminated provided these conditions are met.

The ESUG clarifies that the restructuring privilege is applicable for a DES.[1494] Creditors acquiring their shares via a DES can claim this particular benefit in line with appropriate regulations in section 39 subsection 4 clause 2 InsO.[1495] If shares are included into the plan and are withdrawn, there has to be a financial compensation in so far as the shares are still of value. [1496] Normally a residual value is not expected in insolvency proceedings, if a compensation is claimed it has to be done outside the insolvency proceedings so as not to delay the proceedings.[1497]

[1492] MoMIG - Gesetz zur Modernisierung des GmbH-Rechts und zur Bekaempfung von Missbraeuchen (Bundesgesetzblatt 2008 I 48).

[1494] BT Drs. 17/5712 (n 294) 32.
[1495] See chapter 7.2.2.4.
[1496] Section 251 III InsO.
[1497] BT Drs. 17/5712 (n 294) 32.

There were demands coming up in the legislative process of the ESUG to clarify the duration for this privilege.[1498] The privilege lasts until a sustainable restructuring sets in.[1499]

It is as yet unclear how to define the actual length of time by which the sustainability of restructuring ("Nachhaltigkeit der Sanierung") has been effected.[1500] It should be secured that the privilege does not already end when the insolvency grounds, the over-indebtness or the illiquidity, respectively imminent illiquidity are removed.[1501] The restructuring privilege should not cease to continue if the restructuring undertaken turns out to be unsuccessful, as eliminating this risk was the exact reason for these regulations. It was discussed whether the stage of sustainability is already reached with the confirmation of the insolvency plan.[1502] Looking at the spirit and purpose of the regulation, sustainable restructuring and with it the expiry of restructuring privileges should be considered achieved when it is that the actions taken led to secure the continuation of the company, as it has been given a positive forecast for a going concern ("positive Fortfuehrungsprognose"), with the risk of excessive indebtedness or illiquidity at least averted for the current and coming financial year.[1503] It was finally decided, however, to leave the status quo and to await the implications of the change recently introduced.[1504]

The introduction of section 39 IV 4 InsO through the MoMIG and the general application of the restructuring privilege in a DES are positive changes in the Darwinian sense with regard to the aim of fostering this procedure and one example of a minor change which had a high impact on the usage of DESs. This slight amendment will have a significant effect on the usage of the DES in practice. The potential insecurity of a possible treatment of the swapped capital as equity in the case of insolvency is eliminated. The uncertainties with regard to the duration of the restructuring privilege hamper the usefulness of

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[1498] Hirte Das Gesetz zur weiteren Erleichterung der Sanierung von Unternehmen (n 1482) 634.
[1499] Ibid
[1500] Ibid 633.
[1501] Ibid 643
[1502] Meyer (n 16) 848.
[1503] Arne Wittig, 'Das Sanierungsprivileg für Gesellschafterdarlehen im neuen Q 39 Abs. 4 S. 2 InsO' in: Bitter, G. et al (eds), Festschrift für Karsten Schmidt: zum 70. Geburtstag (Verlag Dr Otto Schmidt Cologne 2009), 1758.
[1504] BT Drs. 17/5712 (n 294) 26.

this amendment slightly as this might lead to a restrained usage of a DES. A clearer definition of the duration of the restructuring privilege would indeed be helpful to settle this uncertainty. It remains to be seen whether a further amendment will follow with regard to such a clarification.

7.3.1.6. European Law Concerns

It is finally left open whether the DES, or more specifically the consequent increase in company capital is in compliance with the scope of the Second Company Law Directive.

The Directive follows the principle that a capital increase would necessitate the authorisation of a general meeting by the shareholders.[1505] The prevailing opinion on a capital increase being carried out in insolvency proceedings is that it would not be subject to this Directive.[1506] It is argued, that the Directive should not apply to compulsory collective procedures ("kollektives Zwangsvollstreckungsverfahren"), meant only for the satisfaction of creditors.[1507] This opinion, however, is not covered by relevant decisions of the ECJ.[1508] In the particular case of the *Kefalas-decision*,[1509] the ECJ clarified that the resolution of the general meeting would also be needed in case of the company facing financial problems,[1510] seeing the purpose of a DES as not so much for the satisfaction of the creditors, but especially for the restructuring of the company.[1511] A regular result of a DES would be the dilution of the value of shares which in accordance to article 25 of the Directive should not be possible without a resolution of the general meeting.[1512] Therefore it could be argued that the regulations of the ESUG with regard to DES violate European law. However, it could be argued that shareholders forfeit their influence where the aim of the creation of new shares is to satisfy the creditors.[1513] As the

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[1505] BT Drs. 17/5712 (n 294) 26.
[1506] See more details to the KredReorG for example Christopher Paulus, 'The new German system of rescuing banks' BROOK. J. CORP. FIN. & COM. L. 171.
[1507] Jens Bormann 'Kreditreorganisationsgesetz, ESUG und Scheme of Arrangement' (2011) NZI 892, 894.
[1508] Bormann (n 1507) 894.
[1509] Ibid
[1510] Ibid
[1511] Ibid
[1512] Ibid
[1513] Eidenmueller, Engert (n 1423), 547; Wolf (n 26) 180.

shareholders' rights are worthless in an insolvency scenario, they do not need any more protection and it is very likely that the infringement of their rights within a DES is not illegitimate under European law.

7.4. England

7.4.1. Introduction

The DES is a frequently used restructuring tool in England. It has been applied successfully in a number of prominent cases, such as *Savoy Hotel*[1514], *Mytravel*[1515] or *IMO.*[1516] Interestingly, the DES was also used by *Schefenacker*[1517] and *Deutsche Nickel,*[1518] the two prevalent forum shopping cases where the companies had relocated their COMI from Germany to England.[1519]

7.4.2. Technical Implementations

The technical implementation can also be carried out through a cut in capital. Decreasing capital[1520] in a public company would require a special resolution in combination with a court approval.[1521] Another alternative, in this case for a limited company, would be a solvency statement issued by the directors.[1522] A capital increase must consist of authorised but so far not issued share capital or, if this is not sufficiently available, needing to be covered by the articles of association or based on a special company resolution.[1523] Depending on the chosen procedure, there are specific features still to be dealt with as follows and taking into account the obstacles analysed above.

[1514] *Savoy Hotel Ltd, Re* [1981] Ch.351, 3 All ER, 646.
[1515] *MyTravel Group Plc* [2004] EWHC 2741
[1516] *Re IMO Ltd [2009]* EWHC 2114
[1517] See appendix one
[1518] See appendix one
[1519] See appendix one
[1520] See section 617 (2) (b) CA 2006.
[1521] Section 641 (1) (b) CA 2006.
[1522] 642, 643 CA 2006.
[1523] Hagemann (n 29) 130.

7.4.3. Obstacles

Depending on the procedure chosen, there are certain regulations to be considered for a DES. Even though applicable also for an administration procedure, the DES is normally carried out in a CVA or SoA due to their flexible nature, for which reason the focus will predominantly be on these procedures.[1524]

7.4.3.1. Company Voluntary Arrangement

As analysed in chapter three, a CVA consists of a company proposal to all its members and creditors; it is considered a formal procedure, without court involvement, but nevertheless binding in nature.[1525]

7.4.3.1.1. Shareholders' Approval

Company law regulations require the approval of shareholders for cases affecting their rights.[1526] For a CVA procedure, separate meetings of shareholders and creditors would have to be called to approve the proposed DES.[1527] With regard to the creditors, a majority of 75 percent in value of the company's creditors present and voting at the meeting is needed,[1528] whereas the shareholder vote requires a majority of 50% in value held by shareholders present and voting at the meeting.[1529] However, the CVA would have effect regardless that the shareholders vote against it.[1530] As a result, in practice it is not possible for the shareholders to block the CVA, but they can challenge the approval on the ground of unfair prejudice.[1531] Interestingly, there seems to be no recorded discussion about this, neither in practice nor amongst

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[1524] For the administration procedure, there are no special regulations for a DES, therefore the general company law measures have to be applied.;Hagemann (n 29) 217.
[1525] Part I Insolvency Act 1986; Flechter Law of Insolvency (n 547) 477, Tribe Tudor Orthodoxy (n 683).
[1526] See section 145 CA 2006.
[1527] Part 1 IA 86.
[1528] Flechter Law of Insolvency (n 547) 408.
[1529] Ibid
[1530] Section 4 A (2) IA 86; Weisgard (n 686) 33; originally the CVA required the simple majority of shareholders' approval, amended by the IA 2000, a comment from Milman before the introduction of this change: "the current procedure, requiring a meeting of members to be called, simply complicates matters and generates additional costs" (David Milman, Francis Chittenden, *Corporate Rescue: CVAs and the Challenge of Small Companies* (Certified Accountants Educational Trust 1995).
[1531] If the shareholders decision defers from the one of the creditors, shareholders can apply (within 28 days) to the court for an order that the decision of the company meeting is to have effect instead of the decision of the creditors' meeting, but only Where a moratorium is in force. (See section 4 A IA 86, Weisgard (n 686) 33.)

academics.[1532] As noted above, the approval is needed generally, but explicit procedural integration is not subject to discussion.[1533]

7.4.3.1.2. Unfair Prejudice - Shareholders

Claiming unfair prejudice is the only possibility for a shareholder to challenge a DES within a CVA procedure.[1534] As discussed in chapter four, the shareholder has to prove that he is in a financially worse situation after the implementation of the CVA than he would have been without.[1535]

7.4.3.1.3. Exclusion of Pre-emptive Rights

English company law provides pre-emptive rights for the existing shareholders to protect their proportionate stake against dilution.[1536] In a private limited company these rights can be excluded via a special resolution.[1537] Section 565 CA 2006 could apply for public companies with a capital contribution done in the form of the creditor bringing his claim into the company as a non-cash consideration.[1538]

7.4.3.1.4. Differential Liability

A theoretical problem of differential liability could arise from section 580 CA 2006, stating that shares are not allowed to be issued at a discount.[1539] As indicated earlier, however, claims under English law are valued as cash considerations[1540]; in consequence, any challenge with regard to differential liabilily can be ignored.[1541]

[1532] Bork, Rescuing Companies (n 22) 15.27.
[1533] Wolf (n 26) 125.
[1534] section 6 IA1986
[1535] Cross-reference to chapter 4.4.2.2.
[1536] Eilis Ferran, Look Chan Ho *Principles of Corporate Finance* (second edition, Oxford University Press 2013) 115.
[1537] See 571 CA 2006.
[1538] Hagemann (n 29) 556.
[1539] Ibid
[1540] See chapter 7.4.3.1.8.
[1541] Section 583 CA 2006; this in fn as exampler what to consider in practice:
<http://www.bristows.com/articles/debt-equity-swaps-all-the-rage> (last visited 19.09.2015).

7.4.3.1.5. Creditors' Approval

In a CVA, there is no differentiation between creditor groups as would be the case in a SoA.[1542] With all unsecured creditors eligible to vote, a majority requires a minimum of 75% of the totalised claims held by all creditors with voting rights, regardless of the number of creditors.[1543] Original reform suggestions of the DTI[1544] to lower the threshold to a simple majority were finally discarded on the argumentation that it would not have significant effects on acceptance levels and concern being raised about potential claims of creditors unwilling to find themselves bound a simple majority.[1545] It is still however possible to exclude certain creditors by the 75% majority vote.

7.4.3.1.6. Unfair Prejudice - Creditors

Creditors will be free to challenge the CVA on grounds of unfair prejudice.[1546] Again, unfair prejudice is present on being confronted with a worse position because of the CVA, comparing the financial situation resulting from the CVA with facts as they would be without participating in the CVA.[1547]

7.4.3.1.7. Cram Down

One could argue that the binding effect of the CVA appears to be imposed on dissenting shareholders and creditors. In actual fact, however, a "forced inclusion" of secured creditors is not allowed, so there is no "cram down" in reality.[1548]

7.4.3.1.8. Valuation of the Claim

The question of how to evaluate claims in the case of a DES does not seem to be an issue in England. The explanation will be found in the varying

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[1542] See chapter 3.3.4.
[1543] See rule 1.17 (1) IR 86; rule 1.19 (2) IR 86.
[1544] DTI 1995 (n 570) 15, 16.
[1545] Finch Corporate Insolvency Law Principles and Perspectives (n 547) 512.
[1546] Section 6 IA 86.
[1547] Keay and Walton (n 515) 160..
[1548] See section 4 (3) IA 86, Hagemann (n 29)

considerations for a capital increase. In a private limited company the appropriate appraisal is done by the company directors or the shareholders, leaving it up to them to assess the non-cash contribution, there being no separate scrutiny by a court.[1549] A judicial control would only take place in the case of an obvious disproportion between the valutation and the actual payment.[1550]

This is different in the case of a public limited company, where stringent criteria for the assessment of non-cash considerations apply.[1551] The contribution is subject to an independent valuation, required to having been carried out within a period dating back a maximum of 6 months.[1552] Under English law, a remission of debt is categorised as equal to a payment in cash and not subject to any specific non-cash consideration.[1553] The claim is consequently rated at nominal value.[1554]

7.4.3.2. Schemes of Arrangement

As highlighted in chapter three, the SoA procedure represents another restructuring tool, although on strict terms not an insolvency procedure; it offers the possibility for a company in financial distress, insolvent or not, to enter into negotiations for a compromise with its creditors, with the aim to restructure the company.[1555]

7.4.3.2.1. Shareholders' Approval

The SoA will require the same majorities as needed for a CVA procedure.[1556] A major difference to the CVA is the necessity for the formation of particular groups.[1557] The proposal, however, would affect all shareholders as it will be binding for all participants alike. A capital decrease would affect the rights of

[1549] Steffek (n 815) 11,12; Sabine Otte, *Das Kapitalschutzsystem der englischen private limited company im Vergleich zur deutschen GmbH* (Verlag Dr. Novac Hamburg 2006) 50; Hagemann (n 29) 123.
[1550] Steffek (n 815) 12.
[1551] See section 593 CA 2006, see as well Hagemann (n 29) 123.
[1552] Section 593 (1) (a) CA 2006.
[1553] Section 583 (3) (c) CA 2006; *Truex v Toll* [2009] EWCH 396; Wolf (n 26) 191.
[1554] Wolf (n 26) 191.
[1555] Tolmie (n 568) 82, more details see chapter 3.3.5.
[1556] See chapter 3.3.5.
[1557] See chapter 3.3.5.

shareholders, making them eligible to form their own group in the proceeding.[1558] Shareholders not affected economically and not confronted by any negative effects through the scheme, could be exempted.[1559] It can be assumed that shares in a company are worthless on there being no working capital left or negative working capital.[1560]. However, shareholders should only be excluded if there is no doubt that their rights are unaffected.[1561]

A minority protection by way of unfair prejudice, for example, is not necessary as the desired protection is given through the formation of interest groups in the process. The consequences or procedural integration of the shareholders' approval appears again nor to be a matter for controversial discussion.[1562] For the SoA this would be understandable due to the procedure allowing the modification of shareholder rights.[1563]

7.4.3.2.2. Cram Down

It is arguable that the SoA represents a forced inclusion of dissenting shareholders and creditors, all being protected in the procedure by the formation of specific interest groups.[1564] It could be said the outcome of a scheme has a "cram down" nature[1565] as it binds all creditors, and therefore it is not possible for dissenting creditors to be considered by the consenting majority. This possibility helps to eliminate unwanted blocking potential from so-called "hold-out" creditors who just want to create a nuisance value ("Laestigkeitswert") in dissenting.[1566]

[1558] Hagemann (n 29) 148
[1559] Hagemann (n 29) 148; Steffek (n 815) 134.
[1560] Hagemann (n 29) 148.
[1561] *Re Neath and Brecon Rly Co.* [1892] 1 Ch. 349; there is the possibility to raise an objection in the hearing (more details see Pilkington (n 136) 105,106.
[1562] Bork Rescuing Companies (n 22) 15.27.
[1563] See above, section 895 (1) (b) CA 2006.
[1564] See chapter 4.4.4.3.
[1565] Pilkington (n 136) 13.
[1566] Ibid, 12.

7.4.3.2.3. Creditors' Approval

Creditor groups not affected economically and not confronted by any negative effects through the scheme, could be exempted.[1567] The "no economic interest-approach" is applied.[1568] The question to ask is whether the creditors have "any real economic interest in the company".[1569] "That involves looking at the reality. Economic interests for the purpose are real, not theoretical."[1570] For this purpose courts would look at the enforcability of the debt and the chance of realisation. Seeing evidence of there being no realistic chance for receiving any money through a liquidation as the only alternative to the scheme, no economic interest can be asserted and it would be justifiable to deprive the creditors of their claim.

Once the classes have voted on the scheme, there is no further remedy available for the creditors due to the "cram down" nature of the proceeding as explained above.

7.4.3.2.4. Differential Liability

The remarks made with regard to a CVA apply for a SoA procedure in the same way; differential liability plays an only subordinate role in English law anyway.[1571]

7.4.3.2.5. Restructuring Privilege

Statutory restructuring privileges for loans are unknown to the English insolvency law regimes, the single exception being an inter-creditor agreement by which creditors might be given certain contractual privileges.[1572]

[1567] IMO (n 1085).
[1568] Pilkington (n 136) 108-116; IMO (n 1085); MyTravel (n 1515).
[1569] MyTravel (n 1515) 19.
[1570] Ibid 20.
[1571] See chapter 7.4.3.1.4.
[1572] My Travel (n 1515) 19.

7.4.3.2.6. European Law Concerns

England faces the same challenges as Germany with regard to the Second Company Law Directive. Interestingly there are no discussions about the conformity of the DES in England with EU law. The reason might be the pragmatic approach in England. There were so far no infringment proceedings initiated by the European Commission and this might be an indicator that they do not see a DES as a violation of the Second Company Law Directive.

7.4.4. Company Voluntary Arrangment or Schemes of Arrangement?

The choice for either a CVA or a SoA procedure should be made depending on the circumstances of each individual case.[1573] The SoA will offer the advantage of greater protection for the company in requiring a court sanction, thereby often leading to delays and higher costs. A CVA would normally be implemented without court involvement, unless a creditor challenged the CVA; also the formation of interest groups is not necessary.[1574] In contrast to the SoA, the CVA carries the risk of challenge due to unfair prejudice after a decision has been made for the procedure, whereas the SoA would tend to offer greater security once being approved, with the legal effect also extending to the secured creditors.[1575] This greater certainty could be seen as one of the main reasons why the use of the SoA procedure is progressing and the figures for CVA's are declining. A new trend is to combine the SoA and CVA in a DES and use the advantages of both procedures.[1576]

7.5. Comparison

The DES is a valuable restructuring tool in both countries. After investigating the technicalities and, in particular, the obstacles in connection with a DES in Germany pre- and post-ESUG and in England are compared and contrasted. Whether or not the changes in Germany were driven by forum shopping

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[1573] More and detailed flowchart see Geoff O'Dea, Julian Long, Alexandra Smyth, *Schemes of Arrangement – Law and Practice* (Oxford University Press 2012) 113.
[1574] Raquel Agnello, Ben Griffiths, 'Creditor schemes of arrangement and company voluntary arrangements in recent debt restructurings' (2013) 2 CRI 47, 47.
[1575] Ibid 47.
[1576] Ibid, cases such as *Fitness First, Travelodge and Bowlplex.*

activities and whether these changes to the DES procedure helped to enhance Germany's insolvency regime is critically evaluated.

The changes in connection with the DES in Germany are one of the clearest examples of being a result of forum shopping. The first thing mentioned in the introduction of the Government Draft is that German companies had migrated to England to get into the benefit of the English insolvency regime, one reason being the lack of a possibility of a DES in Germany.[1577] The lack of a functioning DES was one of the main reasons why *Deutsche Nickel* migrated to England.[1578]

7.5.1. Shareholders' Approval

The necessity to obtain the approval of all shareholders was a major obstacle pre- ESUG. Shareholders were not involved and an infringement of their rights was not allowed.[1579] The ESUG introduced changes to include the shareholders in the insolvency proceedings as one voting group, thereby opening the possibility for an infringement, but the court would be able to declare a consenting voice on their behalf even if they rejected the plan.[1580]

In England, it is necessary to distinguish between the two procedures. In general terms, both CVA and SoA procedures require the consent of shareholders. The rights of shareholders can, however, be excluded in a SoA procedure if the shares have no economic value left.[1581] Due to the "cram down" nature of the SoA proceeding, binding all shareholders and creditors, one could speak of a forced inclusion of dissenting creditors, although they are protected through the formation of the classes.[1582] The CVA has effect even if the shareholders votes against it.[1583] Therefore shareholders can be excluded, which serves to highlight that the interest of creditors is given priority in critical

[1577] Bt. Drs. 17/5712 (n 294) 1 Problem und Ziel
[1578] See appendix one.
[1579] See chapter 7.2.2.1.
[1580] Meyer (n 16) 848.
[1581] See chapter 7.4.3.2.1.
[1582] See chapter 7.4.3.2.2.
[1583] Section 4 A (2) IA 86; see more details: Weisgard (n 686) 33.

times, with the interest of shareholders having to stand back.[1584]A CVA procedure would not offer the possibility of forming interest groups, but instead, where applicable, the shareholders could lodge an appeal against unfair prejudice.[1585]

The possibility of infringing shareholders rights as introduced by the ESUG was clearly driven by forum shopping activities.[1586]

The general inclusion of shareholders in the process together with the possibility of infringing their rights can, without a doubt, be regarded a "race to the top". The situation pre-ESUG made a DES almost impossible and regulations were clearly not adapted to the demands of insolvency practice. The growing importance of the DES exemplified by the migration of German companies to England in order to benefit from a DES, led Germany to react and adapt national insolvency law to better withstand inner EU-competition. Interestingly the first statement of the Law Commission led to the reforms in 1999 suggesting an exclusion of shareholders rights with shares of no economic value, similar to the system in England.[1587] But was never picked up in any further reform discussion again.

There are certain differences remaining between the legal approach in Germany and England, mainly attributable to the diverse procedures being applied. The situation in Germany is more comparable to the SoA procedure in that insolvency plans also demand a formation of classes. Whereas in England there is no further remedy available for the shareholder once the scheme is approved, in Germany there is the possibility of suing for remedies under section 251, 253 InsO.[1588]

The "cram down" effect of the SoA procedure is one major difference to the DES procedure under German law. Furthermore, there is the possibility under

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[1584] Keay and Walton (n 515) 150; Hagemann (n 29) 201.
[1585] See chapter 7.4.3.1.2.
[1586] See chapter 7.5.
[1587] Erster Bericht der Kommission fuer Insolvenzrecht (n 303) 282.
[1588] See chapter 4.3.4.

the SoA procedure of excluding individual shareholders in the first place if they are not economically affected.[1589] The economic approach was recommended in Germany during the reform process leading to the InsO, but was not implemented. Such a solution was not part of the ESUG reform discussions.

Within a CVA procedure the shareholders' vote can be overruled by the creditors' meeting and the CVA is nevertheless effective.[1590] Due to the lack of the formation of classes the shareholders have the possibility of challenging the CVA on the grounds of unfair prejudice.[1591]

The situation in England looks different, especially within the SoA procedure. Due to the character of the SoA procedure, a binding force for all involved parties can be achieved much more easily and earlier as discussed above.[1592] The CVA is even effective notwithstanding that the shareholders voted against it,[1593] so in fact their rights can be excluded completely.

Overall it can be concluded that the introduction of the possibility of infringing shareholders' rights in Germany can be seen as a race to the top as the DES as a restructuring tool becomes more attractive and practicable. However, the remaining possibility of remedies under section 251, 253 InsO and especially the limitation to the DES within an insolvency plan procedure could be classified as a half-hearted approach and a failure to conform fully to the Darwinian Theory as in practice most of the DESs are conducted in informal proceedings. In other words the reforms and hence the removing of obstacles still only applies to the minority of the cases. Again, the legislator should have solved the issue for out-of-court restructurings as well as the practice demands it. The adaptation is not far reaching enough and further changes will be necessary in the future for a more perfect DES regime in Germany.

[1589] See chapter 7.4.3.2.1.
[1590] Section 4A (2) IA 86
[1591] See chapter 7.4.3.1.2.
[1592] See chapter 7.4.3.2.
[1593] Section 4 A (2) IA 86

The beauty of the English regime in this context is that parties are able to choose either the CVA or the SoA depending on their individual needs, offering flexibility to the complexity of the cases and not a "one size fits all" solution. Germany does not offer this flexibility and the requirement for a DES are still more burdensome post-ESUG. The solution would have probably been to introduce a new pre-insolvency procedure and to imbed the DES within such a more customisable procedure.

7.5.2. Creditors' Approval

In Germany, the consent of all creditors is required in order to accomplish a DES. The ESUG brought about no changes, although there were demands for a so-called "fiction of consent" in the provisional Discussion Draft.[1594] The removal of such a provision was based on breach of property protection, by considering the claim of each individual creditor as property.[1595]

In England, the same arguments regarding shareholders for both the SoA procedure and the CVA can be applied for the creditors as well. In a CVA procedure, creditors can be excluded by majority vote, but having recourse to the remedy of unfair prejudice provided there is proof for a worsening position caused by the CVA.[1596] In a SoA procedure, a group of creditors can be excluded on grounds of not being economically affected.[1597] Once approved the cram down like effect in a scheme applies and it is binding for all creditors.[1598]

The decision of the German legislator not to change the status quo with regard to the necessity of the creditors' approval might have been driven by forum shopping activities, especially looking at the first Draft with a "fiction of consent" laid down. However, looking at the reasoning of the legislator, the decision not to make it possible to infringe creditors' rights was more a dogmatic one. As explained above, claims of creditors fall under the property

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[1594] See above 7.3.1.2.
[1595] Ibid
[1596] See chapter 7.4.3.1.6.
[1597] See 7.4.3.2.3.
[1598] Ibid

protection of the GG.[1599] In contrast to the shareholders' situation it is difficult to argue that the claims of the creditors are economically worthless. Therefore, it cannot be concluded that leaving the status quo with regard to creditors' consent was driven by forum shopping activities it is more an outcome of the boundaries in German law with regard to the protection of fundamental rights under the German Constitution. Although it is still of interest to see whether and in what extent this decision can improve the insolvency landscape in Germany. It could be argued that leaving the status quo and asking for the consent is a justifiable race to the top as a DES should not be allowed without the consent of all creditors as no creditor should be forced into a shareholder position against his will.[1600]

However, it is argued that requiring the consent of all creditors is to be considered a "race to the bottom". The argument that individual rights cannot be replaced by a majority vote would hardly reflect a comprehensive consideration of this topic. It would be inappropriate in the long run to continue simply disregarding the impact on all parties concerned. The fear of a worse position is not the only reason for blocking a DES, in fact the ambition to block a DES vary extensively. Creditors might simply want to create a disruptive factor, trying to pressure creditors with greater claims to pay their claims off in full or at least at a premium.[1601] These creations of nuisance value should at least have been considered and discussed. The explanation is the fear of a breach of fundamental rights and again a reflection of Germany's conservatism in not tackling this issue, but just refusing to deal with it at all. Interestingly it is possible to infringe creditors' rights under the new SchVG.[1602] The reason might be that it is impossible to standardise all creditors[1603] and therefore the necessity to have the approval of all creditors would not be realistic as unanimity could never be achieved.[1604] However, the example of the SchVG shows that there is a way to infringe creditors' rights and therefore

[1599] See chapter 7.3.1.1.
[1600] See chapter 7.3.1.2.
[1601] See as well Pilkington (n 136) 12.
[1602] See chapter 2.3.8.
[1603] Rechtsauschuss, BT-Drs. 16/13672 'Beschlussempfehlung und Bericht zum Schuldverschreibungsgesetz BT Drs. 16/12814' http://dip21.bundestag.de/dip21/btd/16/136/1613672.pdf, 19.
[1604] Ibid, 13.

should have been at least a matter of discussion due to its impact on the proceedings. The possibility of excluding certain dissenting creditors could make all the difference in restructuring a company.

Altogether, leaving the status quo unaltered is arguably another occasion of a failure adapting to the needs of the environment in the Darwinian sense. It is, of course, justified to have a regulation in place to prevent exclusion minority creditors having valid reasons for dissent, but there should be a possibility of excluding creditors dissenting for merely tactical reasons. In spite of its pressing nature, the legislator has left this question unanswered for the time being. In comparison to the situation in England, sticking to prohibiting the infringement of creditor rights no matter what the circumstances, will be a disadvantage for Germany, although a better adaptation in the sense of the Darwinian theory remains open for possible future action. The possibility of infringing creditor rights remains of major importance for a DES. In this respect, England would be holding out a clear advantage over Germany for the time being.

7.5.3. Valuation of the Consideration

Looking at the valuation of swapped debts, circumstances in Germany deviate largely from those prevalent in England. Pre-ESUG it was altogether unclear whether to approach the valuation according to company law or to look for an insolvency law solution.[1605] The changes through the ESUG indicate that in future liquidation values are taken and therefore the legislator intended to follow the insolvency law solution.[1606] However, the crux of the problem is still not solved as the new regulations still not offer a clear specification of how to value the consideration. It would have been at least helpful if the legislator had included more criteria for the valuation of the claim.

As discussed above, England does not face a similar challenge as the valuation for a private company is done by the directors, whereas for a public

[1605] See chapter 7.2.2.2.
[1606] See chapter 7.2.2.2.3.

company the debt remission is considered a payment in cash, with the nominal value taken as the claim value.[1607]

Due to the different approaches and regulations with regard to the valuation of the claims it seems unlikely that the changes through the ESUG were driven by forum shopping activities. Although not driven by forum shopping activities, the question should be asked whether the changes brought about will lead to an enhanced usage of the DES in Germany.

The general tendency of the German legislator to follow the insolvency law solution, taking the liquidation value as the norm, is generally an enhancement of the situation. The insolvency solution offers incentives for the creditors and as their approval is needed it will encourage the use of the DES. The insolvency solution has disadvantages for the shareholders, however, due to the new possibility to reduce the shareholders' rights, the obstruction of shareholders can be minimised. However, there is still no clear indication how to value the consideration, which is still an uncertainty that could hinder the use of the DES procedure in practice.

It would probably have been advisable to take a closer look at the handling of the situation in England so as to find a more pragmatic approach. The German legislator was to all appearances inspired by the English model for a DES, but failed to delve into the details of the process.[1608] The open challenges regarding the valuation of the consideration, leading to uncertainty and a potential lack of attraction will in all likelihood cause a less frequent use of this tool in Germany. Now with the benefit of hindsight, the German legislator should have used the reform not only to clarify the approach, but to look for a more practical solution to meet market demands all the better. The mere requirement of applying the liquidation value will be enough to hinder a more frequent utilisation of the DES.

[1607] See chapter 7.4.3.1.8 and 7.5.3.
[1608] See details to the DES process in England: chapter 7.4.

7.5.4. Differential Liability

The existing risk of an additional contribution ("Nachschusspflicht") pre-ESUG was prevented by providing that shareholders would not be held liable for a claim having been overvalued.[1609] However, there is still no legal certainty which the legislator was actually aiming for. As discussed previously,[1610] new creditors might still face the risk of having to provide for an additional contribution.

England does not face the problem of differential liability as claims are valued as cash considerations.[1611]

Due to the different regulations and approaches in Germany and England it is rather unlikely that this particular change was driven by forum shopping activities. It was recognised instead that this particular uncertainty had prevented a wider use of the DES, which the Legislator wanted to amend.

The removal of the possible need for existing creditors to provide additional funding is indeed a "race to the top", improving chances for the more frequent use of a DES. The removal of the uncertainty about a cash contribution at least for the existing creditors makes it more likely that they will vote for a DES. As we have seen above, all creditors have to approve the DES and more certainty about not facing any additional contribution in the future might help them to make a positive decision.

Having said that, this is yet another situation were the legislator did not use the reform as a fresh start, but gave with the one hand and took with the other, as the uncertainty for new creditors is still present. This fails to replicate the analogy with the Darwinian Theory as the restructuring tool is still not perfectly adapted to the needs of the practice. New creditors face a less attractive situation as there is not the potential liability of the existing creditors to

[1609] See chapter 7.2.2.3.
[1610] See chapter 7.3.1.4.
[1611] See chapter 7.4.3.1.8.

contribute additionally in the case of overvaluation. This might have an effect on new creditors willing to invest. The legislator should have solved the problem at its roots, trying to bring more clarity to the valuation of the claim, making an overvaluation less likely.

7.5.5. Restructuring Privilege

The uncertainty about the acquisition of shares via a DES falling under the restructuring privilege was removed by the ESUG. There is no connection to forum shopping in this respect as restructuring privileges are unknown in England. This particular change can only be seen as an improvement of the insolvency landscape as it helps to enhance the usage of a DES in Germany.

7.5.6. European Law Concerns

As highlighted above, both countries face the same challenge with regard to European Law concerns in relation to a DES as they are both regulated by the Second Company Law Directive[1612]. The topic is examined in Germany whereas in England there are no debates about the conformity with EU law with regard to DES.

7.5.7. Insolvency Law Solution

A general difference between the approaches in England and Germany is that the German legislator chose to solve a company law conflict with an insolvency law solution. The changes introduced by the ESUG are merely for DESs within an insolvency plan procedure.[1613] A DES outside a formal proceeding does not fall under the new regulations due to the insolvency law solution, whereas the regulations in England apply for all DESs in and outside formal insolvency proceedings.

[1612] Council Directive 77/91/EEC (Second Company Law Directive).
[1613] See chapter 7.2.2.2.2.

The solution in Germany is to be seen as a missed opportunity as the DESs are mainly applied pre insolvency, in informal restructuring attempts.[1614]

7.6. Mini Conclusion

Summarising, the general change of the DES regime in Germany was driven by forum shopping acitivities, whereas not all detailed changes within the procedure can be traced back to forum shopping due to the specialities and differences in the systems. All the changes have the common aim to simplify the procedure.

Overall it can be concluded that the reduction of the hurdles could be seen as a race to the top. Because of the simplification of the procedure, it is likely that it will be used more frequently. An increased application of this important and attractive restructuring procedure[1615] will strengthen the German rescue culture.

Especially the possibility of infringing shareholders' rights by including them as a class in an insolvency plan proceeding could be seen as a major improvement as obstructing shareholders were the main problem in a DES procedure pre ESUG. However, there are still more hurdles to overcome than in the English equivalent. In the SoA there is the possiblity of excluding shareholders with claims of no economic value in the first place, which was discusses in Germany pre InsO, but never followed through. There is no cram down like nature of the proceedings in Germany, leaving uncertainty as to claims under minority protection rules. In England there is the chance to select the SoA procedure which once approved is binding in nature.

Leaving the status quo with regard to the requirement of the creditors' consent cast the biggest shadow across the DES in Germany. The aim of the legislator was to facilitate restructurings via DES. Asking for a hundred per cent creditors' approval conflicts with this aim as there is still potential for individual

[1614] Hagemann (n 29) 235,236.
[1615] Discussion Draft (n 502) 33.

creditors to obstruct, which should have been avoided, especially as "hold-out" creditors will use this bargain power to get the best out of the deal as they know that without their consent the DES would fall through. A mandatory inclusion of creditors in a consent approved by the majority is exceptionally beneficial from an economic perspective to avoid a "freeloader situation" as it is advantageous for an individual creditor to wait and hope for other creditors to provide the necessary restructuring contribution.[1616]

This is yet another instance where Germany had the chance to change the legislation more courageously, but ended up with a compromise, which will lead to the necessity of more amendments as the situation is not adapted perfectly to the insolvency environment.

The existing uncertainty about the valuation of the claims is another example of a fettered approach, another uncertainty which has not been removed and which will lead to at least some reservations amongst creditors about swapping their equity. It would have been easy to introduce at least a few more criterion how to value the claims as explained above. It remains unclear why this has not been done.

The big hurdle of facing differential liability was at least removed for existing creditors which is to be seen as a major improvement. However, leaving uncertainty for new creditors is hampering the proceedings and a step back with regard to the legislator's aim.

The changes with regard to equity substitution can be seen as a race to the top as the possible treatment of capital as equity was removed as well as the uncertainties around the swap for the creditors. However, the insecurity around the duration of the restructuring privilege could have been avoided by a further amendment giving clarification.

[1616] Schaefer (n 1011) 201.

By embedding the changes in the DES procedure into the insolvency plan procedure, in other words by not making positive changes for out-of-court DES restructurings, the legislator missed the chance to resolve the problems around the DES more holistically. Most DES happen pre insolvency and therefore do not benefit from the changes and the old hurdles remain. Allowing the incentives only in a formal insolvency procedure could result in creditors refusing to agree to DESs in informal workouts, which could lead to an even less frequent use of DES in practice overall. This is the result of trying to resolve a company law problem with an insolvency law solution. The legislator should have changed the DES procedure in general and not only for the cases of insolvency.

Comparing the overall handling of the DES procedure in England and Germany, the approach in Germany is still not as sophisticated as in England. In England the parties have a wide range of procedures to choose from, which is not an "one size fits all" solution, but more open to flexible and customised solutions. Both procedures used in England for a DES have their advantages and are both very flexible tools as explained above.

Embedding the DES in the existing structure of an insolvency plan does not seem to be the right approach. It would have been more effective to introduce a pre-insolvency proceeding, allowing more flexible and less bureaucratic solutions, in which a DES could have been included. But this would have amounted to breaking with existing structures in Germany, allowing an intrusion into the German paternalistic system of commitment to justice ("Paternalistisches System der Justizfoermigkeit").[1617] Nevertheless, in order to have modernised effective and well adapted insolvency law regulations and procedures adapted to the needs of the economic environment, some traditions have to be surrendered.

[1617] Haarmeyer ESUG (n 1106) 5.

Chapter Eight

Preparatory Insolvency Proceedings

"The protective umbrella proceeding- a possibility for an early, quick and quiet restructuring"[1618]

We need a pre-insolvency restructuring procedure, I fear it will only happen if the EU forces it on us"[1619]

8.1. Introduction

A major novel innovation introduced by the ESUG was the creation of a new procedure for the timespan between filing and actual opening of proceedings, the so-called "protective umbrella proceeding" ("Schutzschirmverfahren").[1620] This chapter critically evaluates whether the introduction of this new procedure was driven by forum shopping activities, in comparing and contrasting it to similar procedures in England and analysing whether this change resulted in an improved rescue landscape in Germany. The challenge of this chapter is to identify the nature of the protective umbrella proceeding and find comparable procedures in England.

8.2. Nature of the Protective Umbrella Proceeding ("Schutzschirmverfahren")

For the first time in German insolvency history the ESUG introduced an independent restructuring procedure to bridge the timespan between filing and opening of proceedings.[1621] This is at least what can be taken from comments by the legislator concerning this new proceeding.[1622] It could be argued that the protective umbrella proceeding is no independent restructuring procedure on its own, but a specific form of the normal insolvency proceeding

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[1618] Heinz Vallender, 'Das neue Schutzschirmverfahren nach dem ESUG' (2002) GmbHR, 450, 450.
[1619] *"Wir brauchen ein vorinsolvenzliches Sanierungsverfahren, ich befuerchte dieses kommt erst, wenn die EU uns zwingt"* Grell, 10. Handelsblatttagung, Frankfurt, May 2014.
[1620] New section 270b InsO.
[1621] See chapter 2.3.3.
[1622] BT Drs 17/5712 (n 294) 40 (zu section 270b InsO)

("Insolvenzantragsverfahren").[1623] The German Bar Association ("Bundesrechtsanwaltskammer", BRAK) entitles it "a separate small procedure" ("eigenes kleines Verfahren")[1624] and Merten speaks of an "independent preliminary insolvency proceeding" ("eigenstaendiges Eroeffnungsverfahren") with the aim of transferring the protective umbrella proceeding into a regular insolvency plan proceeding.[1625] Flechter speaks of a form of "pre-pack".[1626] It might well be claimed that the protective umbrella proceeding represents a pre-pack plan that is prepared between the application for filing and the actual opening of insolvency plan proceedings.[1627] Section 270 b InsO carries the title "preparation of a restructuring" ("Vorbereitung einer Sanierung"). Within the InsO framework it is to be found under the chapter "self-administration" and could therefore be regarded a special form of self-administration.

The protective umbrella proceeding offers the debtor the opportunity to prepare a restructuring plan under self-administration,[1628] given special protection as per section 270b InsO, subsequently implemented in the insolvency plan.[1629] To benefit from this new procedure, the debtor has to file an application before the occurrence of illiquidity, but imminent illiquidity or overindebtness must be present.[1630] Under these circumstances the court may decide a time limit of up to three months under the protective umbrella, supervised by the court in co-operation with a preliminary trustee ("vorlaeufiger Sachwalter") in an effort to pave the way for a successful restructuring.[1631] In other words, the protective umbrella proceeding cannot be categorised to represent an independent restructuring procedure, as it only prepares the insolvency plan proceeding in self-administration. A stand-alone protective umbrella proceeding is not possible. It can therefore be regarded a preparatory

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[1623] Schulte-Kaubruegger (n 18) 3.
[1624] BAK (n 504) 7.
[1625] Merten (n 893) 143,144.
[1626] Flechter, *Comment Protective Umbrella Proceeding* (n 81) 25.
[1627] Jessica Klein, 'Pre-pack administration: a comparison between Germany and the United Kingdom: Part 2' (2012) Comp. L. 303, 309.
[1628] See chapter 5
[1629] Discussion Draft (n 502) 270b InsO ("Vorbereitung der Sanierung") The protective umbrella proceeding has and will have an impact on the role of the IOH in Germany, however the discussion would go beyond the scope of this research, but will be topic for further research.
[1630] Ibid
[1631] Ibid

proceeding, a special form of the preliminary proceeding leading to an insolvency plan.

8.3. Comparable Procedures in England

Due to the lack of directly analogous preliminary proceedings[1632] in England there is apparently no directly comparable proceeding. It could be argued that the protective umbrella proceeding should be compared to pre-insolvency proceedings as the protective umbrella proceeding was introduced instead of the latter.

In the light of the reform discussions in Germany, a decision was needed as to whether to have an independent Restructuring Act with a separate pre-insolvency procedure or to just implement amendments to the InsO. The ESUG is the result of the latter path. The Minister of Justice at the time, Mrs Leutheusser-Schnarrenberger, explained in her speech on the ninth German Insolvency Day 2012 ("Neunter Insolvenzrechtstag 2012") that a separate pre insolvency proceeding was not chosen, but that a new path was to be followed with the protective umbrella proceeding. Before taking further steps in the direction of a pre-insolvency proceeding, experience should be gained with the new law in practice, to subsequently judge on the possible requirement for a separate procedure preceding insolvency.[1633] The Minister, however, held out the prospect of discussing this topic anew in the second step of the three-tier insolvency reform plan.[1634] Leutheusser-Schnarrenberger stated that such an independent pre-insolvency restructuring procedure would be a completely new approach by reference to existing practices in England and France.[1635] She explained that several questions remained open, for example, whether such a procedure should be integrated in the InsO or not, whether a court should be involved, as also the eligibility for such a procedure and the matter of a stay of execution ("Vollstreckungsschutz").[1636] Although Leutheusser-Schnarrenberger was optimistic about finding a practical solution, the reform

[1632] Preliminary Proceedings as explained in chapter 2.3.3.
[1633] Leutheusser-Schnarrenberger, 9. Insolvenzrechtstag (n 21).
[1634] Ibid
[1635] Leutheusser-Schnarrenberger, 7. Insolvenzrechtstag (n 6).
[1636] Ibid

discussions with regard to such an independent proceeding were dropped in the end. The Bundestag invited the Government to review the law reform 5 years after its coming into force, and in this context asked it to clarify whether the need for a separate pre-insolvency proceeding still existed in spite of the protective umbrella proceeding now established.[1637]

The reasons why the original proposal for a review of this topic during the second stage of the insolvency reform plans was not considered were not published. It can only be assumed that the protective umbrella proceeding was regarded as a good alternative to a totally separate proceeding and that the numerous critical voices raised against such an independent proceeding resulted in postponing the review. A possible reason could be the negative experience suffered with the two separate proceedings in place before the introduction of the InsO.[1638] The reform suggestion made by the Law Commission ahead of the 1999 reforms to have a separate restructuring within the regular insolvency proceeding was turned down as well.[1639]

8.4. Discussion about a Separate Pre-Insolvency Proceeding

It is, therefore, of interest to look at the discussions around a separate pre-insolvency proceeding in Germany which took place before the drafting of the ESUG. There were several voices demanding a separate pre-insolvency proceeding, using the argument of numerous advantages which such a proceeding would have in comparison to a formal insolvency proceeding. Pre-insolvency proceedings could be defined as consisting of "initiating quasi-collective proceedings under the supervision of a court or an administrative authority for the purpose of enhancing corporate restructuring efforts to prevent the commencement of insolvency proceedings."[1640]

A pre-insolvency proceeding could have the advantages of greater flexibility, substantial efficiency, less cost in comparison to a formal procedure and a

[1637] BT-Drs. 17/5712 (n 294) 6.
[1638] See chapter 2.2.
[1639] Erster Bericht der Kommission fuer Insolvenzrecht (n 303) 155.
[1640] Vienna-Heidelberg Report (n 116), 11.

shorter duration of the proceedings.[1641] A unified procedure ("Einheitsverfahren") as presently used in Germany would not be up-to-date anymore due to the diversity of needs.[1642] A separate insolvency procedure would encourage an earlier filing as it could be designed to eradicate any weak points in current insolvency procedures, known to be time consuming and cost intensive, causing the loss of control over the procedure and upholding the stigma of insolvency.[1643] Clearly, such a new procedure would have to be drafted in such a way as to eliminate exactly these weak points by creating a procedure which is faster and less complicated, which could be used with confidence.[1644] A separate procedure could, of course, carry the risk of an "over-restructuring", as the lack of obligatory inclusion of shareholder rights might encourage the debtor to always try such an independent proceeding first, even though the preconditions would only be met in rare and specific circumstances.[1645] Furthermore, the positive experience in England, highlighted below, served to set a good example.[1646]

An independent insolvency law proceeding would help to include so-called "hold-out" creditors ("Akkordstoerer") in the proceedings.[1647] The BGH ruled that there is no cooperation duty between shareholders in an out-of-court restructuring attempt,[1648] which tends to trigger a freeloader mentality. An independent pre-insolvency proceeding could prevent this by including the possibility to infringe shareholders' rights.[1649]

An interesting argument was put forward by Eidenmueller, using a general German virtue expressed by Nietzsche, "the German sense for flourishes and pensiveness" ("deutscher Tief- und Schnoerkelsinn")[1650] claiming that an independent restructuring law would result in "over-regulation"

[1641] Hoelzle Die erleichterte Sanierung von Unternehmen (n 806) 207.
[1642] Florian Jakoby, 'Insolvenzrechtsreform ESUG: Meilenstein, aber kein Ruhekissen' (2011) DB M01.
[1643] Volker Beissenhirtz, 'Plaedoyer fuer ein Gesetz zur vorinsolvenzlichen Sanierung von Unternehmen' (2011) Zeitschrift fuer das gesamte Insolvenzrecht 57, 59.
[1644] Ibid
[1645] Horst Eidenmueller, 'Reformperspektiven im Restrukturierungsrecht' (2010) ZIP, 649,655.
[1646] See chapter 8.9.
[1647] Eidenmueller in Paulus (n 468) 1345.
[1648] "Akkordstoerer Urteil des BGH, BGH, Urteil vom 12.12.1991, WM 1992, 322.
[1649] Eidenmueller objects that this aim could also be achieved by the BGH changing its judgment and allowing to include shareholders rights in out of court restructurings, see Eidenmueller in Paulus (n 468) 1344
[1650] Nietsche; Eidenmueller in Paulus (n 468)1345.

("Ueberregulierung").[1651] There is always fear that the legislator would regulate a new procedure in great detail, including all matters in connection with such a pre-insolvency proceeding. This could then result in a flawed and tedious proceeding.[1652] The argument is interesting in the sense of lending support to repeated comments in this research work about Germany's reform attempts with regard to insolvency law often being complicated and overly bureaucratic.

Arguing on the basis of this German virtue is, of course, a bit like "putting the cart before the horse". This is, however, exactly what has to be changed in Germany in order to better adapt to the needs of commercial reality. Just because basic mentality in Germany is tending to overly complicate regulations and approaching reforms without innovative ideas for a fresh start does not mean that it would not be beneficial to have the courage to create legislation neglecting the German sense for "flourishes and pensiveness". The former Minister of Justice Leuttheusser-Schnarrenberger reasoned that a mentality change ("Mentalitaetswechsel") is needed in Germany, hence a different insolvency culture. For thinking to change, the law has to change.[1653] However, before the way thinking of the general public can change, the way of thinking of the legislator has to change towards a more courageous and pragmatic approach.[1654] If "safeguards are over-engineered"[1655], procedures are created which are not practical and therefore not supportive for achieving a more restructuring friendly insolvency culture, and this in the end does not only have negative consequences for the debtor and creditors, but to the public interest.[1656]

Some psychological arguments could be listed which hamper the acceptance of a pre-insolvency procedure in Germany: namely the absence of a culture for settlement ("fehlende Vergleichskultur"), a potentially exaggerated sense

[1651] Nietsche; Eidenmueller in Paulus (n 468)1345.
[1652] Ibid
[1653] Leutheusser-Schnarrenberger, 7. Insolvenzrechtstag (n 6).
[1654] See as well Methodology chapter 0.7.
[1655] Flechter *Comment Protective* Umbrella Proceeding (n 81) 25.
[1656] Flechter Spreading the gospel (n 70) 530.

of justice ("uebertriebenes Gerechtigkeitsstreben") and a significant loss aversion ("grosse Verlustaversion").[1657]

8.5. Justification for comparing the Protective Umbrella Proceeding with the Schemes of Arrangement and the Company Voluntary Arrangement?

Comparing the protective umbrella proceeding with the SoA and the CVA could be justified because the protective umbrella proceeding was chosen as an alternative to an independent pre-insolvency proceeding. The question however, is whether these proceedings are indeed comparable. Is the mere fact of the protective umbrella proceeding having been chosen instead of a pre-insolvency proceeding reason enough to compare and contrast otherwise completely differently structured proceedings? The only common denominator lies in the fact that all proceedings aim for the restructuring of a company as the final result.

It will be claimed that the protective umbrella proceeding is not comparable to the SoA or the CVA due to its preparatory nature. The preliminary nature of the protective umbrella proceeding renders it impossible to compare the requirements with those for separate insolvency proceedings. A successful protective umbrella proceeding can only merge into an insolvency plan proceeding. Due to its precursory nature, the main aim of the protective umbrella proceeding is not to restructure a company , but to pave the ground for a restructuring in an insolvency plan proceeding, meanwhile giving the debtor legal certainty for preparing the insolvency plan within a known time frame. The insolvency plan procedure then follows.

Stand-alone procedures such as the SoA or the CVA cannot be compared to a preliminary procedure with obviously different aims and preconditions. Not being an independent method, the protective umbrella proceeding would have to be considered in the wider context of an insolvency plan proceeding.

[1657] Gerrit Hoelzle 'Unternehmenssanierung außerhalb der Insolvenz – Überlegungen zu einem Sanierungsvergleichsgesetz' (2010) Neue Zeitschrift für Insolvenz- und Sanierungsrecht 207, 208.

Comparing the requirements for each procedure could only give a distorted image.

Comparing the attestation, which must accompany commencement of the protective umbrella proceeding to the proposal would not be correct as the attestation only opens the opportunity to get into the benefit of the protective umbrella proceeding and is not the restructuring plan, whereas the CVA proposal is already the restructuring plan itself. The proposal is therefore comparable just to the insolvency plan. Another example is the discussion regarding the liability of the originator of the attestation, which cannot be compared to that of the nominee or the supervisor in view of the totally diverse functions. The same would apply for the possible termination and suspension of the proceedings, the concept of a preliminary proceeding being completely different.

Efforts to compare the protective umbrella proceeding with foreign pre-insolvency actions are futile in terms of legal methods.[1658] The attempt to compare the entry requirements for the protective umbrella proceeding to those for independent pre-insolvencies for example, is misconceived due to its different natures. The right moment to enter insolvency proceedings remains a general point for discussion and comparison, though being an exceptional feature of the protective umbrella proceeding. This would serve to demonstrate the incomparability of the proceedings; the focus should have been to change the entry requirement for the insolvency plan proceeding as such or to introduce a stand-alone proceeding with possibly diverse entry requirements.

The same would apply for the discussion on self-administration as a point of comparison. Self–administration is not only discussed in connection with the protective umbrella proceeding, but a topic of a more general nature. Any attempt to compare the availability of a moratorium in the protective umbrella and pre-insolvency proceedings will fall short as well. A moratorium in a

[1658] See for example Camek (n 23).

preliminary proceeding is according to the current statutory system not possible as the entire effects of the procedure ("vollstaendige Verfahrenswirkung") occur automatically with the opening of the proceedings. It is therefore only possible to order interim measures.[1659]

Looked at methodically, other points of comparison such as the predictability and the choice of the IOH[1660] could not be placed in a comparative analysis of particularities included in the protective umbrella and pre-insolvency proceedings either.

8.6. Comparability

It is possible to analyse whether the protective umbrella proceeding in itself represents a valid and appropriate procedure to establish a rescue culture in Germany,[1661] making a pre-insolvency procedure obsolete. Comparing it to entirely different proceedings such as the CVA and the SoA would appear methodically inadequate. This leaves only a comparison with the preparatory phase of the SoA or the CVA, as put forward in the following. The function of the protective umbrella proceeding is to prepare the actual insolvency plan as the next stage and it could be comparable to the pre-pack administration procedure in England.

8.7. Germany pre-ESUG

Germany's insolvency structure in regard to available proceedings is quite simple. As explained in chapter two there was only one way for insolvency and the IOH decided which direction to take on a case to case basis.[1662] The main tool for restructuring pre–ESUG was and still is the insolvency plan procedure. Apart from the "general" insolvency procedure and the insolvency plan procedure, there was only the possibility for informal rescue attempts. The

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[1659] Carnek (n 23) 178.
[1660] Ibid 181.
[1661] Leutheusser-Schnarrenberger, 7. Insolvenzrechtstag (n 6).
[1662] See chapter 2.3.1.

insolvency plan procedure included and still includes the possibility of pre-packs and transferred restructurings.[1663]

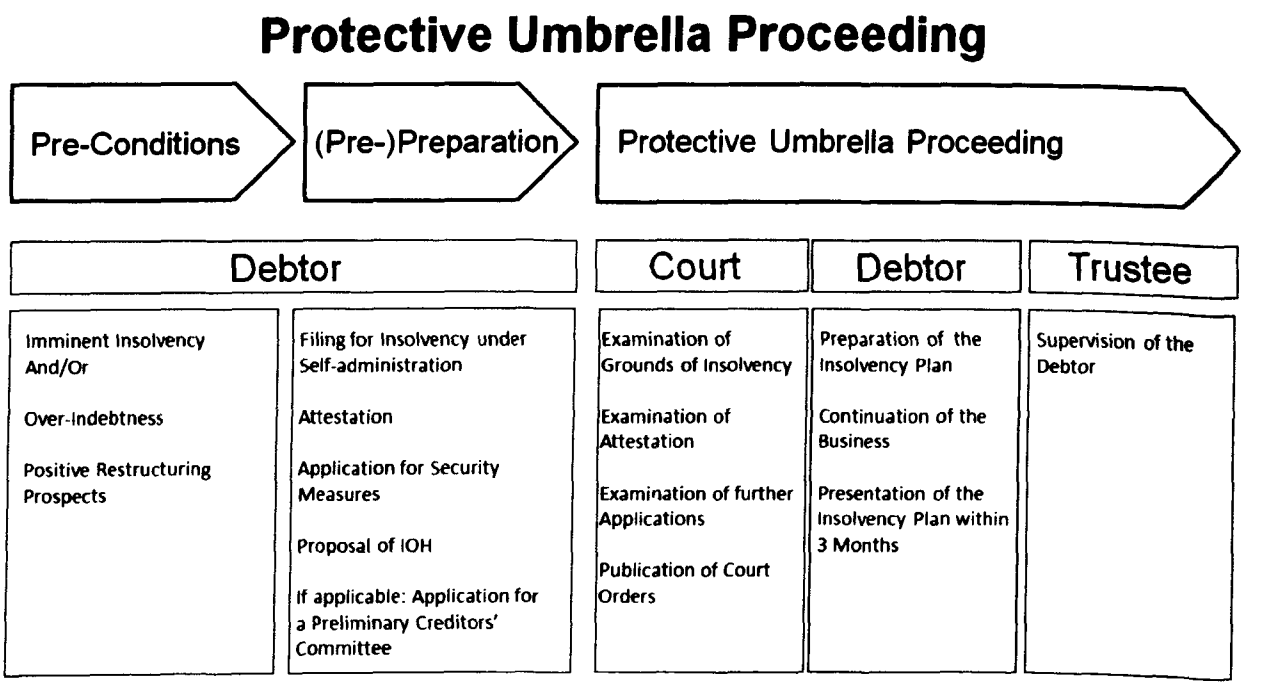
8.8. Germany post-ESUG

8.8.1. Protective Umbrella Proceeding

The Government decided for the introduction of the protective umbrella proceeding instead of opting for an independent pre-insolvency procedure as explained above. Relevant changes were embedded in the existing structure. This procedure was thought to increase the confidence of a debtor in the insolvency procedures, while at the same time creating an incentive to file for insolvency at an early stage. The aim is to eliminate the concerns of the debtor about losing control over the company. The debtor should be guaranteed legal certainty for a fixed period of time for preparing the presentation of the insolvency plan, appointing and mandating a preliminary trustee, reducing the competencies of the court and the possibility to establish insolvent's liabilities ("Masseverbindlichkeiten").[1664] The necessary requirements to be applied were discussed in chapter two.[1665] The current chapter focusses on challenges surrounding this procedure and relevant areas for discussion. Figure five summarises the pre-conditions, the necessary steps for the preparation and the duties of the court, debtor and trustee in the interest of clarity.

[1663] See introduction Terminology 0.7.The focus of this chapter is to look at the new protective umbrella proceeding as a formal rescue procedure, therefore the discussion is mainly limited to formal procedures. Although informal procedures are a main part of the restructuring landscape of each jurisdiction, it would go beyond the scope of this research to discuss these informal options in depths.
[1664] Merten (n 893) 144.
[1665] See chapter 2.

Figure eight: Protective Umbrella Proceeding[1666]



8.8.2. Challenges

8.8.2.1. Attestation ("Bescheinigung")

The debtor will have to include an attestation together with the application, demonstrating the state of illiquidity or excessive indebtedness being imminent as well as stating that the restructuring aspired to would not obviously lack the prospect of success ("nicht offensichtliche Aussichtslosigkeit der Sanierung"). This certification needs to be issued by an experienced tax adviser, a chartered accountant, a qualified lawyer or a person with comparable qualifications ("Person mit vergleichbarer Qualifikation").[1667]

The unpublished statement of the BMJ[1668] requested that the word "obviously" ("offensichtliche") should be removed with regard to the potential restructuring success, arguing that this term would most likely discourage the debtor to apply for a protective umbrella proceeding. The court should only be allowed

[1666] http://www.rsi-beratung.de/leistungen/unternehmen/insolvenznahe-beratung/ (amended and translated by the author)
[1667] Section 270 b I s. 3 InsO.
[1668] Bundesministerium der Justiz, 'Stellungnahme des Bundesministeriums der Justiz zu den Pruefungsauftraegen der Berichterstatter der Koaltionsfraktionen' (n 1020) 13.

to carry out an evidential test ("Evidenzpruefung") which would not be the case if they have to estimate an "obvious" success, the protective umbrella proceeding would otherwise only be applicable in exceptional cases. This recommendation was not implemented and the published documents do not even discuss this request.

The requirement to provide an appropriate attestation led to two critical discussions. Firstly, the quite vague term "a person with comparable qualifications" opened debates about all the necessary qualifications which the issuer of the attestation should bring with him. No doubts were raised concerning IOH's and Specialist Qualified Lawyers practising insolvency law ("Fachanwaelte fuer Insolvenzrecht") as well as Specialist Advisers for Restructuring and Insolvency Administration awarded the seal of approval by the German Tax Association ("Fachberater fuer Sanierung und Insolvenzberatung "mit dem Guetesiegel des Deutschen Steuervereins").[1669] All other persons applying would have to prove their individual qualification, leaving it up to the court to decide upon their suitability.[1670] The Federal Council demanded a further specification by limiting the right of attestation to, for example, specialist qualified lawyers in insolvency ("Fachanwalt fuer Insolvenzrecht") or similarly noted qualifications.[1671] This would be of particular importance to avoid the risk that the inherent advantages of the protective umbrella proceeding are overshadowed at the stage of filing by disputes among the involved parties over the formalities of section 270b I S.3 InsO.[1672]

The vague wording raises doubts about whether other professionals, for example, management consultants or university lecturers, are sufficiently qualified to issue such a certificate.[1673] The question of whether the originator of the attestation can be the trustee at the same time has to be unambiguously negated. In order to respect the interests of the creditors it would certainly be necessary to apply the "four-eye-principle", which also implies that the trustee

[1669] Willemsen, Rechel (n 1021) 295, 296.
[1670] Ibid, para 270b, recital 20.
[1671] Bt. Drs. 17/5712 (n 294) 58.
[1672] Ibid
[1673] Merten (n 893)146.

cannot exculpate himself if the conditions for the protective umbrella proceeding are not met.[1674]

This sparked off discussions on how and to what extent the court should be able to identify the appropriate qualifications. Submitting the attestation represents a condition of admissibility, on the basis of which the court could act "ex officio" ("Amtsermittlungsgrundsatz"), but prevailing doubts give occasion for further investigation. This in turn would, of course, contradict the character of urgency ("Eilcharaker") of the proceeding and endanger the restructuring of the company which will probably be contingent upon swift action.[1675] It would therefore seem appropriate to oblige the debtor to enclose proof of the qualification of the issuer of the certificate.[1676] The original Discussion Draft did not provide an explanation,[1677] which was then later substantiated in the Government Draft.[1678]

8.8.2.2. Content of the Attestation

Secondly, it remains unclear which specific requirements are necessary with regard to the content of the attestation, which is particularly important for laying out prospects of success following a restructuring. The Discussion Draft simply stated that the attestation had to be reasoned, but refrained from demanding a comprehensive restructuring report in accordance which formalised standards ("umfassendes Sanierungsgutachten entsprechend formalisierter Standards").[1679] The legislator argued that this would involve high costs, making access to this procedure substantially more difficult, especially for small and medium sized companies.[1680]

It could be argued that the certificate should be orientated towards the restructuring standard IDW 6[1681] as the quality of the standard is a

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[1674] Merten (n 893)146.bid
[1675] Vallender Schutzschirm (n 1618) 451.
[1676] Ibid
[1677] Discussion Draft (n 502) 17.
[1678] Bt. Drs. 12/5712 (n 294) 58.
[1679] Ibid
[1680] Ibid
[1681] see http://www.idw.de/idw/portal/d616086

fundamental precondition for a successful restructuring.[1682] Furthermore, orientation towards given standards ensures that "goodwill certificates" ("Gefaelligkeitsbescheinigungen") for tactics of insolvency delay are excluded.[1683] The IDW designed a draft for a standard attestation for the protective umbrella proceeding called the IDW ES 9[1684] to assist the party concerned. This draft explains the specifications necessary for an attestation.[1685] The decision to leave the content of the attestation open for interpretation could furthermore result in companies being pushed into the protective umbrella proceeding without fulfilling the necessary requirements.[1686]

8.8.2.3. Liability

Apart from the content being left open for interpretation, it remains unclear whether and how the originator of such a certificate could be held liable for an incorrect attestation. It is suggested that the originator of an attestation should be liable for the incorrect assessment of a debtor's financial position. This could be on the basis of the legal concept of "a contract with protective effect to the benefit of third parties" ("Vertrag mit Schutzwirkung zugunsten Dritter").[1687] As part of the examining principle ("Untersuchungsgrundsatzes") the court would have to review the formalities and the content of the attestation.[1688] This scrutiny is thought necessary to avoid the potentially high misuse of the procedure along with the strong position of the debtor. For a careful examination the court will in all likelihood seek to obtain an expert opinion to review the restructuring concept attested to, which will naturally lead to a time delay.[1689] The challenge is to find a balance between a proper scrutiny of the attestation and the interest for procedural efficiency ("Interesse an einer Verfahrensbeschleunigung").[1690] In case of the attestation having

[1682] Vallender Schutzschirm (n 1618) 451.
[1683] Ibid
[1684] http://www.idw.de/idw/portal/d616086 (last visited 14.09.2015)
[1685] Bernd Richter, Maximilian Pluta, 'Bescheinigung zum Schutzschirmverfahren gemaess paragraph 270b InsO nach IDW ES 9 im Praxistest' (2012) BB, 1591, 1593.
[1686] Eberhard Braun, 'Die Insolvenz verliert das Stigma des Scheiterns' (2013) Interview on the insolvency blog http://insolvenzblog.de/tag/schultze-braun (last visited 19.08.2015).
[1687] Willemsen, Rechel (n 1021) 300.
[1688] Merten (n 893) 150.
[1689] Ibid.
[1690] Ibid

been written by a highly reputed party of well-known expertise, the court might limit the examination to a plausibility test. It will therefore be advisable to involve the court before the filing in order to avoid delays in the proceedings.[1691]

8.8.2.4. The Necessity of an Attestation - Darwin contradicted

The necessity of an attestation as an entry requirement for the protective umbrella proceeding could be interpreted as a good example of over-regulation. The above discussion and still existing uncertainties connected to it could be seen as demonstrating another example of a fettered Darwinian approach. The protective umbrella proceeding should offer an efficient procedure for the debtor to closely evaluate all possibilities for a restructuring. Elements of uncertainty about the necessary qualification of the certifier[1692] and the fact that the contents needed for the attestation[1693] could be open for interpretationaire hurdles to overcome which are not compatible with the overall aim to create a procedure encouraging a debtor to seek for help at a timely stage. It can hardly be understood how these impediments for such a preparatory proceeding could foster earlier filings. Finding the right party to write the attestation for which the required contents have not even been properly set out, could still make another pre-preparatory phase necessary before the intended benefits of the new proceeding can finally be utilised. Next to these two hurdles the uncertainty around the liability does not contribute towards the legislator's aim to create an efficient procedure. Here lies another example of Germany's sense for flourishes and pensiveness ("deutscher Tief- und Schnoerkelsinn").[1694] The first study of Roland Berger confirms the theoretical problems with the attestation, revealing that 44 percent of all applications were rejected due to insufficient attestation.[1695] A more recent study reveals that: (1) the application with the complete restructuring concept and (2) the extent and quality of the attestation remain the biggest challenges. The study reveals furthermore that a standard has not yet established itself for

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[1691] Merten (n 893) 150.
[1692] See chapter 8.8.2.1.
[1693] See chapter 8.8.2.2.
[1694] Nietzsche, See Eidenmueller in Paulus (n 468) 1345.
[1695] Roland Berger 2012 (n 1205) 23.

the content of the attestation, whereas the usage of the newly established standard IDW ES 9 is declining.[1696]

Furthermore demanding an "obvious" restructuring success already for the attestation is another instance of Darwin contradicted. The recommendation of the BMJ to delete at least the requirement of an obvious restructuring success should have been implemented as the necessity of the "obviousness" demands an in depth examination of the restructuring success and not only an evidential test. This knowledge leads to another reason why the protective umbrella proceeding will remain a procedure for particular cases. It will furthermore discourage debtors from filing for such a proceeding.

8.8.2.5. Time Period/ Moratorium/ Protective Measures ("Sicherungsmassnahmen")

The debtor will have to present the restructuring plan within a timespan of a maximum of three months.[1697] The court will set the time limit by assessing the complexity and the asset structure of the debtor.[1698] It could be felt that the time allowed is tight for the preparation of a comprehensive insolvency plan, making it essential to get this process started as quickly as possible. [1699]

The determinate time will not include any automatic stay or moratorium. Filings for a protective umbrella proceeding can often cause the need for additional liquidity as some creditors may declare their claims due and terminate contracts. The legislator reasoned that the procedure was especially designed for debtors aiming to restructure via an insolvency proceeding in coordination with the main creditors.[1700] For this purpose it would be necessary to achieve consensus with the main creditors in the run-up to the proceeding. Arrangements undertaken with the major creditors beforehand, for example in maintaining credit facilities, could help the debtor to avoid illiquidity with the

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[1696] Roland Berger 2014 (n 1207) 27: 56 % of the respondents specified the application with the complete restructuring concept as the most difficult factor and 39 % of the respondents the extent and quality of the attestation.
[1697] Section 270b I s.2 InsO.
[1698] Merten (n 893) 151.
[1699] Ibid 151
[1700] Bt. Drs. 12/5712 (n 294) 40 to § 270b (Vorbereitung einer Sanierung).

filing. It can reasonably be concluded that a debtor would not qualify for the protective umbrella proceeding without having obtained consent with important creditors in the interim.[1701] It was further argued that a moratorium would not be necessary due to the sufficient control possibilities of the independent trustee, the court and the preliminary creditors' committee.[1702]

There could, however, still be claims that the lack of a moratorium makes the procedure of less practical relevance. Having no such regulation in place would cause a race amongst the creditors to benefit from the remaining free assets. In only a few privileged cases funds would be kept available in order to avoid illiquidity during the three month period.[1703] Even with the argument of sufficient control being valid, the decisive question concerns the kind of information these organs are supposed to give with regard to financing in covering the three months.[1704]

It could be argued that the protective umbrella proceeding tends to result in an enforced consensual agreement. The procedure is built on the assumption that the proposal was pre-discussed with the main creditors. Their consent is essential to draw any benefit from it at all. However, what alternative do creditors really have? The debtor would approach the creditors suggesting his intention to apply for a protective umbrella proceeding, outlining the alternative likely to be a liquidation with worse prospects of return, true to the motto: "each compromise is the result of a credible threat".[1705] It is, of course, the threat of potentially higher losses making creditors agree to the suggested proceeding, thereby also creating the necessary faith in a consensual rescue attempt. This would serve to explain that the protective umbrella proceeding is used to practically enforce consent prior to insolvency.

Although the debtor would not profit from a moratorium, the court is empowered to order protective measures.[1706] The court can prohibit certain or

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[1701] Bt. Drs. 12/5712 (n 294) 40 to § 270b (Vorbereitung einer Sanierung).
[1702] Richter (n 1685) 1594.
[1703] Weiland (n 1282) 7.
[1704] Richter (n 1685) 1994.
[1705] Hoelzle Sanierungsgesetz (n 1657) 208.
[1706] See section 270b subsection 2,3 InsO in connection with section 21 subsection 2, 1 No.3 InsO.

all executions ("Zwangsvolstreckungen"). Flechter finds it "puzzling" that such a "vital" element is missing and that it is left to the courts to realise somehow the "breathing space "aimed for.[1707] It would be easy to argue that it is possible to attain the results equal to a formal moratorium, but there remain uncertainties as to the kind of protective measures the court would order, which could have been solved better by introducing a formal moratorium.

8.8.2.6. Termination/ Suspension

Section 270b IV InsO lists circumstances under which the court would rescind the order for a protective umbrella proceeding. First, the court will rescind the order on realising restructuring has become hopeless ("Eintritt der Aussichtslosigkeit").[1708] This indeterminate legal concept ("unbestimmter Rechtsbegriff") of "hopelessness of the restructuring" could evoke discussion and in consequence delay the proceeding. In practice, examples might be the failure of negotiations with a bank or the failure of a planned DES.[1709] Secondly, the court might rescind the order on request by the preliminary creditors' committee, a creditor being entitled to separate satisfaction ("absonderungsberechtigte Glaeubiger")[1710] or by an insolvency creditor in order to prevent the deterioration of that creditor's position.[1711]

The Discussion Draft provided for a suspension of the procedure in section 270 b III 1 InsO on the debtor becoming illiquid before the expiry of the term.[1712] This was changed during the legislative process at the request of the Law Committee.[1713] It was left up to the insolvency court to decide whether the proceedings should be terminated or not.[1714]

The Law Committee saw the danger of individual creditors, especially banks, who would have the exceptional right of termination in the case of a

[1707] Flechter Comment on Protective Umbrella Proceeding (n 81) 25.
[1708] Section 270b IV no.1 InsO.
[1709] Willemsen, Rechel (n 1021) 302.
[1710] Definition see chapter 4.2.1.
[1711] Section 270 b IV 2 and 3 InsO.
[1712] Discussion Draft (n 502) 46.
[1713] Bt.-Drs. 17/5712 (n 294) 59, 71.
[1714] Ibid; Section 270b IV InsO; Leutheusser-Schnarrenberger, 9. Insolvenzrechtstag (n 21).

deterioration, and using this reason as a threat potential against the debtor.[1715] This could work contrary to the aim of the legislator, in leaving it for the creditors to decide whether a protective umbrella proceeding can be executed.[1716] For the procedure to continue even in the case of illiquidity, it will be necessary to consider that the interest of creditors is still preserved.[1717]

These uncertainties surrounding the success of a protective umbrella proceeding and the threat potential of dissenting creditors are yet further instances of the Darwinian Theory not applying. The objective was to create a procedure to facilitate restructurings, which, however, can hardly be reached by creating these elements of uncertainty. As Flechter noted "This potential instability factor could threaten the conclusion of a pre-packaged plan on optimal commercial terms."[1718]

8.8.3. Difference between Preliminary Self-Administration and Self-Administration under the Protective Umbrella Proceeding

Referring to chapter five, there are two alternatives for the opening proceedings; the simple self-administration under section 270 a InsO and the protective umbrella proceeding under section 270b InsO. The protective umbrella proceeding can be regarded a special form of a self-administration procedure. Both offer advantages and disadvantages. With the protective umbrella proceeding the debtor is able to determine the trustee, which is not the case for the simple self-administration procedure, though the debtor possibly has a certain influence through the preliminary creditors' committee. The self-administration proceeding is, however, less intensive with regard to the preparation, not requiring any attestation as would be the case for the protective umbrella proceeding.[1719]

[1715] Leutheusser-Schnarrenberger, 9. Insolvenzrechtstag (n 21)., Richter (n 1685).1592,1593.
[1716] Bt.-Drs. 17/5712 (n 294) 59, 71.
[1717] Ibid
[1718] Flechter, Comment on Protective Umbrella Proceeding (n 81) 25.
[1719] The BCG has shown that the general self-administration procedure is used much more frequently than the protective umbrella proceeding (see Boston Consulting Group, 'Zwei Jahre ESUG- Hype weicht Realitaet' (2013) <http://www.ifus-institut.de/fileadmin/pdf/BCG_-_Zwei_Jahre_ESUG.pdf>

8.8.4. Difference between Protective Umbrella Proceeding and the "normal" Preliminary Insolvency Proceedings

It is furthermore of interest what incentives the protective umbrella proceeding offers in comparison to the "normal" preliminary proceeding. As explained in chapter two, following the filing for insolvency there is always a preliminary phase of a maximum of three months for the preliminary IOH to assess and form an opinion on the financial situation of the debtor to suggest the next steps to be taken.[1720]

Both proceedings are of preliminary nature with a timeframe of a maximum of three months. Neither would include an automatic stay. The protective umbrella proceeding would always be a DIP proceeding, which is not automatically the case for normal preliminary proceedings unless specifically applied for under section 270 a InsO.[1721] A preliminary trustee is appointed in both cases under self-administration, with the debtor having an influence only on the choice for the protective umbrella proceeding.

As discussed earlier,[1722] the protective umbrella proceeding would require the prescribed attestation. Both preliminary procedures can be used to prepare the restructuring plan. The actual difference speaking in favour of the protective umbrella proceeding is the greater security offered by paving the way for an insolvency plan with the aim of restructuring, whereas for the normal preliminary proceeding the decision for an insolvency plan would be kept open. In other words, the protective umbrella proceeding stands for a better chance of restructuring, as the restructuring plan would, of course, always be prepared in the preliminary phase. Another, though not so obvious, difference is the "labelling" of the proceeding, which in turn could have a psychological effect. The protective umbrella proceeding is labelled as "preparation of a restructuring", whereas the normal preliminary proceeding is more simply called a "preliminary insolvency proceeding". Looking at the content and the minor difference to the normal preliminary proceeding, it could

[1720] Section 22 subsection 1 lit. 3 InsO.
[1721] See chapter 5.
[1722] See chapter 8.8.2.1 and 8.8.2.2.

as well be argued that the entire "new" procedure is just window dressing. In labelling it "restructuring" and calling it an "independent restructuring procedure", the legislator created the false impression of a totally different procedure, which is not really the case as demonstrated above.

8.8.5. Practical Experience

The protective umbrella procedure came into force on 1st of March, 2012. It has since been used in practice for several cases already. In 2012 the proportion was 0.9% of all insolvencies, however in 2013 it was used for only 0.5% of all insolvencies[1723], which reinforces the prediction of this thesis that in the long run this proceeding will disappear as it leads to specialisation rather than uniformity. Well-known companies, such as Loewe, Solarwatt, Centrotherm, Leiser, Pfleiderer, Hein Gehrike, Suhrcamp and SIAG have decided to choose the new procedure, just to name a few.[1724] As these example demonstrate, the protective umbrella proceeding is solely a procedure for high profile cases and not for small and medium sized companies,[1725] particularly due to the various pre-conditions as discussed above.[1726]

According to a recent study, 36% of all parties asked considered the protective umbrella proceeding negative, and 32% called it positive.[1727] The protective umbrella proceeding is seen positive for the going concern of a company through the effects of earlier filing and the inclusion of creditors.[1728] The main reason for the rejection of an application is insufficient attestation under section 270b InsO.[1729]

[1723] Roland Berger 2014 (n 1207) 5.
[1724] Ibid
[1725] Ibid 10 ;As reflected in the prominent cases listed in the study
[1726] See chapter 8.8.2.
[1727] Ibid 16; positive has the meaning of successful/ mainly successful and negative has the meaning of mainly unsuccessful or not at all successful (positive: Überwiegend/sehr gelungen bzw. Negative: überwiegend nicht/gar nicht gelungen).
[1728] Ibid, 20
[1729] Ibid, 23, 44% of the applications

8.9. England

8.9.1. Introduction

England stands for a long tradition of a mixture of insolvency and pre-insolvency proceedings. There being no single route for insolvency, the procedure has to be chosen at the stage of filing.[1730] The English insolvency landscape has a variety of formal procedures to offer as shown in chapter three,[1731] namely administrative receivership, administration, CVA, SoA and the pre-pack administration, in addition to informal rescue attempts.

As discussed, the protective umbrella proceeding cannot be taken for a direct counterpart to the CVA and the SoA procedure[1732], but it could be compared with their preparatory phase due to its preliminary nature. It could furthermore be compared to the pre-pack administration because of its preparing character. Last but not least, it will be interesting to evaluate whether it is in general advisable at all to have a pre- insolvency proceeding, an approach which Germany is not following.

8.9.2. Preparatory Phase of the Company Voluntary Arrangement

The CVA could be the first comparable procedure. Relevant stages of the procedure are described in chapter three.[1733] For the purpose of this chapter, the focus is put on details of certain features of the preparatory phase, in order to be able to compare and contrast it to the protective umbrella proceeding.

[1730] See chapter 3.3.1.
[1731] See chapter 3.3.
[1732] See chapter 8.5; 8.6.
[1733] See chapter 3.3.3.4.

Figure nine: Preparation of a CVA

There being no formal preliminary proceedings, the preparatory phase includes basically just strategic issues, before the proposal is handed in; neither are any legal requirements to be met in filing for a CVA. The debtor does not need to be insolvent and there are no time limits in which to act.

As figure nine shows the preparatory phase of the CVA generally involves four steps. After deciding to restructure the company through a CVA by way of a resolution of the board, the directors would generally appoint an advisor to help in developing the proposal. The advisor will normally be a turnaround specialist or an IOH. However, the involvement of a third party is not mandatory. First of all, a financial forecast of the debtor has to be included in the proposal, making a review of the financial position and a business plan an absolute necessity. When a draft of the proposal has been completed, it should be discussed with the secured creditors and potentially amended before the final draft is ready for the supervisor nominated for the CVA and to for filing at court.[1734]

The "official" CVA procedure will start from here on but this, as discussed above, is not part of the current comparison.

[1734] See as well chapter 3.3.4.

8.9.3. Preparatory Phase of Schemes of Arrangement

The preparatory phase of the SoA procedure is similar to that of the CVA, without legal requirements, but just strategic steps to follow, paving the way to a successful voting for the scheme among parties involved in the process. The scheme will have to be prepared, often again by involving an advisor, although this is not necessary. A pre-discussion with the main creditors is common practice as well.

8.9.4. Pre-Pack Administration

The general procedure of a pre-pack administration was discussed in chapter three.[1735] To avoid repetition, the focus here concerns the points of importance for comparing pre-packs with the protective umbrella proceeding.

Pre-packs are a way of preparing the sale of parts or all the assets of an insolvent business as a going concern.[1736] The key feature is the fact that the sale of the insolvent entity is negotiated and arranged ahead of commencing the administration procedure.[1737] Pre-packs have no formal nature and there are no regulations on pre-pack administration to be found in the IA 86. The only regulation existing is the SIP 16, a non-binding code of good conduct, issued by the Association of Business Recovery Professionals.[1738] Therefore all the hurdles to be overcome in connection with the protective umbrella proceeding in Germany do not exist for pre-packs. There is no necessity for an attestation in order to initiate the pre-pack procedure. Due to the lack of formality, there is no moratorium or automatic stay, which must be regarded as one of the uncertainties of the proceeding. There are also no termination or suspension rules included. The pre-pack in England is always aimed at the sale of the company as a going concern, which is different to the equivalent so called "pre-voted pre-pack" under Chapter 11 in the US, which could aim at the restructuring of the company as well.[1739]

[1735] See chapter 3.3.7.
[1736] Sandra Frisby, Case Comment- DKLL Solicitors v HMRC (n 787) 1.
[1737] Ibid
[1738] R3, a regulatory body responsible for the supervision of IP's.
[1739] Neil Devaney, "Pre-packagings–A step in the wrong direction?' (2007) 26 Int'l Fin. L. Rev. 26, 26.

SIP 16 introduced certain basic principles and essential procedures which the IP has to comply with. Keeping detailed records for the reasoning for and justification of decisions would be essential. It will be necessary to disclose specific information to the creditors, which would in particular include any detail around the sale, leading to more transparency in the process.[1740]

There were attempts to change the pre-pack procedure and include more formalities. The legislator decided nevertheless against a more demanding procedure, not wishing to undermine the advantages of this speedy and effective restructuring tool.[1741]

As it is, SIP 16 strikes an optimal balance between the necessary transparency and the speediness of the procedure. McMohan explained pre-packs in a very pragmatic way by stating that pre-packs are "An instant solution without the risk that business interruption will erode value while at the same time exposing businesses and assets to the market in such a way as to ensure that value is maximised."[1742] It seems that England finds a balance in their regulations to support a well-functioning insolvency regime. Flechter sees the "proportionality"[1743] as essential, as over-regulation would have negative effects not only on the parties, but for the public interest as well. The regulations with regard to pre-packs in England could be seen as an example of a good adaptation to the environment in the Darwinian sense. Other options such as not allowing the IOH preparing the pre-pack to undertake the post administrative work not giving statutory force to the disclosure requirements of the SIP, which could probably lead to more security to prevent abuse in

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[1740] see SIP 16

[1741] "The Government is not convinced that the benefit of new legislative controls presently outweighs the overall benefit to business of adhering to the moratorium on regulations affecting micro-business which is an important plank of this Government's deregulatory agenda". (Davey, E. Written Ministerial Statement, Pre-Packaged Sales in Insolvency 26.01.2012); alternative suggestions in the consulation paper: 1. *Give statutory force to the disclosure requirements required by SIP 16; 2.Restrict exit from pre-pack administration to compulsory liquidation, so as to achieve automatic scrutiny by the official receiver of directors' and administrators' actions; 3. Require different insolvency practitioners to undertake pre- and post-administration appointment work and 4. Require the approval of the court or creditors, or both, for the approval for all pre-pack business sales to connected parties,* see detailed discussion: Walton, Government consultation (n 795).

[1742] Sonia McMahon, "Pre-pack sales by administrators: the implications of SIP 16 (2009) 2(2) CRI 51, 51.

[1743] The Graham Report defines "proportionality as follows: "regulators should only intervene when necessary. Their remedies should be appropriate to the risk posed, and costs identified and minimised." see Graham Review (n 797) 12.

connection with pre-packs were not adopted due to their negative consequences, undermining the benefits of this useful restructuring tool. This is an example that England is embracing a practical approach and avoiding over-regulation in favour of a beneficial insolvency regime. Even the key recommendations of the Graham Review, suggesting some changes to the pre-pack regime are all geared towards a "voluntary" improvement of the pre-pack regime, all requiring action from insolvency regulators and the profession rather than the government.[1744]

8.10. Comparison

8.10.1. Introduction

There being no equivalent of the protective umbrella proceeding in England it would seem at first glance that English systems did not serve as example for the new German procedure. However, the decision not to introduce a separate pre-insolvency procedure, but to opt for the protective umbrella procedure instead, could well have been a deliberate one after looking at the existing procedures applied, inter alia, in England. The creation of a new, distinguishable procedure might have been the outcome of having studied a variety of procedures used in other jurisdictions. Looking at the discussion around the protective umbrella proceeding as outlined above, the decision for it was deliberate, arguing against a separate pre-insolvency proceeding. It is claimed that the decision not to establish a separate pre-insolvency system was a failure to attain perfection in this area. The protective umbrella proceeding can after all not really be considered a suitable restructuring tool to replace a separate pre- insolvency proceeding.

[1744] Key recommendations: **Key recommendation 1**: Pre-pack Pool. On a voluntary basis, connected parties approach a 'pre-pack pool' before the sale and disclose details of the deal, for the pool member to opine on. **Key recommendation 2**: Viability Review. On a voluntary basis, the connected party complete a 'viability review' on the new company. **Recommendation 3**: SIP 16: that the Joint Insolvency Committee considers, at the earliest opportunity, the redrafted SIP16 in Annex A.**Recommendation 4**: Marketing: that all marketing of businesses that pre-pack comply with six principles of good marketing and that any deviation from these principles be brought to creditors' attention.**Recommendation 5**: Valuations: SIP16 be amended to the effect that valuations must be carried out by a valuer who holds professional indemnity insurance. **Recommendation 6**: SIP 16: that the Insolvency Service withdraws from monitoring SIP16 statements and that monitoring be picked up by the Recognised Professional Bodies.

8.10.2. Preparatory Phase of Company Voluntary Arrangement and Schemes of Arrangement

It could be argued that only the preparatory phases of the CVA and the SoA are comparable with the protective umbrella procedure, as the author would regard the latter as a special form of preliminary proceeding. Although preliminary proceedings are unknown in England, the timeframe up to implementing the CVA and the SoA can be taken as comparable.
However, looking at the requirements for the preparatory phase of the protective umbrella proceeding and those for the CVA and the SoA, a comparison would not prove very productive. Whereas the preparatory phase of the protective umbrella proceeding includes several formal requirements, such as the attestation, there are no similar requirements to be met for the CVA nor for the SoA procedure. The only conclusion to be drawn from this is that the preliminary phase in Germany looks quite complicated, whereas the preliminary phases in England have no formal requirements at all: yet another example that the English approach is more adapted to the needs of commercial reality.

8.10.3. Pre-Packs

Both the protective umbrella proceeding and the pre-pack administration are similar in the preparation of a pre-packaged plan and therefore comparable due to their inherent preparatory nature. The main difference, however, is that the pre-pack in England always serves to prepare the sale of the insolvent business, whereas the protective umbrella proceeding aims at preparing a plan for the successful restructuring of the business as a going concern. In this respect, the protective umbrella proceeding is more comparable to the pre pack equivalent in the US, where the so-called "pre-voted pre-pack" is prepared before the filing and the outset of the proceedings and in general is utilised to restructure the company as a going concern.[1745]

[1745] Devaney (n 1739) 26.

It is striking again that pre-pack administration is a very flexible and non-bureaucratic solution with nearly no formal requirements. The protective umbrella proceeding on the other hand would have to overcome several bureaucratic hurdles in order to be successfully implemented in an insolvency plan. As explained above, there are several rules in place for creditors to suspend or terminate the protective umbrella proceeding. It would seem yet again that the German legislator failed to find a balance between protective rules on the one hand and a commercially viable solution on the other. As such it would appear to represent the classic case of over-regulation in the sense of the Nietzsche quotation.[1746] The same topic has been an issue in England with regard to the abuse of pre-packs for phoenix trading.[1747] However, as explained above, the English legislator decided to maintain the simple approach, and left the status quo in order not to weaken a very important and successful restructuring tool, in line with Fletcher's argument of "proportionality".[1748] "Proportionality" is a key word which is picked up by the Graham Report as well, the latest review on pre-packs.[1749] Having this in mind it is of interest, that rather looking for changes in the regulation, self-regulation measures were suggested, imposing responsibilities on the insolvency regulators and insolvency profession rather than the government. This embraces the idea that a regulator does not always need to interfere, which is an awareness, it seems that Germany has not achieved yet. "If the safeguards are over-engineered in the interests of providing assured protection against abuse, the result can be a Rolls-Royce rescue vehicle that no one can afford to drive."[1750] This is a quote in support of one of the outcomes of this thesis that German's mentality of over-regulation hinders courageous and modern insolvency laws and results in a fettered approach.

[1746] Nietzsche, See Eidenmueller in Paulus (n 468) 1345.
[1747] Although Frisby's study revealed that there are not more phoenix cases in connection with pre-packs then with normal sales, see Frisby Insolvency Outcomes (n 636).
[1748] Flechter Spreading the gospel (n 70) 530.
[1749] Graham Review (n 797) 12.
[1750] Flechter Comment on the Protective Umbrella Proceeding (n 81) 25.

8.10.4. General Lack of Pre-Insolvency Proceeding

The protective umbrella proceeding itself needs to be looked at from the perspective of its possible advantages and disadvantages.

The proceeding was implemented with the aim of increasing the chance under the protective umbrella and the supervision of the court to pave the way for a successful restructuring.[1751] It should boost the confidence of a debtor in insolvency procedures, lending encouragement to him to file for insolvency at an early stage. The concern about losing control should be eliminated by the aspect of self-administration.[1752] The protective umbrella should create legal certainty to prepare and present an insolvency plan within a guaranteed period of "breathing space".[1753] In short, the protective umbrella proceeding specifically aims at encouraging the debtor through providing higher certainty and self-control to file for insolvency at the earliest possible moment in order to foster restructuring.

But did the legislator actually reach the objective set out? Can we consider the introduction of the protective umbrella proceeding as a race to rescue, to more uniformity with the English system? The above has shown that there is not a comparable proceeding in England, hence the protective umbrella proceeding as a "unique" proceeding is to be seen as a specialisation rather than a uniformity. The overall argument that forum shopping fosters alignment with more rescue-friendly regimes is not disapproved by this finding. Although it could be argued at first sight that the protective umbrella proceeding is a tool fostering rescue-friendliness, it is only seen as a right step in the short run.

However, the protective umbrella proceeding is overall to be considered as burdensome and over-regulated. In particular the necessity and uncertainties surrounding the attestation and the instable factors around the termination and suspension tend to render this procedure a cumbersome one. Such a

[1751] Flechter Comment on the Protective Umbrella Proceeding (n 81) 25.
[1752] Ibid
[1753] Merten (n 893) 144.

burdensome proceeding is time-consuming which does not foster restructurings. The debtor would, of course, gain through the self-administration, but this is also possible to find apart from the protective umbrella proceeding, even with the advantage that an attestation is not required. It will be remembered that nearly half of all section 270b InsO applications failed due solely to an insufficient attestation. This figure appears unbelievably high and already demonstrates that the aim of a less burdensome and secure procedure has not been met. The entire procedure seems to be no more than window dressing. It lets the debtor and the creditors alike believe in a new and efficient restructuring method, but it could turn out in leaving them with nothing more than a preliminary proceeding, not really distinguishable from the "normal" preliminary proceeding. Going through the burdensome route of attestation would offer a debtor greater certainty about the company getting restructured as a going concern, but this could also be reached through the general insolvency plan proceeding. The "labelling" is different, calling it "preparation of restructuring", but looking at the content it is nothing other than the preparation of the insolvency plan, which again could also be done through a "normal" procedure. It seems that the procedure is more designed for large insolvencies, where the burden of the attestation is worth going through. However, for the largest part of insolvencies this new procedure is to be seen as too cumbersome. There is a positive spirit about this proceeding in Germany; however, the author predicts a declining usage of the protective umbrella proceeding in coming years, once the novelty wears off. This positive spirit can be attributed to the fact that it adds some positive aspects, which are often seen in isolation. The awareness will evolve that a genuine pre-insolvency proceeding is the only way forward. This specialisation in the form of a unique procedure and the failure to create uniformity in the law with more rescue-friendly regimes in form of a real pre-insolvency procedure will therefore not lead to a race to the top in the long run. This specialised procedure will only have short time positive effects.

8.10.5. Necessity for a Pre-Insolvency Proceeding

Apart from the individually specific aspects of the analysed procedures, it would appear necessary to discuss both the advantages and disadvantages of pre-insolvency proceedings in general. As discussed above there was a lively debate in Germany concerning the possible introduction of a separate insolvency proceedings.[1754]

Examples of such pre-insolvency proceedings are the US Chapter 11 procedure,[1755] the conciliation proceedings in France[1756] and the accordo die ristrutturazione dei debiti in Italy[1757] and last but not least SoA and CVA in England.[1758]

Bruederle[1759] summarises the qualities for a pre-insolvency proceeding with "early, quick and quiet".[1760] In other words, there should be some incentive for the debtor to file for insolvency at an early stage, as it gives procedures of great flexibility with minor or no court involvement. The connection between an early filing and the success of a restructuring is highlighted in several places. The general possibility of having a procedure at an early stage of financial difficulties can already form an incentive for a debtor to seek for help early, which could have a potential influence on the entire procedure to possibly tip the scales to the success of a restructuring. The best restructuring proceeding is worthless if there are no assets left. Experience has shown that a large number of companies seek for help too late, thereby missing the chance for a successful restructuring.

Pre-insolvency proceedings have several advantages in comparison to insolvency proceedings. Pre-insolvency proceedings are more flexible, quicker, more efficient and less cost intensive than insolvency proceedings.[1761]

[1754] See chapter 8.4.
[1755] US Bankruptcy Act, chapter 11.
[1756] L 611-4 et seq. Code de Commerce.
[1757] Article 182 bis of the Italian Insolvency Act.
[1758] Vienna-Heidelberg Report (n 116) where all pre inso procedures are listed, 47-62.
[1759] Rainer Bruederle Former Federal Minister of Economics and Energy
[1760] Beissenhirtz, Plaedoyer fuer ein Gesetz zur vorinsolvenzlichen Sanierung von Unternehmen (n 1643) 59.
[1761] Hoelzle Sanierungsgesetz (n 1704) 210.

Such a proceeding would furthermore help to prevent obstruction actions from shareholder and creditors, abusing potential bargain power.[1762] The trend goes towards "ex ante solutions" rather than "ex poste" reactions to financial difficulties.[1763] The SoA procedure can therefore be seen as the restructuring tool of the future as it alleviates the "ex ante-solution".[1764]

A movement away from the idea that restructuring is a tool attached to insolvency laws should be considered. This is because insolvency laws remain tainted with stigma. The SoA is a good example for a viable and suitable restructuring tool, especially looking into the future, with more and more companies dealing internationally.

Taking the CVA and the SoA[1765] as examples for pre-insolvency procedures and looking at their key features, they come to exactly embrace the idea behind a pre-insolvency procedure.[1766] Both procedures encourage early filing as there is even no necessity of being insolvent.

Furthermore, both procedures offer good flexibility with very little court involvement. In a CVA, the court would normally not be involved at all, unless a creditor challenged the proceeding. For the SoA the court would have to approve the scheme, following which it is of a binding nature with no further remedies available. Both could be seen as procedures with a "cram down" nature, which is another important feature of a pre-insolvency proceeding in helping to include "hold-out" creditors and dissenting shareholders.[1767]

Germany is still very reluctant to accept the necessity of such a procedure for various reasons explained above.[1768] The arguments used are yet again be traced back to Germany's sense for "flourishes and pensiveness".[1769] The biggest issue and hence as well potential pitfall of this comparative work is the

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[1762] Eidenmueller objects that this aim could also be achieved by the BGH changing its judgment and allowing to include shareholders rights in out of court restructurings, see Eidenmueller in Paulus (n 468) 345.
[1763] Finch The Recasting of Insolvency Law (n 1243) 713.
[1764] Tribe Companies Act schemes of arrangement (n 750) 390.
[1765] Other pre-inso procedures see Vienna Heidelberg report (n 116) 47-62.
[1766] For details of these two procedures see chapter 3
[1767] See chapter 4 and 7.
[1768] See chapter 8.4.
[1769] Nietzsche, See Eidenmueller in Paulus (n 468) 1345.

apparent difference in mentality between the English and the German legislators. Germany still holds on to traditional features such as the immense influence of the courts. Or like Haarmeyer expresses it: a paternalistic system of commitment to justice ("Paternalistisches System der Justizfoermigkeit").[1770] Next to holding on to traditions, there are a lot of examples in this thesis of Germany's tendency towards over-regulation. The urge to make regulations watertight against abuse and regulate every thinkable scenario is firmly anchored in the German legal mentality. This anchor has to be removed enable the creation of insolvency laws which are practical and flexible.

The argument that the implementation of a pre-insolvency procedure would lead to flawed and tedious proceedings[1771] in Germany is probably correct, but not very convincing in the sense that reform ideas have to tolerate changes; coming to know about flaws will require a less bureaucratic, more courageous approach to develop pre-insolvency proceedings better in line with the commercial reality and the needs of a modern insolvency law. The arguments put forward by Eidenmueller are further examples of this different mentality, a lack of a culture for settlement ("fehlende Vergleichskultur"), an exaggerated sense of justice ("uebertriebenes Gerechtigkeitsstreben") and a considerable loss aversion ("grosse Verlustaversion").[1772]

There is no doubt that a pre-insolvency proceeding is necessary in a modern insolvency landscape. However, due to the reasons explained above, Germany still seems "advice-resistant" ("beratungsresistent"). The Minister of Justice Maas just highlighted on the most recent German Insolvency Day ("Deutscher Insolvenzrechtstag") in March 2015, that economically viable restructuring solutions and the granting of a second chance for companies in financial difficulties could be achieved without pre-insolvency proceedings.[1773]

[1770] Haarmeyer, ESUG (n 1106) 5.
[1771] Ibid
[1772] Eidenmueller *Unternehmenssanierung zwischen Markt und Gesetz* (n 900); see as well Hoelzle Sanierungsvergleichsgesetz (n 1657) 210.
[1773] Heiko Maas, 'Rede des Bundesministers der Justiz und für Verbraucherschutz beim 12. Deutschen Insolvenzrechtstag' (Berlin 19. March 2015) <http://www.bmjv.de/SharedDocs/Reden/DE/2015/20150319-Insolvenzrechtstag.html?nn=5913042 Rede: 12. Deutscher Insolvenzrechtstag>

As Grell expressed it on the occasion of a conference: "We need a pre-insolvency restructuring procedure, I fear, it will only happen if the EU forces us to"[1774] Looking at the key features of a pre-insolvency procedure and the key features of the protective umbrella proceeding, it cannot be assumed that Maas is right with his assumption. The necessity of a pre-insolvency procedure is regarded more highly in 2013 than in the first year after the ESUG came into force in 2012.[1775]

8.11. Mini Conclusion

Can the protective umbrella proceeding be seen as a possibility for an early, quick and quiet restructuring? It can be concluded that this proceeding is a possibility for an earlier, quicker and quieter restructuring, but only in comparison to the situation pre ESUG. It offers a preparatory proceeding with certain facilitating factors towards a restructuring, but does it offer a viable restructuring tool, reaching the aim of the policy makers? Due to the various hurdles and insecurities, the procedure does not offer a tool which is very likely to enhance restructurings to a great extent. Although some positive cases restructured with the aid of the protective umbrella proceeding can be recorded, these cases are, for the most part, large insolvency cases and already in the second year after the implementation the numbers are declining.[1776]

The protective umbrella proceeding is not itself a pre-insolvency proceeding and cannot be compared to one due to methodological issues. However, a pre-insolvency procedure is missing in the German insolvency sphere. The various advantages, especially the overall incentive of a possibility for an earlier restructuring outweigh the disadvantages.

[1774] Frank Grell, 10. Handelsblatttagung, Frankfurt am Main May 2014.
[1775] Roland Berger, 2014 (n 1207) 39; 2013: 36% of the respondents see the necessity for a pre-insolvency proceeding (2012 study: 28%), the prediction of the author is that this figure will further increase; an SME survey on the acceptance of the ESUG has shown that 74% of the respondents ar in favour of introducing a stand-alone pre-insolvency proceeding
[1776] Ibid, 13, 0,9% of all insolvency cases in 2012 were protective umbrella proceedings, in 2013 only 0,5% of all cases

The aim of achieving a new "restructuring culture" and a "shift in paradigm" and a "culture of second chance" cannot be achieved by half-hearted changes. The new procedure is still burdened with numerous hurdles. Flechter gets to the heart of it by reasoning that: "Despite the number of years spent in developing this latest addition to the German insolvency law repertoire, one is inclined to concur with Professor Bork's conclusion that this has not succeeded in bringing to the table a genuine pre-insolvency procedure with the capability of enabling a financially challenged company to conclude and implement a pre-packaged restructuring in a protected, commercially supportive legal environment. Those companies with the means to do so may still find it worthwhile to reposition themselves so as to be eligible to undergo a pre-packaged administration under English law."[1777]

[1777] Flechter, *Comment Protective Umbrella Proceeding* (n 81) 25.

Chapter Nine

Conclusion

This research was carried out in order to determine whether forum shopping activities from Germany to England can be considered as drivers of insolvency law perfection, and to examine at the same time whether Germany had moved closer to the objective of establishing a culture of second chance through changes to the InsO introduced by the ESUG.

The ESUG example demonstrates that forum shopping activities serve to promote the development and improvement of existing laws, enhancing the perfection of existing insolvency regimes by causing an alignment with rescue-friendly provisions in a race to the top, a race for more rescue-friendly regimes.

9.1 Original Contribution to Knowledge - Novelty

The original contribution to knowledge of this thesis is the observation that forum shopping results in an alignment and convergence of insolvency systems because EU jurisdictions imitate each other in their rescue-friendly provisions. A race to rescue is seen as a race to more "perfection" as establishing a rescue culture is the overall objective of modern insolvency law policy makers. This race to rescue leads to more alignment and uniformity amongst the jurisdictions. Appreciating that forum shopping activities indeed result in driving jurisdictions to adapt and align their insolvency regulations with more rescue-friendly provisions of other regimes will assist the German legislator to become aware that this convergence is the true path to avoid unwanted migrations of companies. Another observation of this thesis is that half-hearted attempts of convergence for more rescue-friendliness can only result in a culturally fettered adaptation by analogy with the Darwinian Theory, making it very likely that further adaptations will be needed to eliminate forum shopping activities.

9.2. Insolvency Darwinism

By applying the term "Insolvency Darwinism" the thesis refers to the development which jurisdictions inside the EU undergo, drawing an analogy to living organisms in the process of evolution. Similarly to living creatures, jurisdictions have to keep track of changes in the economic environment and adapt to these changes in order to survive the competition. Jurisdictions will not easily go extinct in the Darwinian sense. However, within the system of the EU it is imaginable over a longer period, for a majority of companies will decide to transfer the COMI to another Member State if national legislation keeps on refusing to improve the existing insolvency regime because of an unwillingness to adapt to a changing economic environment. The Member State with the insolvency regime best adapted to the prevailing economic environment represents in all likelihood the jurisdiction which companies are attracted to. As the insolvency industry is an important factor for sustainable economic prosperity, the reputation of having a "bad insolvency regime" could reflect on the overall economic situation of the country. A functioning and modern insolvency system is closely linked to the economic welfare of a country. Jurisdictions offering an up-to-date and flexible insolvency arena, indicative of an overall modern economic system are better able to attract international companies to locate there.

9.3. Insolvency Law Perfection

The general definition of "perfection" as "a state that could not be better"[1778] or "the highest or most nearly perfect degree of quality or trait"[1779] are useful as a starting point to define "insolvency law perfection", but these definitions have to be seen in the context. It is argued that a perfect insolvency regime offers a legal framework which enables stakeholders to find the best possible solution for the majority of the parties involved. Every case is different and hence procedures must be designed to allow for flexible solutions helping to foster restructurings in accordance with agreements between the stakeholders. The

[1778] See chapter 0.5.2.
[1779] Ibid

legislator's duty in this context is to provide for a framework preventing abuse and offering protection for the parties involved. A "perfect" regime should not create obstacles and should respect the economic implications of insolvency. Hence court involvement should be kept to a minimum and only allowed where absolutely necessary. A "perfect" insolvency regime should pave the way for the stakeholders to find a mutually acceptable solution, enabling the debtor to be rescued, if economically sensible, constructively opening a second chance, beneficial for the other stakeholders as well.

9.4. Rescue-Friendliness – the Overarching Policy Aim

This thesis demonstrates that jurisdictions inside the EU race to rescue and imitate each other in their rescue-friendly provisions, leading to higher degrees of convergence and uniformity. This can be regarded a race to the top in line with the overarching aim of modern policy-makers like the governments in England or the US in efforts to nurture the rescue of companies. The targeted objective of modern insolvency law is to elevate prospects for restructuring, in other words, facilitating the establishment of a rescue culture. Enhancing restructuring possibilities has become a crucial factor in modern insolvency systems. Since the Cork era, the overriding policy driver in England is the emphasis on rescue with the rehabilitation of companies as the overarching aim. Rescue should be the overarching objective and any regime pursuing this is be seen in a race to the top.

The effects of a successful rescue are by no means positive for the debtor only, but will be beneficial also for creditors, suppliers, employees and generally for society as a whole.[1780] A race to rescue is therefore the way towards a "perfect" insolvency regime. In consequence, convergence and alignment with a rescue-friendly regime would be a positive outcome of forum shopping activities. Sustainability, and not a quick return in the form of high liquidation rates for the creditors, is the key for a well-functioning insolvency law under long-term considerations. Selfish interests of individual stakeholders

[1780] Cork Report (n 57) 55.

should not matter in creating a flexible framework to facilitate viable restructurings with an outcome beneficial for the majority of the parties involved.

This thesis and the analysis of the changes to the InsO by the ESUG manifest that jurisdictions like Germany, historically less equipped with rescue-friendly provisions, have been pushed in policy terms to align their systems with more rescue-friendly regimes by imitating their rescue-friendly provisions.

9.5 Closer Alignment

Almost all major changes, leaving the half-hearted approach aside for the moment, led to an improved rescue arena compared to the situation prior to the ESUG. Through the imitation of England's rescue-friendly provisions, Germany has become more aligned with the overall more rescue-friendly regime in England.

The possibility of installing a preliminary creditors' committee and the new possibility for this committee to influence the IOH appointment could enhance the participation of creditors and could be considered as a step in the direction of further improving the German insolvency landscape and hence a race to the top. Although in fact a change to more creditor-friendliness, this represents a modification which can be seen as rescue friendly as well. The main creditors will in general be the first in perceiving signs of financial difficulties of a debtor. The main creditors are in close contact with the debtor during these times and the fact that they are have an influence on the person who will have a say during the proceedings will help to encourage the debtor to file for insolvency at an earlier stage. Putting the choice into the hands of creditors comes partly as an alignment with the situation in England. The changes were driven by forum shopping activities as the obvious lack of creditor influence on the party to be appointed to the position of IOH was recognised as being a flaw in the old system, in comparison to England where creditors were the force to decide upon the IOH appointment. Regulations in this respect are now better aligned and more uniform than they were pre- ESUG.

Much the same applies to reducing the blocking potential in the hands of dissenting creditors and shareholders who had in the past been able to undermine otherwise promising restructuring attempts. Here again, the change was driven by forum shopping activities, showing the powerful blocking potential prevalent in Germany prior to the ESUG had been a major obstacle for restructuring endeavours, whereas the English system was proven to reduce remedies for dissenting creditors and shareholders to a minimum and included proceedings of a cram-down nature. The reduced blocking potential of shareholders and creditors has created a higher convergence between the English and the German system in a new alignment to more rescue-friendliness.

The amendments to the self-administration procedure helping to reduce several existing hurdles and cutting back elements of uncertainty will encourage debtors to file for insolvency at an earlier stage, paving the way towards more rescue-friendliness. It is argued that the modifications to the self-administration procedure in Germany were caused by forum shopping activities, although this may not always appear so on the surface. Reinforcing methods for the self-administration procedure is considered as an appropriate compromise in trying to incentivise debtors to file for insolvency at an early stage without having to implement a separate independent pre-insolvency restructuring procedure. Due to the nature of English pre-insolvency proceedings, the CVA, as also the SoA, leave the DIP as the norm. In consequence and following the changes through the ESUG, the German system is now better aligned with the methods in England, resulting in a greater uniformity of the proceedings in question.

In fostering the establishment of an improved rescue regime in Germany, obstacles to implement a DES in Germany were cut in order to promote a more frequent use of this important restructuring tool. These changes, clearly driven by forum shopping activities, led to a more uniform DES regime in Germany and England. England had succeeded early on in creating a DES regime which offered a trouble-free way for successful restructurings; certain hurdles to a

smoother path in Germany having been removed, the systems in the two countries do not conform as such, but stand more aligned now than before the latest German reforms.

Again, much the same can be said about the introduction of the protective umbrella proceeding. The implementation of this new preliminary procedure offers the possibility of an earlier and quicker restructuring in comparison to the situation before the ESUG. In consequence the additional establishment of this opportunity serves to pave the way for an overall more rescue-friendly insolvency landscape. The introduction of the protective umbrella proceedings must be regarded as a specialisation rather than an expression of uniformity with the English system. It represents a unique preparatory procedure, comparable only to the preparatory phase of the CVA and the SoA as well as certain aspects of pre-packs in England.

Though appearing negative, this actually underlines the outcome of this research. Viewed in isolation, the protective umbrella proceeding seems to be an improvement. However, it could be argued that the introduction of this proceeding is to be seen as a specialisation rather than an alignment with more rescue-friendly regimes. The procedure will not withstand the competition amongst the Member States and therefore will not be successful in the long run. The protective umbrella proceeding will have to be replaced with a stand-alone pre-insolvency procedure in alignment with more rescue-friendly regimes.

This "specialised" procedure is seen as burdensome and over-regulated. Looked at in greater detail, the protective umbrella procedure is hardly distinguishable from the general preliminary proceeding. The only benefit to speak of is a higher degree of clarity for the debtor about the company getting restructured. It is questionable, however, whether much benefit can be drawn from this minor advantage considering the effort it takes to get the necessary attestation. A well prepared insolvency plan outside a protective umbrella proceeding would bring about the same result, so it seems that the legislative aim is primarily directed at achieving a psychological effect instead of

presenting a really worthwhile instrument to the market. The title of the protective umbrella proceeding is "preparation for a restructuring", avoiding the term "insolvency"; however, it is still embedded into the normal insolvency procedure. There was at first a positive reaction to this proceeding in Germany for which the author predicts a consciously declining usage over the next few years, seeing the novelty wearing off, as this procedure is seen as a case of window dressing. The reason is that the protective umbrella proceeding is not offering an alternative to a stand-alone pre- insolvency proceeding. This specialisation in the form of a unique procedure and its inherent lack of uniformity with procedures offered by more rescue-friendly regimes offering a real pre-insolvency procedure will not lead to a race to the top in the long run. It can be forecast that this particular procedure will lead to only have short-term positive effects. A genuine pre-insolvency procedure stands for a definite requirement in a modern insolvency landscape and the refusal to introduce one will only necessitate further adaptation later on.

9.6. The Necessity for a Comparative Approach

These findings have so far left the half-hearted approach taken by the German legislator to one side. At this point, the relevance of a comparative approach is revealed, as the changes introduced by the ESUG did not happen by looking in isolation at the national law. The reforms were provoked by forum shopping activities from Germany to England, so the changes were not made in a legal vacuum, but with having an eye on the apparently more flexible and rescue-friendly provisions in England, which were in turn influenced by the US. An analysis of the changes introduced by the ESUG without a comparative aspect would therefore be incomplete. It is no longer possible to be parochial while operating in a globalised world.

The work of comparing and contrasting between the German and English regimes resulted in the second stage of findings of this thesis. Adaptation in the Darwinian sense brings about a more perfect regime and this can be observed when looking at the situation pre- and post-ESUG in isolation. All in all, the changes paved the way towards a more perfect insolvency landscape

in Germany. In relative terms, however, the comparison with the English regime demonstrates that changes introduced by the ESUG are in fact the result of half-hearted attempts of alignment with a more rescue-friendly regime, a fettered approach in the Darwinian sense, and certainly not consequently adapted to the economic environment. This results in the need for more changes for better adaptation to withstand the competition amongst the Member States of the EU. There are no new forum shopping cases reported since the introduction of the ESUG as it seems that the ESUG is "tested" in Germany. However, in the long run more forum shopping cases are expected based on the findings of this thesis. German companies will still be attracted abroad as English law, in line with the theme "Survival of the fittest", is better adapted to the economic environment. In view of the failure fully to adapt taken during the reform process, Germany will not be able to compete with England as yet.

9.7. Germany's Fettered Approach

The half-hearted policy of reform is a recurring theme throughout the entire ESUG reforms. In the end, the policy aim of the German legislator to establish a culture of second chance and promote an earlier filing for insolvency is contradicted by the outcomes.

The strengthening of creditors' rights in the form of enhanced participation through the preliminary creditors' committee and the new possibility for the creditors' committee to influence the choice of the IOH must be seen in context. A preliminary creditors' committee is installed for a minority of cases, at the same time limiting any influence on the IOH appointment to those cases alone. The new regulations are packed with obstacles, resulting in delays; they are not constructed to promote rescue in the long run. The idea of more creditors' participation has not been adopted, leaving a complicated and bureaucratic solution instead. An alignment in the Darwinian sense, on the other hand, would have made it the norm for the main creditors to be the determining party also deciding on the IOH instead of leaving this with the courts.

The same would apply to limiting the creditors' and shareholders' blocking potential. Reducing the blocking potential is surely a good step, but not going far enough to adapt to the needs of the economic environment. Minority interests should not be given the power to obstruct an otherwise mutually agreed restructuring, especially if these rights are misused to obtain bargaining power. The best answer to avoid such problems is a proceeding with a so-called cram down nature, as explicitly demonstrated by the English example.

The strengthening of the self-administration procedure gives a further example. Seen in isolation, leaving the debtor in charge as the norm can well be regarded a race to the top, as it helps to prepare the ground for a successful restructuring. However, the newly introduced provisions do not provide for an automatic order of self-administration if the debtor applies for it, instead they burden the application with preconditions, which is seen as a conservative and half-hearted approach. It has not been taken into consideration that even the smallest insecurity could impede the debtor in deciding whether to file for insolvency or not, which in turn could easily lead to a belated filing. An automatic order would have been the right step and an optimal adaptation in the Darwinian sense, as demonstrated by the CVA and SoA procedure in England. The changes to the self-administration must be seen in conjunction with the decision of the Legislator not to introduce a genuine and stand-alone pre-insolvency proceeding, and are the result of trying for a compromise solution.

Modifications to the definition of "independence" concerning the IOH represent a simple element of clarification, as to which the author takes the view that these will not lead to any perceptible improvement. Regrettably, the German legislator did not use the opportunity to open the door for the originator of the insolvency plan to subsequently become the acting IOH. The IOH's status of independence as a fundamental pillar would have been sufficiently maintained by adhering to the original proposal of not excluding him as such, but this idea was dropped in the process. Thinking ahead in line with the predominant policy

aim of strengthening the rescue culture, it would have been a courageous step to allow the originator to be the subsequent IOH. Utilising the expertise gained in writing the plan would certainly have meant a positive step in favour of quick and efficient restructuring. The originator should at least not be excluded from the outset, this is embraced by the English regime.

The DES system in Germany was improved by reducing several hurdles which had been difficult to overcome in the time pre-ESUG. Although now being seen as a race to the top, a race towards more rescue-friendliness, the approach is still fettered. Whereas the German DES regime is more aligned with the system in England, it has not been adapted as well as the English system. The biggest flaw must be seen in the requirement of having to obtain the approval of creditors, which can lead to encourage dissenting creditors to misuse their bargaining power, an option which creditors rightly do not have in the English regime. Whereas the English regime is adapted to the environmental needs to have a system in place to facilitate restructurings, the German legislator ended up with a half-way solution, contradictory to the actual policy aim of strengthening the rescue culture. The lack of clarification with regard to the valuation is another instance of a fettered approach. The legislator, though being aware of the uncertainties and discussions concerning the valuation, did not use the opportunity for clarification which is in turn still spreading doubts as to the prospects for a successful DES. Whereas the English DES regime can be made use of for any DES, be it in a formal insolvency proceeding or with an informal process, the German Legislator decided to restrict the method to formal insolvency proceedings. With the majority of DES cases coming about in informal rescue attempts and not being given the opportunity to draw a benefit from the otherwise positive changes, the new regulation might even impede a pre-insolvency DES altogether; creditors could be refusing to agree to an "informal" DES, calculating that they will gain an extra benefit from a formal insolvency proceeding.

The implementation of the protective umbrella proceeding could be considered a race to the bottom, seen in the light of the missed opportunity to introduce an authentic pre-insolvency procedure, so typical of the conservative

approach towards necessary changes. In Germany the "new" procedure is neither able to achieve the policy aim for a shift in paradigm nor to establish a culture of second chance. The only way forward in this context would be to finally install a genuine pre-insolvency procedure. A modern rescue-regime calls for such a procedure, as it offers invaluable advantages, such as greater flexibility, substantial efficiency, less costs in comparison to a formal procedure and a shorter duration of the proceedings.[1781] A pre-insolvency proceeding fosters earlier filing, one of the key factors for a successful restructuring. Pre-insolvency proceedings reduce the stigma of insolvency and are able to prevent "hold-out" creditors obstructing the proceedings.[1782]

9.8. "Distrustful of change while full of reforming energy"[1783]

This research could assist the German policy maker to realise that it takes an alignment with provisions of more rescue-friendly regimes to prevent forum shopping. In accordance with Manson's criticism[1784], Germany was trying to imitate rescue-friendliness, but failed due to German characteristics hampering the approach. This echoes Manson's words referring to company law reforms in England in the nineteenth century: "distrustful of change while full of reforming energy".[1785]

This thesis set some starting points to find out the reasons for the conservative approach taken by the German legislator. What could be said is that the nature of the fettered approach taken by Germany traces back in part to the German sense of flourishing and pensiveness ("Deutscher Tief- und Schnoerkelsinn"),[1786] which helps to explain the tendency of the German legislator to undertake extensive regulation. This tendency towards regulating all relevant and possible questions and details ends in not being able to remove "legislative clutter".[1787] The habit of including every little detail leads to

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[1781] Hoelzle Sanierungsvergleichsgesetz (n 1657) 208.
[1782] Eidenmueller in Paulus (n 468) 1345; Kolja von Bismarck, 'Expertengespraech zur Insolvenzrechtsreform - Gedaechtnisprotokoll (21. April 2010, unpublished policy material provided via email from the CDU on request of the author)
[1783] Ibid 428
[1784] Edward Manson, 'Tinkering Company Law' (1890) 6 L.Q. Rev. 428.
[1785] Ibid 428
[1786] Eidenmueller in Paulus (n 468) 1345.
[1787] Milman, Corporate Insolvency Law (n 469) 4.

complexity and inflexibility which in turn leads to less practical usage. The compulsion to make regulations watertight against abuse and covering every possible scenario is firmly anchored. This anchor has to be lifted in order to create state-of-the-art, practical and flexible insolvency laws.

Another reason could lie in the fact that the German legislator is trying to hold on to old traditions, the substantial influence of the courts being a good example. Germany's approach is shaped by its paternalistic system of commitment to justice ("Paternalistisches System der Justizfoermigkeit").[1788] Insolvency law is still seen as the "hour of court proceedings"("Stunde des gerichtlichen Verfahrens"), which must, however, be regarded an error of historic concern.[1789] The economic mandate given to insolvency law is in blatant contrast to the German commitment to justice.[1790] In other words, courts in Germany might historically have a different function compared to their counterparts in England, but this only appears to conceal the obvious unwillingness to bring about necessary changes to the existing structure. Legislation is not adapting to the environmental changes, which would require procedures with less interference by the courts.

It will be interesting for further research to look deeper into the reasons for the fettered approach in Germany.

9.9. Reciprocal Learning

Looking at the comparative outcome, it would seems that England is offering in many respects a more "perfect" rescue regime. This thesis has focused on the most recent changes to the insolvency regime in Germany, as has been demonstrated, these changes have been influenced by forum shopping activities from Germany to England. It would be incorrect to suggest that reciprocity did not exist in relation to discrete elements of Germany's rescue provisions that do have merit. The picture is not all bleak in Germany, for

[1788] Haarmeyer ESUG (n 1106) 5.
[1789] Ibid
[1790] Ibid

example the possibility of financing the wages through insolvency substitute benefits from the German Employment Agency ("Insolvenzgeld der Agentur fuer Arbeit") for the first three months of the insolvency proceedings shows that Germany itself can provide indicators towards corporate rescue perfection in the sense of the application of the Darwinian Theory examined in this thesis. These discrete points do not however, detract from the overall conclusion that the ESUG reforms have led to a half-hearted overall regime as far as encouraging rescue is concerned.

9.10. Recommendation for Future Research

In addition to the findings presented above, there is scope for supplementary research which could develop certain aspects of this thesis further. In having identified the analogy with the Darwinian Theory as partly driving developments forward, the author intends to delve into questions of unofficial convergence of corporate rescue regimes taking place on a global scale.

Additionally it would be interesting to supplement this research by analysing the socio-legal and historical background of the development of insolvency laws in England and Germany.

This thesis provides inspiration to delve deeper into some more specific aspects resulting from this thesis, such as a comparison of the role of the IOH in England and Germany, or an empirical research on the effectiveness of creditors' committees in England and Germany, in addition to an already published article[1791] or a comparative analysis of the treatment of suppliers and employees in insolvency proceedings in Germany and England.

The author's intention is furthermore to publish this thesis as a monograph. Another future aspect of this work will be to continue to follow up the development of German insolvency law. The author intends to expand her research towards different approaches outside formal insolvency procedures,

[1791] Luecke, Creditors' Committees (n 862).

comparing and contrasting aspects of informal workouts and potentially the role of different forms of dispute resolution in insolvency cases.

9.11. Concluding Remarks

Overall it can be concluded that this thesis has confirmed the research hypothesis. The example of the ESUG reforms demonstrate that forum shopping activities are drivers of insolvency law perfection, with the result of a better adapted insolvency landscape looking at the overarching aim of rescue-friendliness. This alignment with more rescue-friendly regimes is seen as a race to the top. At the same time the outcome of this thesis underlines that alignments have to be carried out courageously, adapting to the economic reality, and overcoming certain traditions, in order to be able to survive the competition amongst the EU Member States. Germany has not embraced this vigorously; their fettered approach towards insolvency law reforms will result in more necessary changes in the future.

Appendix one

Forum Shopping Cases

1. Deutsche Nickel

Deutsche Nickel Aktiengesellschaft[1792], subsidiary of Vereinigte *Deutsche Nickel Group* ("VDN"), a company in the metalworking industry, started facing financial difficulties in 2004 in the wake of a declining demand for coins following the first minting and introduction of Euro coins at the beginning of 2002. Several endeavours to restructure the company failed mainly owing to the inability to attain the necessary voting majority specified under the German "Schuldverschreibungsgesetz" ("Bond Act")[1793]. Recognising that a debt-equity-swap would be achievable under English law, *Deutsche Nickel AG* moved their registered address to England in 2005 by transferring business operations to *DNICK Holding plc.*[1794] The transfer was made possible due to the principle of universal succession ("Anwachsung") as per section 738 (1) of the German Civil Code.[1795] The *Deutsche Nickel A*G became a private limited partnership (GmbH & Co KG) under the terms of the German Conversion Act ("Umwandlungsgesetz"), with the new company, *DNICK Ltd.* as one of the general partners. By transferring interests from the partnership, Deutsche Nickel AG and *Deutsche Nickel GmbH & Co KG* ceased to exist, and all assets and liabilities automatically transferred to DNICK Ltd. as the only remaining general partner. In consequence, an administration procedure commenced in April 2005.[1796] Within two months of a CVA proceeding, the creditors converted their claims into assets of *DNICK Holding PLC.*, possible by having received the 75% voting majority required, compared to the 95% necessary

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[1792] Synonym of an English PLC
[1793] See chapter 2.3.8.
[1794] Vallender Gefahren für den Insolvenzstandort Deutschland (n 10) 132, it was not a „real" debt to equity swap as the creditors did not receive equity in the company against which they had a claim, but equity for a waiver of the claims, see Tashiro (n 200) 175.
[1795] Ringe (n 31) 5/6.
[1796] Court Case number 2771/2005.

according to German law.[1797] In 2006, the group announced that the restructuring of the company had been successful.[1798]

The motivation of Deutsche Nickel behind the action was simple. A restructuring in Germany proved impossible, whereas the English insolvency law opened the opportunity to restructure the company with the necessary consent of the creditors in the form of the CVA. Another factor speaking in favour of England was the possibility to influence the choice of the IOH by the debtor and the creditors involved, as also leaving the debtor in charge, all easier in practical application under the English regime than could be expected with the German self-administration procedure.[1799]

2. Schefenacker

Similar to *Deutsche Nickel,* a second well-known case concerns *Schefenacker AG.*[1800] The company with a longstanding success story as supplier of rear view mirrors to the automotive industry, began facing financial difficulties in 2006, mostly due to an earlier investment decision for a credit-financed take-over of their English competitor Brita PLC: at the time of a beginning downturn in the market.[1801] The company opted to move their centre of interest to England in order to execute a debt-to-equity swap according to English law. Using the same technique of universal succession as described in the case of *Deutsche Nickel, Schefenacker PLC,* following negotiations with its shareholders and creditors came up with the proposal for a CVA.[1802]

The motivation of *Schefenacker* was the possibility of a successful restructuring under English law, not achievable with insolvency regulations in Germany.[1803] The CVA enabled the company to attain the required 75% vote

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[1797] More on debt to equity swap see chapter 7.
[1798] www.presseportal.de; http://www.rws-verlag.de/hauptnavigation/aktuell/news-detail/period/1141167600/2674799/archived/browse/2/select/newsticker_kanzleien/article/340/Ashurst-beraet-Deutsche-Nickel-Gruppe-bei-erfolgreicher-Restrukturierung-1.html
[1799] Volker Beissenhirtz, 'Gestaltungsoptionen durch Rechtsform und Sitzverlegung' (2007) Sanierung Insolvenz 27, 27.
[1800] AG stand for Aktiengesellschaft and is an equivalent to an English Plc.
[1801] Ringe (n 31). 6,7.
[1802] Richard Mitchel, 'The lesson of Schefenacker' (2007) <http://www.mwe.com/info/pubs/rmitchell0807.pdf >(last visited 14.09.2015).
[1803] Tashiro (n 200) 174.

of the creditors, overruling a number of minority investors and creditors, who had tried to oppose the previous restructuring attempt in Germany.[1804]

3. Brochier

In contrast to companies having successfully transferred their centre of interest to England, it seems worth mentioning that moving the COMI could also encounter unforeseen difficulties as demonstrated by the case of *Hans Brochier GmbH & Co KG*[1805]. Following the examples of Schefenacker and *Deutsche Nickel,* the company also tried to make use of the law of succession[1806]. What happened is that within minutes after the directors appointed an English administrator at the newly registered address, the German employees filed for insolvency at the responsible Local Court.[1807] Unaware of the appointment of a receiver in England, the German court decided to open insolvency proceedings. Arguments about the English insolvency proceeding, having been opened first were denied by the local court in Germany, ruling that English proceedings would be in violation of "ordre public"[1808]. The English court subsequently announced the opening in England as invalid.[1809]

What remains is that *Brochier* had again been encouraged by the perspective of a successful restructuring judged to be higher under English law.

4. Rodenstock

Rodenstock used the "new way" of forum shopping by applying a foreign restructuring tool, in this case the English SoA, without the necessity of moving the COMI to benefit from the favourable insolvency law proceeding of another

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[1804] Mitchel (n 1802).
[1805] AG Nuremberg, Urteil v. 15.08.2006-8004 IN 1326 bis 1331/06 und Urt. V. 01.10.2006 -8034 IN 1326/06, NZI 2006, 186.
[1806] See chapter 7.2.1.
[1807] Ringe (n 31).
[1808] AG Nuremberg (n 1805).
[1809] *Hans Brochier Holdings Ltd v Exner* [2006] EWHC 2594= [2007] BCC 127 = [2007] NZI 187; Ballmann, 'Der High Court of Justice erschwert die Flucht deutscher Unternehmen ins englische Insolvenzrecht – Der Fall Hans Brochier - Hintergründe und Folgen' [2007] Betriebs-Berater 1121; Dirk Andres and Andreas Grund, 'Die Flucht vor deutschen Insolvenzgerichten nach England – Die Entscheidungen in dem Insolvenzverfahren Hans Brochier Holdings Ltd.' (2007) NZI 137.

EU Member State. The company is one of Europe's largest manufacturer and distributor of spectacles and contact lenses, with over 4000 employees in more than 80 countries. After encountering financial difficulties, the company made use of the SoA for a successful restructuring. Rodenstock is registered in Germany, where the company also has its COMI. Not holding any assets in England, Rodenstock had built up considerable liabilities, governed by English law via a facility agreement and containing a clause giving English courts exclusive jurisdiction to settle arising disputes, as the majority of the creditors was based in England.[1810] It was suggested to enter a SoA in order to be able to bind the senior creditors to an alteration of their rights under the finance facility, allowing *Rodenstock* to restructure its debts while at the same time avoiding German insolvency proceedings.[1811] The English court was able to sanction the scheme in accordance with the Companies Act 2006, allowing such sanction for "any company liable to be wound up",[1812] which includes overseas companies.[1813] Restricting the court in granting an according order, case law defines three requirements which have to be met by oversees companies.[1814] The first condition for foreign companies is to have established a sufficiently relevant connection with England[1815], which was affirmed in the case of Rodenstock due to the fact of the majority of creditors being based in England, with agreements also governed by English law. Secondly, there must be a reasonable possibility for any party applying for the winding-up order to also draw a profit from it. The third condition is that there has to be at least one party falling under jurisdiction of the court with an interest in the distribution of the debtor's assets, again under jurisdiction of the court.[1816] An issue widely discussed in this particular case concerned the effectiveness of the approved English scheme and the question of whether it would be recognised in Germany.

[1810] *Re Rodenstock GMbH* [2011] 1104
[1811] Ibid
[1812] S. 895 CA 2006
[1813] Elms (n 139) 114.
[1814] *Re Real Estate Development Co* [1991] BCLC 210 (Ch.).
[1815] Rodenstock (n 1810).
[1816] Elms (n 139) 114; *Re Drax Holdings* [2004] 1 WLR 1049; *Re Sovereign Marine & General Insurance Co Ltd* [2006] BCC 774.

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