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ARTICLE

Clawback of Transactions before Insolvency: Comparison of the German and English Provisions on Voidable Transactions

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Introduction

In recent years insolvencies have become international with the globalisation of the economy. However, the law did not follow this trend. There is still a certain tension between the process of 'globalisation' and the legal system still being stamped by national structures. As a result of the globalisation process, the economic consequences of an insolvency may extend across various countries and legal systems, while the legal solutions to it are still limited to the national territory. It is possible that on an international level results might be reached which would be unthinkable on a national level. One famous example is the *Maxwell*[1] case, where one lawsuit in the US concerning the rescission of a transaction undertaken in England, was rejected by the US court (otherwise well-founded) because of the general principle that the effects of an insolvency procedure are limited to the state in which the insolvency procedure takes place. Hence, only by crossing the border, a creditor could escape an otherwise well-founded avoidance action.

In order to prevent such an unfair decision in the future, international bodies like the European Union established rules, like the European Regulation on Cross Border Insolvencies.[2] A comparison of German and English law on voidable transactions in insolvency is particularly interesting since both laws belong to different families of law, namely to the continental and anglo-american system.

1. Aims and principles of the rescission of voidable transactions

A comparison of the aims and principles governing the provisions concerning voidable transactions shows a different dogmatic approach in Germany and England. Under German law, the main aim of voidable transactions provisions is to support equal treatment of all creditors.[3] Only on a secondary level, unrighteous advantages are corrected.[4] Thus, the rules governing voidable transactions under German law are, in general, a specification of the *pari passu* principle.

The English rules governing voidable transactions are rather narrow.[5] According to some legal writers, the rules pursue various aims. They serve to increase the assets of the insolvent debtor; protect against unrighteous advantages of single creditors; and secure the principle of *pari passu*.[6] Judicial decisions and

Notes

1 170 B.R. 800 (Bankr p.D.N.Y., 1994); cf. also *Maxwell Comunications Copn plc.* [1994] All ER 737.

2 Council Regulation (EC) No 44/2001 of 22 December 2000 on jurisdiction and the recognition and enforcement of judgements in civil and commercial matters.

3 (In Germany named '*par-condicio-creditorum*'), E. Jaeger and W. Henckel, *Konkursordnung – Großkommentar* (9th edn, Berlin, 1997), s. 29 para. 2; R. Pfefferle, *Konkursanfechtung und Rückschlagsperre* (Heidelberg, 1982), p. 53; L. Häsemeyer, *Insolvenzrecht* (2nd edn, München, 1998), p. 443; H. Haarmeyer and W. Wutzke and K. Förster, *Handbuch zur Insolvenzordnung* (2nd edn, München, 1998), p. 423; C. Eichberger, *Die besondere Konkursanfechtung* (Regensburg, 1990), p. 2; M. Zeuner, *Die Anfechtung in der Insolvenz* (München, 1999), para. 1; S. Smid, *Grundzüge des neuen Insolvenzrechts* (3rd edn München, 1999), p. 237; A. Breutigam and M. Tanz, 'Einzelprobleme des neuen Insolvenzanfechtungsrechts' (1998) ZIP 717; R. Bork, *Einführung in das neue Insolvenzrecht* (2nd edn, Tübingen, 1998), para. 2, 204; M. v. Campe, *Insolvenzanfechtung in Deutschland und Frankreich* (Heidelberg, 1998), p. 7, 14; C. Niehus, *Die Insolvenzanfechtung in der Bundesrepublik Deutschland und den Vereinigten Staaten von Amerika* (Köln, 1999), p. 30; BGH, Urt. v. 2.2.1972 – VIII ZR 152/70, BGHZ 58, 108.

4 Pfefferle, n. 3 above; v. Campe, n. 3 above; Niehus, n. 3 above.

5 Cf. e.g. the short dogmatic reasonings in L. Doyle, *Insolvency Litigation* (London, 1999), para. 9.02; I. Fletcher, *Cross-Border Insolvency: National and Comparative Studies* (Tübingen, 1992), p. 222.

6 R. Goode, *Commercial Law* (2nd edn, London, 1995), p. 856; M. Bunge, *Die Konkursanfechtung im englischen Recht* (Bonn, 1933), p. 1; M. Hemsworth, 'Voidable Preference: Desire and Effect' (2000) *Ins L&P* 54; Cork Report, para. 1209; D. Prentice, 'Some observations on the law relating to Preferences', in: Cranston, Ross (ed.) *Making Commercial Law* (London, 1997), p. 442; Doyle, n. 5 above, para. 9.02; K. Kamlah, *Die Anfechtung in der Insolvenz von Unternehmen* (Göttingen, 1994), p. 120; V. Finch, *Corporate Insolvency Law* (Cambridge, 2002), p. 398.

literature underline the latter as being the primary one. The English rules concerning voidable transactions in fact aim to rectify any unrighteous advantages (with the exception of s. 238 Insolvency Act of 1986 (IA 86) cf. below). This conclusion follows from the fact that under English law, it is generally not possible to rescind judicial decisions (cf. below). Finally, the interpretation of subjective criteria in the provisions governing voidable transactions by the court as shown in *Re MC Bacon* confirms the fact that jurisprudence tends to follow the theory concerning unrighteousness rather than the *pari passu* principle.

The difference in narrow approach between the two legal systems carries serious consequences: due to the more objective approach of the *pari passu* principle, transactions undertaken within the twilight period are generally voidable, whereas transactions under the theory of unrighteousness are generally regarded as being valid and become voidable only under certain (subjective) circumstances. Hence, coming from a theoretical background, English law seems to be more reluctant than the German legal system to allow claw backs.

2. The enforcement of the rescission of voidable transactions

The effectiveness and efficiency of the substantive rules concerning voidable transactions also depend on the procedural possibilities, which will be looked at next:

a) Admissibility of court actions

The German *Insolvenzordnung* comprises of several different types of insolvency procedures: the General Insolvency Procedure (*Regelinsolvenzverfahren*), the Insolvency Plan Procedure (*Insolvenzplanverfahren*) – equivalent to the English administration procedure, the Debtor In Possession Procedure (*Eigenverwaltung*) and the Consumer Insolvency Procedure (*Verbraucherinsolvenzverfahren*). The rescission of transactions prior to insolvency is possible in all kinds of insolvency proceedings, even in the *Insolvenzplanverfahren*.[7]

The English insolvency law in contrast allows rescission only in some types of procedure. Apart from the bankruptcy procedures for individuals, the English legal system comprises of four insolvency procedures for companies, namely the company Voluntary Arrangement, ss 1 ff. IA 86, Administration, s. 8 ff IA 86, Administrative Receivership, ss 28 ff IA 86 and Winding Up (Liquidation), ss 73 IA 86. In principle, only in administration and winding up the rescission of voidable transactions is possible, although in other types of procedures the respective transaction may be avoided under the rules of s. 423 IA 86, Transactions Defrauding Creditors.[8]

b) Competent courts

Under German law there is a difference between the court being responsible for the execution of the insolvency procedure itself and the court deciding upon voidable transactions. According to s. 2 InsO, the lower courts (*Amtsgerichte*) acting as insolvency courts (*Insolvenzgerichte*) are responsible for the insolvency procedure. The legal action enforcing the rescission of a voidable transaction, however, has to be initiated before a competent civil court.[9] The English legal system, on the other hand, foresees a sole competence for the insolvency procedure as well as for the initiation of legal proceedings in order to avoid certain transactions. Here, the High Court, Chancery Division, is generally competent for both procedures (so-called *vis atractiva concursus*).[10]

c) Entitled persons and opposing party of rescissions

In principle, both legal systems authorise only the insolvency administrator to initiate proceedings in order to rescind voidable transactions. Accordingly, under German law, only the insolvency administrator is able to pursue an action to avoid a transaction.[11] The frequently criticised derogative rule in s. 313 para. 2 InsO is the only rule which states that 'every insolvency creditor' has the right to claim a rescission in the Consumer Insolvency Procedure.[12]

Notes

7 M. v. Campe, n. 3 above, p. 21; W. Henckel, 'Insolvenzanfechtung', in: *Kölner Schrift zur Insolvenzordnung* (2nd edn, Berlin, 1999), para. 3; M. Zeuner, n. 3 above, para. 3; FK-Dauernheim, InsO, s. 129 para. 2.

8 Cf. also L. Doyle, n. 5 above, para. 9.05; I. Snaith and F. Cownie, *The Law of Corporate Insolvency* (London, 1990), para. 20.03.

9 H. Thomas and H. Putzo, *Zivilprozessordnung* (19th edn, München, 1995), s. 19a para. 2; H. Musielak, *Kommentar zur Zivilprozessordnung* (München, 1999), s. 19a, para. 5; HK-Kreft, InsO, s. 129 para. 95; M. Zeuner, n. 3 above, para. 308.

10 I. Fletcher, n. 5 above, p. 223; J. Bunge, *Zivilprozeß und Zwangsvollstreckung in England* (Berlin, 1995), p. 157; J. Bruski, *Die Voraussetzungen der Konkursanfechtung* (Bonn, 1990), p. 39, 41.

11 M. Zeuner, n. 3 above, para. 284; S. Smid, n. 3 above, p. 238; M. v. Campe, n. 3 above, p. 321; O. Jauernig, *Zwangsvollstreckung und Insolvenzrecht* (21st edn, München, 1999), p. 240.

12 Cf. G. Wagner, 'Die Anfechtung im Verbraucherinsolvenzverfahren' (1999) ZIP 689, 690; C. Paulus, ,'Der Anfechtungsprozess' (1999') ZInsO 242, 243; O. Jauernig, n. 11 above, p. 240.

Also, under English insolvency law there is an exception to the rule, that only an 'office holder' (liquidator or administrator as the case may be) has the right to rescind certain transactions:[13] According to s. 423 IA 86 (Transactions Defrauding Creditors), every 'discriminated creditor' has the right to take legal action in order to rescind a voidable transaction.[14]

Hence, both systems recognise the key-role of the insolvency administrator and authorise him to pursue the action. The German exception to this rule is of minor practical effect. The English exception to s. 423 IA 86 provides an indication that this provision is not really a clawback provision in insolvency in the proper sense (cf. also 4.b)).

d) Financing the action

In both legal systems, the insolvency administrator has the right, to finance the legal action out of the insolvent estate, or if he himself provides the necessary funds, to get his costs reimbursed as a preferential creditor.

However, the reality shows a different picture: In particular under the English legal system, the above mentioned means of financing, and also the assignment of debt in question, are in fact heavily restricted by various judgements and legislation. Whilst under German law, the insolvency administrator may have access to legal aid (in case of insolvent companies) the reason being is that he serves the public interest,[15] an English insolvency administrator is expressly excluded from the legal aid, at least in relation to cases of companies which are in insolvency procedures.[16]

3. Common characteristics of all provisions

a) The insolvency of the debtor

The avoidance of certain transactions is generally only admitted within a formal insolvency procedure in Germany and England.[17] Both legal systems differentiate between the formal (procedure) and the material insolvency, whereby the formal insolvency depends on the material. Hence, in both legal systems, the beginning of formal insolvency starts with a presentation of the petition to initiate insolvency proceedings. In order to establish the material insolvency, the German as well as the English legal system rely on the principles of inability to pay debts and over-indebtedness. While under German law both principles are regarded as being equally ranked, in the English legal system over-indebtedness is regarded only as a certain type of illiquidity.[18]

The English legal system looks at both reasons for insolvency for the purpose of avoidance, whereas the German legal system in general only relies on the inability to pay debts as a trigger for the clawback provisions.[19] The exclusion of over-indebtedness as a starting point for avoidance actions in Germany is based on the fact that over-indebtedness might not be identified outside the company and that it is therefore not a valid criteria for avoidance.[20]

Generally, the voidable transaction has to be committed within the period of material insolvency in order to be voidable. Both legal systems, however, have certain provisions which do not refer to the material insolvency at the time the voidable transaction has been committed.[21]

b) Object of rescission

The German provisions, with the exception of s. 132 InsO, refer to the term '*Rechtshandlung*' ('legal valid action' is only a bad translation for it) for defining the voidable transaction as such. The corresponding English term 'transaction' is only used in ss 239, 423 IA 86. Both terms have a rather broad meaning in order to catch a wide variety of human behaviour. The term '*Rechtsgeschäft*' ('transaction in the legal sense') as used in s. 132 InsO has a slightly narrower meaning. The English provisions of s. 244 IA 86 ('Extortionate credit transactions') and s. 245 IA 86 ('Avoidance of certain floating charges') aim at rescinding – as the title of the provisions suggests – particular types of legal contracts. All those terms, either broad or narrow, however, have in common that they focus on the doing, whereas the term 'preference' as used in s. 239 IA 86 focuses on a specific result of a transaction.

Notes

13 E. Bailey and H. Groves and C. Smith, *Corporate Insolvency – Law and Practice* (London, 1992), p. 364; L. Doyle, n. 5 above, para. 9.05, 10.05; P. Totty and G. Moss, *Insolvency* loose-leaf system (July 2002, London) para. H 4-02.
14 *Re Ayala Holdings Ltd* [1993] BCLC 256; L. Doyle, n. 5 above, para. 12.10.
15 BGH, Beschl. v. 8.10.1992 – VII ZB 3/92, (1992) ZIP 1644.
16 Cf. the judgements in *Norglen Ltd v Reeds Rains Prudential Ltd / Circuit Systems v Zuken Redac (UK) Ltd* [1998] 1 All ER 218.
17 K. Kamlah, n. 6 above, p. 20; M. Zeuner, n. 3 above, para. 9; R. Goode, *Principles of Corporate Insolvency Law* (2nd edn, London, 1997), p. 348.
18 Cf. s. 123 (2) IA 86.
19 K. Kamlah, n. 6 above, p. 241; J. Bruski, n. 10 above, p. 153 f.
20 C. Hahn, 'Die gesamten Materialien zur Konkursordnung', in *Gesamte Materialien zu den Reichsjustizgesetzen* (Berlin, 1881), p. 119; E. Jaeger and W. Henckel, n.3 above, s. 30 para. 30.
21 Ss 133-136 InsO; ss. 244, 245, 423 IA 86.

c) Necessity of a measurable result

In order for a transaction to be voidable, this transaction must have a measurable result, i.e. a depletion of the insolvent estate. As a consequence, the German provisions rely on the criteria of a prejudice for all creditors. Such prejudice is assumed, if the fulfilment of the obligations vis-à-vis the creditors is impaired by diminution, frustration, obstruction or delay.[22]

The English legal system does not have such a cohesive approach, since all the provisions follow different patterns in this regard: s. 239 IA 86 focuses on the preferential effect of one creditor (which is just the opposite of the German criteria of a prejudice to all other creditors),[23] whereas there is no unequivocal or even commonly defined criteria for a measurable result within the other provisions.

d) Connected persons

The reforms introduced provisions concerning transactions with persons connected to the debtor.[24] Both legal systems intentions for dealing with this point are similar; for persons close to the insolvent debtor it is easier to be informed about the status of the debtor and they also might have easier access to put undue pressure on him.[25]

In defining the person as being a 'connected person', the English rules are wider than the German rules, as they also encompass relatives in the sidelines, such as aunts and uncles, nieces and nephews,[26] whereas German law only considers brothers and sisters as being connected to the debtor for the purposes of the avoidance provisions.[27]

Having regard to connected persons on the corporate level, a remarkable difference between the legal systems is that German law generally regards shareholders of a company as being connected to the company, if they hold more than 25% of the shares or if they are personally liable partners.[28] Under English law, the shareholders have to hold more than a third of the voting rights to be seen as connected persons, cf. ss 435 (7), (10) IA 86. Employees of the insolvent debtor are generally regarded as connected persons under English law,[29] while in Germany they must work in a prominent position such as a director to be regarded as connected. Furthermore, the English legal system regards companies within a group as being 'connected' within the meaning of avoidance provisions[30] and also includes banks, at least with the construction of a 'shadow director',[31] while under the German law, these two groups in principle are not regarded as connected persons.

e) Time limits

The legislators in both legal systems have restricted the period of time prior to insolvency in which a specific transaction might be regarded as voidable. The respective periods of time, however, may vary considerably in the two systems. In general, the German periods to initiate avoidance actions are shorter than in England. Thus, the period to avoid transactions in the sense of s. 132 para. 1 No. 1 InsO is only three months, while the period of the comparable provision, s. 238 IA 86, is two years to companies and even five years in the case of individuals, cf. s. 241 IA 86. Moreover, the English legal system (in contrast to the German, where the time-limit is in general three years starting with the commencement of the proceedings, cf. s. 146 InsO) neither defines the point in time when the transaction has been concluded nor any time limits for the office holder to exercise the avoidance action.[32]

Notes

22 R. Bork, n. 3 above, para. 212; R. Schmidt-Räntsch, *Insolvenzordnung* (Köln, 1995), s. 129 para. 2; B. Kübler and H. Prütting, *Kommentar zur Insolvenzordnung* loose-leaf system (November 1999, Köln), s. 129 para. 22; G. Kuhn and W. Uhlenbruck, *Konkursordnung – Kommentar* (11th edn, München, 1994), s. 29 para. 25; U. Weisemann and S.Smid (eds), *HandbuchUnternehmensinsolvenz* (Köln, 1999), p. 238.

23 R. Goode, n. 17 above, p. 345 ss.

24 Sec. 138 InsO; ss. 249, 435 IA 86.

25 W. Henckel, n. 7 above, para. 64; D. Prentice, n. 6 above, p. 454; I. Fletcher, 'Voidable Transactions in Bankruptcy: British Law Perspectives', in C. Ziegel, *Developments in International and Comparative Corporate Insolvency Law* (Oxford, 1994), p. 300.

26 I. Fletcher n. 25 above, p. 301; I. Fletcher, *The Law of Insolvency* (4th edn, London, 1996), p. 224; I. Snaith and F. Cownie, n. 8 above, para. 20.19.

27 M. Zeuner, n. 3 above, para. 65; B. Kübler and H. Prütting, n. 22 above, s. 138 para. 7; U. Weisemann and S. Smid, n. 22 above, p. 246.

28 U. Ehricke, 'Insolvenzrechtliche Anfechtung gegen Insider' (1996) KTS 209, 216; W. Henckel, n. 7 above, para. 70; H. Hess and M. Weis, *Das neue Anfechtungsrecht* (2nd edn, Heidelberg, 1999), s. 138 para. 40; M. Zeuner, n. 3 above, para. 73; H. Hirte, 'Nahestehende Personen (§ 138 InsO) – Klarheit oder Rückschritt' (1999) ZInsO 429,430.

29 Cf. s. 435 (4) IA 86.

30 Cf. s. 435 (6) IA 86.

31 *Re a Company* No. 005009/1987 [1988] 4 BCC 424.

32 Although the Cork Report recommended that such a limit be introduced into the Statute, cf. para. 1259 ss., 1282.

4. Provisions regarding voidable transactions

a) Introduction

A structural and systematic comparison based on the individual purpose of the respective provisions of the two legal systems shows that the German system of avoidance follows a gradual system, while English law concerning voidable transactions is still a system of codified case law. Due to this difference in approaches, the following examination is not based on a comparison of a single provision but on the aim of the respective provision.

b) Avoidance outside of insolvency proceedings

The case-law based English legal system becomes apparent with the provision of s. 423 IA 86, Transactions Defrauding Creditors. Although based in the Insolvency Act 1986, it is not even necessary for the debtor to be insolvent.[33] On the other hand, this distinction is thoroughly made under the German law, where avoidance of certain transactions outside of insolvency is only possible under the regulations of the German Avoidance Act (*Anfechtungsgesetz* (AnfG)). The purpose of both regulations, s. 423 IA 86 as well as of the AnfG, is not to enforce the *pari passu* principle but rather to ensure that the single creditor's access to the debtor's assets is not undermined.[34] It is arguable whether s. 423 IA 86 has been correctly placed inside the Insolvency Act, which, undeniably, shall expressly serve to protect the *pari passu* principle.

c) Avoidance of transactions close to insolvency ('Deckungsanfechtung')

The idea of avoiding a transaction merely because it has been completed shortly before the insolvency ('crises of the company') is not established under the English law. Although the Cork Committee dealt with this issue, it expressly rejected the idea of interfering with the execution of contracts before insolvency.[35] The German law, however, puts a great emphasis on this legal construction, known as '*Deckungsanfechtung*'. The corresponding provisions of the *Insolvenzordnung* merely serve the *pari passu* principle and as a prominent example where the otherwise 'holy' principle of *pacta sunt servanda* is overruled.[36] Since the English law does not recognise this principle altogether, a comparison is not possible.

d) Avoidance of transactions in order to skim off advantages ('Vorteilsabschöpfung')

This group of provisions aims to avoid advantages which a creditor may have received over the others through a consideration, which is worth more than the value of the consideration received from the insolvent estate. Accordingly, the aim of the provisions of s. 132 InsO and s. 238 (4) (b) IA 86 is to enforce the *pari passu* principle in skimming off these specific advantages.[37]

Both provisions deal with typical transactions defying other creditors' rights, such as the sale of goods at an undervalue or the overpriced purchase of goods, etc.[38] The scope of s. 132 InsO is broader, however, than the one of s. 238 (4) (b) IA 86 in that the former also deals with omissions, while the latter does not. Both provisions follow a strict objective approach, and do not take any subjective element into consideration.[39] As a defence, however, there is a statutory defence under the English law contained in s. 238 (5) IA 86. This concept is unknown under German law.

e) Avoidance of preferences

The provisions contained in this group (ss 131 I No. 3, 133 InsO, ss 239, 423 IA 86) follow the idea of rescinding an intentional diminishing of the insolvent's assets rather than the *pari passu* principle.

The provisions in both legal systems contain subjective elements. Nevertheless, the comparison of the respective provisions show that – once again – the German provisions require a lower level of 'intention'

Notes

33 P. Wood, *Principles of International Insolvency* (London, 1995), para. 4-21; I. Fletcher, n. 26 above, p. 232; Cork Report, para. 1213.

34 For the German law, cf. M. Huber, *Anfechtungsgesetz* (9th edn, München, 2000), 'Intro', para. 1; M. Huber, 'Das neue Recht der Gläubigeranfechtung außerhalb des Insolvenzverfahrens' (1998) ZIP 897, 898; M. Zeuner, n. 3 above, para. 353; for the English law, cf. Cork Report, para. 1202.

35 Cork Report, para. 1217, 1218.

36 Cf. L. Häsemeyer, n. 3 above, p. 441; E. Jaeger and W. Henckel, n. 3 above, s. 30 para. 1, 3.

37 L. Häsemeyer, n. 3 above, p. 452; K. Kamlah, n. 6 above, p. 138, 204 f.

38 For German law cf. G. Kuhn and W. Uhlenbruck, n. 22 above, s. 30 para. 19; M. Zeuner, n. 3 above, para. 157; B. Kübler and H. Prütting, n. 22 above, s. 132 para. 12; for English law, cf. R. Goode, n 17 above, p. 356; L. Doyle, n. 5 above, para. 9.07.

39 M. Zeuner, n. 3 above, para. 169; W. Henckel, n. 7 above, para. 46; L. Häsemeyer, n. 3 above, p. 455; HK-Kreft, InsO, s. 132 para. 10, D. Milman and R. Parry, *A Study of the Operation of Transactional, Avoidance Mechanisms in Corporate Insolvency* (Oxon, 1997), p. 12; L. Doyle, n. 5 above, para. 12.06; K. Kamlah, n. 6 above, p. 216.

than their respective English counterpart. In particular, the decision in *Re MC Bacon Ltd*,[40] where Millet J. stated that the company must, by doing what it did, have had the desire to improve the creditor's position in the event of an insolvent liquidation, proved to restrict the usefulness of this norm. While Millet J. decided that the mere presence of the requisite desire would not be sufficient by itself, rather it must have influenced the decision, the German courts decided that under s. 133 InsO the debtor only has to have knowledge of the disadvantageous effect of the transaction and to approve it in order to fulfil the German provisions.[41]

f) Avoidance of transactions without consideration

Although the German law does not recognise the principle of 'consideration' as a precondition of a binding contract, a gift or a transaction entered into without any consideration is also viewed sceptically under German law, if granted or completed shortly before the onset of insolvency. Both legal systems, therefore, do not protect those kinds of transactions in the case of insolvency. This becomes apparent by the fact that no subjective requirements have to be fulfilled neither in the German provision of s. 134 InsO nor in the corresponding English provision of s. 238 (4) (a) IA 86. Although there is no need to prove subjective elements, the English provision seems to – at least – be influenced by the doctrine of unrighteousness, since the assessment whether a transaction was entered into without a consideration is (for companies) based on the – otherwise abandoned – *ultra-vires* doctrine.[42] The requirement to look at the principle to determine the lawfulness of a companies act, indicates that in the context of a gratuitous transaction, rather than the economic background of the transaction is assessed than the specific value of the consideration.

g) Measures against indirect depletion of the insolvent estate

As stated in the introduction, the English law relating to voidable transactions is characterised mainly by its nature of codified case law. Due to this fact, the following paragraph does not start with the aim of the provision, but deals with the types of transactions to be avoided in order to encompass all provisions of the English system into the survey.

aa) Credit transactions

Under both German and English law, credit transactions might come under scrutiny if they contain conditions disadvantageous to other creditors. There is, however, no provision under German law comparable to s. 244 IA 86 – Extortionate Credit Transactions. This provision aims at preventing a creditor being preferred due to the excessive rates of interest and not to preserve the *pari passu* principle.[43] German law deals with extortionate credit transactions with the use of s. 138 BGB (*Bürgerliches Gesetzbuch*; the German Civil Code) as being against good morals. Although the provision itself might be useful since the concept of transactions being against good morals is in principle not known to the English legal system,[44] its positioning into the law regarding voidable transactions is questionable, since transactions being against good morals should be avoided regardless of insolvency. Furthermore, the provision is overall useless, since as the case law shows, the interest rates of up to 48% were held not to be extortionate.[45]

bb) Granting of securities

Although both legal systems allow for avoidance of securities which were granted in a critical situation, they differ considerably in their respective systematic approaches. This becomes apparent in s. 245 IA 86 – Avoidance of certain floating charges which only has the function of asserting nullity of a floating charge. Although systematically placed in an insolvency law, it is not a provision regarding voidable transactions in the proper sense. This provision is rather more of an irregularity of the English law: Firstly, it exceptionally allows for rescission of a congruent security as it is sufficient to receive a floating charge within the time limit to fulfil the provision without other subjective or objective criteria to be fulfilled. Secondly, the floating charge in question is not avoided, but automatically regarded as invalid. Hence, the English law acts more strictly in respect of the rescission of a particular type of security than with the rescission of direct benefits. This becomes more obvious when looking at the fact that, in principle

Notes

40 *Re M.C. Bacon Ltd* [1990] BCLC 324.
41 BGH, Urt. v. 18.4.1991 – IX ZR 149/90, (1991) ZIP 807, 808; BGH, Urt. v. 13.7.1995 – IX ZR 81/94, (1995) ZIP 1364; B. Kübler and H. Prütting, n. 22 above, s. 133 para. 7; FK-Dauernheim, InsO, s. 133 para. 9.
42 H. Rajak, *Company Liquidations* (Bicester, 1988), Ziff. 1207, 3; *Evans v Brunner, Mond & Co. Ltd* [1921] 1 Ch 359.
43 K. Kamlah, n. 6 above, p. 141.
44 R. Goode, n. 6 above, p. 100; Powell [1956] 9 CLP 16, 25.
45 *Ketley Ltd v Scott* [1981] ICR 241.

all German avoidance provisions also serve to avoid the granting of securities.

cc) Set-off

Both German and English law allow for an exceptional position of the creditor being in a position for a set-off. Under English law, set-offs are accomplished automatically and independently from the parties' respective wills.[46] It is even prohibited to contract out of a set-off.[47] Generally it is only possible to challenge a set-off if the creditor either knows about the setting of a company's general meeting or that the application for the company's liquidation has been made, cf. r 4.90 (3) IR 86. In contrast, under German law, the set-off within insolvency also depends on an express declaration of the respective creditor. Furthermore, in case the situation for a set-off has arisen due to a voidable transaction of the creditor, a set-off will not be possible according to s. 96 para. 3 InsO without a need for an express rescission.

h) Capital maintenance

German law provides for a detailed system for the protection of a company's equity capital which is twofold. In addition to statutory regulations and judicial precedents, transactions endangering shareholders' equity are also covered by the system of voidable transactions, cf. ss 135, 136 InsO. The English law also contains a protective system with the so-called capital maintenance doctrine. Here, the basic principle is that the capital stock of the company has to be preserved, and accordingly, English law, pursuant to s. 107 IA 86, categorises shareholders of a company as subordinate creditors in case of the company's insolvency. However, this kind of protection of equity capital is not additionally guarded by regulations or case law, providing for transactions contradicting this principle to be avoided. Even to the contrary, a House of Lords decision[48] relating to s. 74 (2) IA 86, liability as contributories of present and past Members, allows for shareholders to not only claim loans granted to the company within the insolvency proceedings, but also to require the company to grant security for those loans and to enforce this security in insolvency.[49]

i) Limitations to the avoidance actions

Even in insolvency, the principle of *pari passu* does not reign without restrictions. It has to be balanced with other principles of (insolvency) law such as the principle of *pacta sunt servanda*. These principles will be discussed below.

aa) Priority rules

Under German law, all provisions regarding voidable transactions are, in principle, equally applicable to the transactions which fall under more than one provision. However, as the main purpose of s. 132 InsO is to serve as a last resort in case the provisions of ss 130, 131 InsO are not suitable to deal with the transaction under scrutiny, this provision is subsidiary and excluded, if one of the aforesaid provisions already avoids the transaction.[50]

Under the English law provisions of ss 238 ss IA 86 are equally applicable. The provision of s. 165 CA 85, however, excludes certain transactions from the application of the avoidance rules altogether.

bb) Restrictions inherent to the avoidance provisions

There are some restrictions, such as s. 142 InsO ('*Bargeschäftsausnahme*') or the statutory defence, s. 238 (5) IA 86, or the concept of 'new value' or 'consideration'. The provision of s. 142 InsO and the concept of new value or consideration aim to protect those transactions, where the debtor has received an equivalent consideration for his own performance.[51] S. 238 (5) IA 86 acts as a statutory defence, which aims at defending such considerations granted in order to try to rescue the company,[52] which has no equivalent under German law.

cc) Subjective elements

Both legal systems generally require the fulfilment of subjective elements in some of their avoidance provisions. While in English law those subjective elements rather follow the theory of unrighteous advantages, German law on the other hand pursues the aim of balancing the principles of *pari passu* and protection of confidence. Accordingly, the requirements for fulfilling

Notes

46 Cf. r 4.90 IR 86; K. Kamlah, n. 6 above, p. 136; M. Vach, *Aspekte der Insolvenzrechtsreform von 1986 in England* (Regensburg, 1990), p. 56.
47 *National Westminster Bank Ltd v Halesowen Presswork & Assemblies Ltd* [1972] AC 785.
48 *Soden v British and Commonwealth Holdings plc* [1997] 4 All ER 353.
49 J. Farrar, *Company Law* (4th edn, London, 1998), p. 446; cf. also P. Wood, n. 33 above, para. 5-32.
50 M. Zeuner, n. 3 above, para. 6; B. Kübler and H. Prütting, n. 22 above, s. 129 para. 42; E. Jaeger and W. Henckel, n. 3 above, s. 29 para. 198.
51 R. Schmidt-Räntsch, n. 22 above, s. 142; M. Zeuner, n. 3 above, para. 50; B. Kübler and H. Prütting, n. 22 above, s. 142 para. 1.
52 L. Doyle, n. 5 above, p. 208; R. Goode, n. 17 above, p. 371.

the subjective elements differ between the two legal systems. Under German law the knowledge of the facts compellingly leading to the conclusion of the debtor's inability to pay his debts or his petition for insolvency is sufficient to fulfil the subjective elements of the avoidance provisions. The English system requires a much higher degree of will in order to establish proof of the subjective elements.[53]

5. Onus of proof

In principle, both legal systems lay the burden of proof concerning all elements of the respective provision on the insolvency administrator. In certain cases, however, the burden of proof is reversed, e.g. in the case of connected persons. Hence, in cases involving connected persons, it is at least rebuttably assumed that the debtor was insolvent at the time of the transaction.

6. Legal consequences of avoidance

Both systems have a similar approach to the legal consequences of avoidance. First, in both systems, the challenged transaction remains valid, and only its legal obligations are cancelled. Secondly, both legal systems only recognise the insolvency administrator as the sole person having the right to demand restitution. Thirdly, in both systems the respective counterclaims of the opposing party is reinstated, if the action in avoidance is successful. The legal consequences of going beyond the mere avoidance, carry both criminal and professional sanctions. These approaches differ considerably.

7. Final thoughts

First conclusions which might be drawn from the comparison of German and English avoidance law are that the avoidance law in both countries stands as an example of its overall legal structure: The German law is statute-based, highly abstract and dogmatic, whereas the English system of voidable transaction is – although in the meantime also statute-based more or less a codified system of precedents and, thus, rather pragmatic.

Finally, although the main aim is to support the *pari passu* principle, the English system rather follows the theory of unrighteousness whereas the German law in this respect is inclined to the *pari passu* principle.

Notes

53 Cf. the decision in *Re MC Bacon* [1990] BCLC 324.

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