



VALERIA CONFORTINI

Dottore di ricerca – Università Roma Tre

## **BETWEEN STRATEGIC USE AND ABUSE OF INSOLVENCY LAW: SHAREHOLDERS' RIGHTS AND CORPORATE REORGANISATIONS UNDER GERMAN *INSOLVENZORDNUNG* AND ITALIAN INSOLVENCY LAW**

*SOMMARIO: 1. Introduction. – 2. Reorganisation by conservation and by novation. Corporate Assets and Corporate Shareholdings. – 3. Shareholders' Treatment within Reorganisation Scenarios: Exclusive v. Inclusive Models. – 4. Insolvenzordnung and the Inclusive Model. The Suhrkamp-Verlag case: between strategic use and abuse of Insolvenzplan. – 5. Obstruktionverbot and Shareholders' Areas of Interest. – 6. Chapter XI and Constitutional Law. – 7. Conclusions.*

**1.** – This study addresses the alternative treatments of corporate shareholders within composition deed proceedings. Given that any impairment of shareholders' rights must be somehow related to their consent, this article will discuss the methods provided for by the law to comply with this principle and its critical aspects.

Following an increasing trend towards strengthening the chances of restructuring the debtor's business as opposed to liquidation, the main European law systems have provided for (or enlarged the existing) arrangements between stakeholders by means of agreements. The introduction of provisions which allow composition deeds to provide for debt-equity swaps and other impairments of shareholders' rights entails the delicate balance of two legal regimes: on the one hand, the rules concerning the creditors' entitlement to autonomously decide the form and extent of the satisfaction of their security interests; on the other hand, those concerning the shareholders' rights. The interests of several parties are confronted in this scenario: debtor, creditors, shareholders, and third parties<sup>1</sup>; this brings about the need to "co-determine" the decisions on the redistribution of the company value<sup>2</sup>.

From the shareholders' point of view, two systems of "co-determination" rules can be found and defined, one as *exclusive* – also known as respect out-of-insolvency entitlements system – and the other as *inclusive*. For the former, the decisions of the parties involved are carried out through two proceedings, related to each other although formally separate. Shareholders, who do not take part in the decision-making process of the composition deed, must actively contribute to the practical implementation of the operations planned in the composition deed. Within

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<sup>1</sup> On the different roles' interests, see L. STANGHELLINI, *Le crisi di impresa fra diritto ed economia*, Bologna, 2007, 52 et seqq.

<sup>2</sup> F. GUERRERA, M. MALTONI, *Concordati giudiziali e operazioni societarie di "riorganizzazione"*, in *Riv. soc.*, 1, 2008, 23.



the latter model, creditors' and shareholders' determinations are brought together in a single proceedings, that is the court-composition deed; shareholders are involved in the decision-making process and thus they are direct recipients of the plan's effects.

German law is exemplary for the purposes of this study, as it has historically encompassed the two aforementioned models, one enforced by the bankruptcy law *Insolvenzordnung* – InsO 1999, and the other introduced by the ESUG in 2012.

Under the aegis of a new “*Insolvenzkultur*”, the latest German reform of bankruptcy law<sup>3</sup> amended the *Insolvenzplan* regulations (§ 217 et seq. InsO), enlarging the possible content of the plan<sup>4</sup>, which until then was restricted to a limited enumeration of measures that could be undertaken, thus turning it into the preferred instrument to relieve the debtor's distress through corporate reorganisation<sup>5</sup>.

At the core of the reform is the change from a legal regime which requires the shareholders' cooperation in implementing the composition deed, to a legal framework where the *Insolvenzplan* (from now on also referred to as insolvency plan or composition deed) may provide for immediate and direct impairment of the shareholders' rights (§§ 217, Satz 2, 225a, 254a Abs. 2 InsO) *regardless* of, or even *against* their will<sup>6</sup>.

The aforementioned models may seem quite different, yet they are both limited by the basic rule of privity of contract and freedom of contract, which demands a necessary correspondence between the act of disposal of one's right and the consent of the recipient of those effects (this rule is valid even when the decision-making process is ruled by the majority principle).

2. – Corporate reorganisations conventionally distinguish between two forms: *conservation* and *novation*. With the former, business activities continue to be run by the same legal entity, whereas in the latter a new legal entity is formed<sup>7</sup>.

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<sup>3</sup> The ESUG (*Gesetz zur weiteren Erleichterung der Sanierung von Unternehmen*) came into force on 1<sup>st</sup> March 2012 (arts. 1-3, 6, 9) and on 1<sup>st</sup> January 2013 (arts. 4, 5, 7, 8). As regards the debate on the new “*Insolvenzkultur*”, proclaimed by the then Minister of Justice during the ESUG bill presentation, see C. THOLE, *Vom Totengräber zum Heilsbringer? Insolvenzkultur und Insolvenzrecht im Wandel*, in *JZ*, 2011, 15/16, 765; H. VALLENDER, *Insolvenzkultur gestern, heute und morgen*, in *NZI*, 2010, 838; E. BRAUN, J. HEINRICH, *Auf dem Weg zu einer (neuen) Insolvenzplankultur in Deutschland – Ein Beitrag zu dem Regierungsentwurf für ein Gesetz zur weiteren Erleichterung der Sanierung von Unternehmen*, in *NZI*, 2011, 505.

<sup>4</sup> Specifically §225a, Abs. 3, InsO, states that the plan can include any lawful rule pursuant the company law (“*jede Regelung (...), die gesellschaftsrechtlich zulässig ist*”). On this point see para 3, below.

<sup>5</sup> This paper focuses on corporations. For the literature on the effects of the ESUG on partnerships see K. SCHMIDT, *Debt-to-Equity-Swap bei der (GmbH & Co.-)Kommanditgesellschaft*, in *ZGR* 2012, 4, 566, 569 et seqq.

<sup>6</sup> T. THIES, *Vorbem. zu §§ 217 ff. InsO*, in A. Schmidt (Hrsg.), *Hamburger Kommentar zum Insolvenzrecht*<sup>5</sup>, 2015, Rdn. 2b. See para 3, below.

<sup>7</sup> An extensive resource on this subject is F. GUERRERA, M. MALTONI, *Concordati*, cit., 24 et seqq.

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Reorganisation by conservation is generally carried out through capital increase or through new financing and it may involve a change in the capital structure or in the inner balance of powers among shareholders<sup>8</sup>. In this case the debtor (the corporation) as a legal entity remains unaltered and the company is not terminated. The company keeps its assets, although creditors may become shareholders.

On the other hand, in reorganisations by novation, company assets are transferred to a new legal entity, either in the form of a composition with an assumptor or through capital transactions which form a new legal entity (e.g., spin-off or merger). The assets of the company in distress are then partially or totally transferred to a new entity, and creditors may be given capital share of the *new co.*<sup>9</sup>.

The fact that, as a rule, any capital transaction requires a shareholders' resolution relies on the principle that corporate assets are separate to corporate capital and shareholdings. Generally speaking, the debtor is liable with all its present and future properties for the performance of its obligations; however, when the debtor is a corporation, the corporate shares in themselves are not part of the corporate assets<sup>10</sup>: the collective proceedings – the court-composition deeds as well as the bankruptcy proceedings – do not produce *direct effects* on the shareholdings<sup>11</sup>.

The corporation, within a composition deed, may well “offer itself” to its creditors instead of performing the original obligation (in addition to the assignment of shareholdings in the company's portfolio)<sup>12</sup>. As I see it, the conclusion that people other than shareholders can dispose of their rights<sup>13</sup> cannot be drawn from the above.

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<sup>8</sup> The capital increase is normally carried out through the approval of the two simultaneous resolutions of capital cut and capital increase. Should the increase be aimed at converting the debt into risk capital, the shareholders' pre-emptive right on the newly issued shares is excluded. See F. GUERRERA, M. MALTONI, *Concordati*, cit., 63 et seqq.

<sup>9</sup> On the reorganisation by novation, in addition to F. GUERRERA, M. MALTONI, *Concordati*, cit., 26, see L. STANGHELLINI, *Le crisi*, cit., 21 et seqq. It is beyond the scope of this paper to discuss the transfer of assets to the *new co.* and the allocation of its shares to the creditors to compensate their credits. This is, in fact, an operation on the restructuring company's assets rather than on its capital.

<sup>10</sup> F. GUERRERA, M. MALTONI, *Concordati*, cit., esp. 33 et seqq., where the Authors maintain that the ‘corporate instrument’ remains disposable for the shareholders and the company board, as well as the entitlement of holdings that – although ‘currently’ deprived of their economic value because of the company's insolvency – still belong exclusively to the shareholders; S. MADAUS, *Keine Reorganisation ohne die Gesellschafter*, in *ZGR*, 2011, 6, 749, 765.

<sup>11</sup> S. MADAUS, *Reconsidering the Shareholder's Role in Corporate Reorganisations under Insolvency Law*, in *Int. Insolv. Rev.*, 2013, Vol.22(2), 106, 111; U. HAAS, *Die Einbeziehung der Anteilsrechte in das Insolvenzverfahren*, in *NZG*, 2012, 961, esp. 963 et seqq.; D.A. VERSE, *Anteilseigner im Insolvenzverfahren*, in *ZGR*, 2010, 299, 304.

<sup>12</sup> G. FERRI JR., *Ristrutturazione dei debiti e partecipazioni sociali*, in *Riv. dir. comm.*, 2006, 10-12, 747, 763.

<sup>13</sup> It is worth mentioning the contrasting opinion of G. FERRI JR., *Ristrutturazione*, cit., 764 et seqq. According to the Author, administrators should be empowered to reorganise the investment, even affecting directly the company's individual holdings. The shareholding is regarded as a representative instrument of the business investment, not also as a “good” out of the “equity” which the insolvency proceedings refer to.

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In a liquidation proceedings, the law confines itself to *defining the ranks* among creditors for the satisfaction of their security interests, placing the investor-shareholder's right to recover investment at the bottom of the hierarchy of interests<sup>14</sup> (residual claimant). Upon completion of liquidation, the company is terminated and therefore shareholdings are dissolved<sup>15</sup>. However, not even in this scenario is the opening of the proceedings capable of a direct impairment of the shareholders' rights<sup>16</sup>. Although almost inevitable, the loss of the share capital is a mere result, in fact, of the execution on the debtor's assets. Shareholders rights' impairment is here a *secondary and rebound effect* due to the dissolution of the corporate assets and of the termination of the corporation itself.

3. – The model based on respecting out-of-insolvency entitlements rests on the principle of the intangibility of shareholders' rights. Typical of the civil law tradition, it is currently in force in Italy, and used to be the German legal regime before ESUG enactment in 2012<sup>17</sup>.

Given that corporate assets are different to shareholdings, creditors are given the option to decide on the means and amounts of their satisfaction (out of the assets) by virtue of an agreement with the debtor (the corporation, by means of its management). With respect to the composition deed between the debtor and its creditors, the shareholders are third parties: they have no voting right during the decision-making process regarding the composition deed, and, subsequently, the decision taken by the creditors produces no legal effects in their respect<sup>18</sup>. In order for the capital transactions provided for in the plan to be practically undertaken and implemented, a shareholders' extraordinary meeting resolution is required.

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<sup>14</sup> The deferred rank is already outlined in company law by the rules on the distribution of profits (art. 2433 cod. civ.). The shareholders' financial claims are postponed to the ones of the creditors: the former are entitled to receive the *surplus* value resulting from the business activity before the creditors' repayments through the profits distribution, provided that that the financial statements indicate that creditors can be paid entirely. On this subject see STANGHELLINI, *Le crisi*, cit., 39.

<sup>15</sup> S. MADAUS, *Reconsidering the Shareholder's Role*, cit., 108.

<sup>16</sup> For all A. NIGRO, *Le società per azioni nelle procedure concorsuali*, in G.E. Colombo, G.B. Portale (directed by), *Trattato delle società*, 9\*\*, Torino, 1993, 344. The Author stresses that insolvency proceedings do not have any *direct* consequences on corporate shareholders, who keep, even within liquidation proceedings (bankruptcy, compulsory liquidation), all the rights and powers entailed by their shareholdings (included the right to dispose and to transfer them).

<sup>17</sup> This solution stems from a heated debate, as it conflicted with the different opinion of the ministerial committee for the 1988 reform (see *Erster Bericht der Kommission für Insolvenzrecht, Bundesministerium der Justiz (Hrsg.)*, Köln, 1985, 282 et seqq.) as well as with part of the jurisprudence (see fn. 34, below), which supported a solution allowing to subdue the shareholders to the measures of approval of the composition. On this subject see D.A. VERSE, *Anteilseigner*, cit., 304.

<sup>18</sup> An opposing view can be found in G. FERRI JR., *Ristrutturazione*, cit., 766. According to the Author, insolvency law lets the reasons of the enterprise and its financing prevail over ownership, allowing reorganisation forms of the former capable of impairing the rights – even the ownership-derived ones – of a subject who did not take part in the composition.



Corporate reorganisation is carried out along two parallel proceedings under different legal regimes. While the shareholders' determinations are ruled by company law (arts. 2479 et seq. and arts. 2365 et seq., Italian cod. civ.), the creditors' are set forth by insolvency law (art. 174 et seq. l. f.). The capital transaction is therefore possible under the following conditions: a) creditor's approval of the plan; b) Court confirmation of the plan; c) a shareholders' extraordinary resolution (or, when provided by the articles of association for certain transactions (i.e. capital increase), a resolution of the board of directors); c.1) the stock transfer or the assignment of shares should the plan provide for security transactions between shareholders and creditors; d) the fulfillment of the required entries and records in the Business Registry or in the register of shareholders<sup>19</sup>.

The two aforementioned proceedings are linked through a proviso clause attached to the shareholders' resolution (arts. 1353 et seq. cod. civ.). As a rule, the shareholders' meeting precedes the creditors' meeting and the shareholders' resolution is provisionally conditioned by the court confirmation of the composition deed<sup>20</sup>. The event inferred as being conditional is the final confirmation of the composition deed, whose legal cognizance is assured by the registration of the order of confirmation in the Business Register (arts. 17, 129 cl. 6, 180 cl. 5 l.f.)<sup>21</sup>. Alternatively, the capital transaction might be only planned and actually deliberated after the court confirmation of the composition deed (considering the practice, this option is more likely a theoretical model). Although sometimes this solution has an economic rationale<sup>22</sup>, creditors are exposed to the risk that the capital transactions planned stand unfulfilled; also, because of this uncertainty regarding the actual implementation of the plan, courts are not likely to approve such plans. Under this legal regime shareholders are third parties as regards the composition deed and under no circumstances can the corporate reorganisation be implemented without their cooperation<sup>23</sup>.

As a consequence, the outcome of the reorganisation may be hindered both in contexts of family-run businesses, where shareholders may be reluctant to relinquish control<sup>24</sup> and within

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<sup>19</sup> Similar mechanism available to the German law before the reform, and discussed by H. EIDENMÜLLER, A. ENGERT, *Reformperspektiven einer Umwandlung von Fremd- in Eigenkapital (Debt-Equity Swap) im Insolvenzplanverfahren*, in ZIP, 2009, 12, 542 et seqq.; K. SCHMIDT, *Debt-to-Equity-Swap bei der (GmbH & Co.-) Kommanditgesellschaft*, in ZGR, 2012, 4, 566, 568.

<sup>20</sup> On this subject see F. GUERRERA, M. MALTONI, *Concordati*, cit., 50 et seqq.; H. EIDENMÜLLER, A. ENGERT, *Reformperspektiven*, cit., 542, esp. fn.12 for further bibliographic information.

<sup>21</sup> F. GUERRERA, M. MALTONI, *Concordati*, cit., 50. A variation of the provisionally conditioned resolution of capital increase (66) is the immediate resolution of increase which sets a performance deadline in a time-framework long enough to allow the court-approval. The creditor's declarations of capital subscription should be delivered contemporaneously the abovementioned resolution, and they shall be not effective until the court approval is final and conclusive.

<sup>22</sup> F. GUERRERA, M. MALTONI, *Concordati*, cit., 66.

<sup>23</sup> E. EIDENMÜLLER, A. ENGERT, *Reformperspektiven*, cit., 542. In the exclusive system "die Gesellschafter einer Kapitalgesellschaft bzw. die von ihnen gehalten Gesellschaftsanteile nicht zwangsweise den Regelungen eines Insolvenzplan unterworfen". See also fn. 30, below.

<sup>24</sup> H. EIDENMÜLLER, A. ENGERT, *Reformperspektiven*, cit., 549; H. EIDENMÜLLER, *Leveraged Buyouts und die Effizienz des deutschen Restrukturierungsrechts*, in ZIP, 2007, 1729, esp. 1736.



the opposite scenario of public companies, where shareholders may have no interest to attend the extraordinary meeting called to approve the capital transaction. In the latter case, it has been shown necessary to provide for incentives to encourage shareholders' participation and obtain the *quorum*<sup>25</sup>. The "price of consent" must therefore be negotiated *outside* of the composition deed proceedings<sup>26</sup>.

4. – Due to the incapacity of the insolvency plan (under InsO 1999) to impair shareholders' rights and the subsequent scarce use of this legal tool<sup>27</sup>, German law amended insolvency law with provisions that resemble the U. S. Bankruptcy Code Chapter XI model. The enactment of ESUG 2012 meant the rule of respecting out-of-insolvency entitlements was abandoned and replaced by a *Insolvenzplan* which may provide for "jede Regelung (...), die gesellschaftsrechtlich zulässig ist" (§225a Abs. 3 InsO)<sup>28</sup>, among which, for example, debt-equity swap by capital increase<sup>29</sup>, assignments of shares<sup>30</sup>, mergers or transformations.

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<sup>25</sup> Such was the issue of the recent Seat-Pagine Gialle composition deed proceedings. The composition draft provided for the creditors' satisfaction through a series of extraordinary operations (merger by acquisition and *debt-to-equity swap* through reserved capital increase). In order to incentive the attendance of the shareholders at the extraordinary meeting, the plan set forth an issue of warrants. The warrants were reserved to the free subscription of the shareholders who would have taken part – even by proxy – in the meeting. The warrants could be exercised only after the composition deed's full performance, in order to assure that shareholders accrued the *surplus* value generated by the reorganisation only after the creditors had been satisfied. The document is accessible at [www.seat.it/concordato-preventivo](http://www.seat.it/concordato-preventivo) (accessed on 30<sup>th</sup> May 2015). This case is an example of the so-called "potential stock", intended to come into existence only after the distressed company actually returns to a solvent position. On this subject see also L. STANGHELLINI, *Le crisi*, cit., 217 esp. fn. 61.

<sup>26</sup> The "consensus compensation" is reflected in the valuation of the creditors' claims during the capital decrease/increase or in the price set for the transfer of the corporate shareholdings. For an example see G. SASSERNRATH, *Der Eingriff in Anteilseignerrechte durch den Insolvenzplan*, in *ZIP*, 2003, 1517 et seqq.; H. EIDENMÜLLER, A. ENGERT, *Reformperspektiven*, cit., 543.

<sup>27</sup> It is a recurring opinion that the requirement of the shareholders' cooperation was one of the main reasons for the scarce use of *Insolvenzplan* until the 2012 reform. See H. EIDENMÜLLER, *Leveraged Buyouts*, cit., 1736; S. SMID, R. RATTUNDE, *Der Insolvenzplan*, Stuttgart, 2005, 143; U. HAAS, *Mehr Gesellschaftsrecht im Insolvenzplanverfahren*, in *NGZ*, 2012, 961, 963; H. VALLENDER, *Insolvenzkultur*, cit., 841; E. BRAUN, J. HEINRICH, *Auf dem Weg*, cit., 506; D.A. VERSE, *Anteilseigner*, cit., 299; H. EHLERS, *Noch eine Reform – § 224 Abs. 2 – 5 InsO*, in *ZInsO*, 2009, 320, esp. 323 et seqq.; F. STAPPER, *Die Praxis der Arbeit mit Insolvenzplänen oder die Insuffizienz des Insolvenzplans: Diagnose und Therapie*, in *ZInsO*, 2009, 2361.

<sup>28</sup> T. THIES, sub § 225a InsO, in A. Schmidt (Hrsg.), *Hamb. Komm.*, cit., Rdn. 11 et seqq.; H. EIDENMÜLLER, *Der Insolvenzplan als gesellschaftsrechtliches Universalwerkzeug*, in *NJW*, 2014, 17.

<sup>29</sup> J.D. SPLIEDT, *Debt-Equity-Swap und weitere Strukturänderungen nach dem ESUG*, in *GmbHR*, 2012, 462 et seqq. In order to implement the conversion of debt into risk capital, the declaration of consent from each one of the involved creditors (*Zustimmungserklärung*) (§ 230, Abs. 2 InsO) is required. From the creditors' side, the conversion of their credits into risk capital is not subject to the majority rule (BT-Druck 17/5712, 31). On this matter see also P. KINDLER, *La procedura concorsuale unitaria (Insolvenzverfahren) nel diritto tedesco*, in F. Vassalli-F.P. Luiso-E. Gabrielli (directed by), Torino, vol. V, 2014, 203; K. SCHMIDT, *Debt-to-Equity-Swap*, cit., 568. On the content and the theoretical aspects of the creditors' declaration see H. EIDENMÜLLER, *Mün-*



Shareholders are *included* in the decision-making process that leads to the composition deed approval<sup>31</sup>. Shareholders' rights may be impaired by virtue of the resolution of a single meeting, encompassing both the creditors and, in an autonomous class, the shareholders (§222 InsO)<sup>32</sup>. In this scenario, shareholders are no longer third parties but rather members of the group of individuals who vote on the plan.

The decision-making process is unified in the one single meeting of the interested parties, encompassing both creditors and shareholders (§ 235 InsO)<sup>33</sup>. The shareholders' consent to the disposal of their rights is no longer expressed in the forms provided for by company law, but rather by those of the composition deed and its majority rule (§ 244 InsO)<sup>34</sup>.

The replacement of company law regulations concerning the shareholders' extraordinary meeting by insolvency law rules concerning the meeting of the interested parties is granted by a legal fiction (§ 254a, Abs. 2 InsO): the shareholders' deliberations and the other expressions of will of the interested parties, expressed in the forms provided for in the InsO, *have the same value as those* expressed in the forms required by the law for such a purpose

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*chener Kommentar zur Insolvenzordnung, sub § 230*, München, 2013. This provision traces a material difference between the shareholders' and creditors' ranks within the InsO: T. THIES, *sub § 225a InsO*, in *Hamb. Komm.*, cit., Rdn. 34; ID, *sub § 230 InsO*, in *Hamb. Komm.*, ibid. Rdn. 5 et seqq.; F. FRIND, *Problemanalyse zu geplanten Neuregelungen des Plan- und Eigenverwaltungsverfahrens nebst Insolvenzstatistik*, in *ZInsO*, 2011, 656, 657. On the other hand, this also reveals a fundamental difference to the Italian system: there, the creditors' rights are subject to the majority rule.

<sup>30</sup> This provision encompasses both the transfer of holdings in portfolio (*an Drittesellschaften*) and the transfer of shares of the company under court-composition (*an dem Schuldner*). On this subject, T. THIES, *sub § 225a InsO*, in A. Schmidt (Hrsg.), *Hamb. Komm.*, cit., Rdn. 48.

<sup>31</sup> C. THOLE, *Vom Totengräber*, cit., 770. German law (BT-Druck 17/5712, 31) has provided for shareholders to be involved in the composition proceedings through their inclusion in a group of subjects with voting rights. There has been a long debate on which technical instrument is needed to put this involvement into practice. Regarding the alternatives, such as the one proposed by the ministerial committee-*Kommission für Insolvenzrecht* to keep the composition proceeding and the shareholders' deliberations separated, thus empowering the approval court to "replace" the shareholders' resolution see H. EIDENMÜLLER, A. ENGERT, *Reformperspektiven*, cit., 549; T. THIES, *Vorbem. zu §§ 217 ff. InsO*, in *Hamb.-Komm.*, cit., Rdn. 2c.

<sup>32</sup> See § 222, Abs. 1, n. 4, which provides for the setting up of an autonomous group of voters for "*den am Schuldner beteiligten Personen, wenn deren Anteils- oder Mitgliedschaftsrechte in den Plan einbezogen werden*". An autonomous group can also be set up for those who hold less than 1% or 1,000 Euros of the risk capital (§ 222, Abs. 3 InsO).

<sup>33</sup> "*Sind die Anteils- oder Mitgliedschaftsrechte der am Schuldner beteiligten Personen in den Plan einbezogen, so sind auch diese Personen gemäß den Sätzen 1 und 2 zu laden*". The provision refers, instead, to § 121 Aktiengesetz (AktG) for the regulations on summoning the shareholders of quoted companies.

<sup>34</sup> See § 244, Abs 3, which lays down a mixed mechanism of majority by heads and by value of claims, so that *Insolvenzplan* is approved with the vote in favour of the majority of those entitled to vote, who represent more than half of the value of claims against the debtor (as regards to the shareholders, the half of the capital share). The replacement of the company law regulations with those of the InsO has also led to a simpler *quorum*: the simple majority (§ 244 Abs. 3 InsO) replaces the qualified majority of three quarters of the capital (§ 118 AktG). On this subject, S. MADDAUS, *Umwandlungen als Gegenstand eines Insolvenzplans nach dem ESUG*, in *ZIP*, 2012, 44, 2133, esp. 2137 et seqq.



(“gelten als in der vorgeschriebenen Form abgegeben”)<sup>35</sup>.

The impairment of the shareholder’s right is an *immediate content* of the plan and a *direct effect* of the court confirmation<sup>36</sup> – and in particular of its becoming final and conclusive (*Rechtskraft der Bestätigung*) (§ 254 InsO)<sup>37</sup>. A different matter is the effectiveness of the composition deed provisions towards third parties, which follows the record of the order of confirmation in the registries by the entitled company bodies. In addition, InsO sets forth the concurring entitlement of the official receiver (*Insolvenzverwalter*)<sup>38</sup>, who is empowered to carry out the entries and records required to execute the composition deed resolution (§ 254a, Abs. 2, Satz 3 InsO), e.g., recording the transfer of shares in the register of shareholders, the company transformation or merger in the Business Registry<sup>39</sup>.

Together with the shareholders’ resolution being drawn into the scope of the provisions regulating the composition deed proceedings, we also observe the rules designed to safeguard minority shareholders being replaced with those safeguarding minorities in the compositions deed proceedings<sup>40</sup>. The right to contest the shareholders’ resolution is replaced by the opposition to the confirmation of the plan and the appeal against the confirmation order (§§ 251, to be harmonised with the *Obstruktionsverbot* rule at § 245 and § 253, Abs. I, InsO)<sup>41</sup>. In contrast to company law – where shareholders who exercise their rights of withdrawal are entitled to a sum equal to the economic value of their shares at the time of the termination of their membership –

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<sup>35</sup> On this subject see T. THIES, *sub § 254a InsO*, in A. Schmidt (Hrsg.), *Hamb. Komm.*, cit., Rdn. 6; BT-Drucks, 17/5712, 36; S. MADAUS, *Umwandlungen*, cit., *ibidem*. For the debate over the impact of this provision see U. HAAS, *Die Einbeziehung*, cit., 963 et seqq.

<sup>36</sup> The provision of subjecting shareholders’ rights to the creditors’ decisions is rooted in those theories of law and economics which state that the expected outcome of the reorganisation must be reserved to creditors, whereas shareholders can keep a share capital and claim to benefit from the surplus of the expected value of the reorganisation only after the full payment of the original creditors’ claims at par value or after a new capital injection. For an example of how these studies have been applied to the German law system before the reform, within the debate on whether to alter the previous legal regime of intangibility of shareholders’ rights see H. EIDENMÜLLER, A. ENGERT, *Reformperspektiven*, cit., 544.

<sup>37</sup> BT-Drucks 17/5712, 18: “mit der Rechtskraft der Bestätigung des Insolvenzplan gelten die in den Plan aufgenommen gesellschaftsrechtlichen Maßnahmen als beschlossen, beispielsweise eine Kapitalherabsetzung, eine Kapitalerhöhung, ein Bezugsrechtsausschluss und ein Fortsetzungsbeschluss“; S. MADAUS, *Umwandlungen*, cit., 2137; U. HAAS, *Mehr Gesellschaftsrecht*, cit., 964.

<sup>38</sup> BT-Drucks 17/5712, 36; T. THIES, *sub § 254a InsO*, in A. Schmidt (Hrsg.), *Hamb. Komm.*, cit., Rdn.11; S. MADAUS, *Umwandlungen*, cit., 2138; U. HAAS, *Mehr Gesellschaftsrecht*, cit., 964 et seqq.

<sup>39</sup> S. MADAUS, *Umwandlungen*, cit., 2138; U. HAAS, *Mehr Gesellschaftsrecht*, cit., 965; J.D. SPLIEDT, *Debt-Equity-Swap*, cit., 470.

<sup>40</sup> D.A. VERSE, *Anteilseigner*, cit., 319; these mechanisms are exclusive and preclude the enforcement of general regulations on safeguarding minority rights. Along this line C. THOLE, *Treuepflicht-Torpedo? Die gesellschaftsrechtliche Treuepflicht im Insolvenzverfahren*, in *ZIP*, 2013, 1937; M. BRINKMANN, *Der strategische Eigenantrag – Missbrauch oder kunstgerechte Handhabung des Insolvenzverfahrens?*, in *ZIP*, 2014, 197; A. MÖHLENKAMP, *Flucht nach vorn in die Insolvenz – funktioniert Suhrkamp?*, in *BB*, 2013, 2828.

<sup>41</sup> On this subject see U. HAAS, *Mehr Gesellschaftsrechts im Insolvenzverfahren*, cit., 965.



§ 225a, Abs. 5, InsO, establishes that – should the plan include provisions which entitle the shareholders to rights of withdrawal, and should they exercise these rights – they are entitled to a sum determined on the basis of the break-up value of the company. Furthermore, this sum may be paid within a time frame of two to three years<sup>42</sup>.

Thus, in the inclusive model, the combination of voting right (which legitimates the impairment of the shareholder's right)<sup>43</sup> and the cram-down rules – *Obstruktionsverbot* (which makes it possible to overrule the dissent of the shareholders' class)<sup>44</sup> allows the implementation of corporate reorganisations regardless of the shareholders' cooperation<sup>45</sup>.

5. – At first glance, both the aforementioned models seem to be consistent with the rule of privity of contract and freedom of contract. Within the respecting out-of-insolvency entitlements model (exclusive model), the impairment of the shareholder's right depends on the shareholders' extraordinary resolution, which is *connected yet separate* to the creditors' resolution to pass the composition deed. Insolvency law regulates creditors' decisions; company law regulates the shareholders'. In the inclusive model, the impairment of the shareholder's right is justified by their inclusion in the decision-making process and by their right to vote on the composition deed. In both of these cases, the vote guarantees that the decision involves the recipient of the effects of the resolution.

Some Scholars have raised doubts on the consistency of the inclusive model with the overall German law. The perplexities do not focus on whether to include shareholders in the decision-making process leading towards the composition deed and to constrain them to the majority resolution<sup>46</sup>; but rather on the cram-down rule (*Obstruktionverbot*) (§ 245 InsO), which shows that the provisions of the composition deed, although formally autonomous, are in fact heteronomous (*Fremdbestimmung*)<sup>47</sup>.

According to § 245 InsO, the insolvency court may confirm the composition deed despite the shareholders' dissenting class if it ascertains that:

a) the treatment they receive is not worse than the one they would have received without the plan. In other words, in case of liquidation the sum received should not be higher than the amount received by means of the insolvency plan (best interest test) (§ 245, Abs. 1);

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<sup>42</sup> U. HAAS, *Mehr Gesellschaftsrechts im Insolvenzverfahren*, cit., 966; P. KINDLER, *La procedura*, cit., 203; T. THIES, sub § 225a, in A. Schmidt (Hrsg.), *Hamb. Komm.*, cit., Rdn. 61.

<sup>43</sup> S. MADAUS, *Der Insolvenzplan*, Tübingen, 2011, 245.

<sup>44</sup> See following paragraph, below.

<sup>45</sup> Non-participation of shareholders to the meeting is considered as equal to an approval of the insolvency plan: T. THIES, sub § 225a InsO, *Hamb. Komm.*, cit., Rdn. 8.

<sup>46</sup> S. MADAUS, *Der Insolvenzplan*, cit., 246.

<sup>47</sup> S. MADAUS, *Keine Reorganisation*, cit., 764.



b) they benefit from the surplus value created by the plan (*angemessene Beteiligung an dem wirtschaftlichen Wert*) (§ 245, Abs. 2), i.e.:

b1) no creditor receives a sum higher than the full value of the original claim (at par value) (§ 245, Abs. 3, Satz 1);

b2) shareholders are treated equally (§ 245, Abs. 3, Satz 2).

According to the Scholars above, this rule reduces the shareholders' voting to a mere formality if one considers that it binds the shareholder's claim to the comparison between the sum offered in the plan and the amount they would receive in a liquidation scenario (which is generally equal to nought). Secondly, it entitles the participation in the surplus value only after the full value of creditors' claims at par value has been paid (an extremely unlikely event). The vote has little to no influence on a decision that cannot be referred to the shareholder's expression of will<sup>48</sup>.

The underlying reasoning for this rule is that the opening of insolvency proceedings modifies the content and the rank of the shareholders' interests: the shareholder is no longer safeguarded as a shareholder but as a *residual claimant* (o "*Quasi-Gläubiger*")<sup>49</sup> of the corporation<sup>50</sup>.

A recent case that hit the headlines exemplifies this well. In May 2013, the historic publishing house Suhrkamp Verlag filed for insolvency proceedings ex §270b (*Eigenverwaltung*) before the Berlin court. The collapse of the company – as reported to the Press – came from an irresolvable difference of opinion among the shareholders and the ensuing decisional stall<sup>51</sup>.

In an attempt to block the composition deed approval, the minority maintained that the actual

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<sup>48</sup> S. MADAUS, *Keine Reorganisation*, cit., 755 observes that "*ob die Gesellschafter dem Plan tatsächlich zustimmen oder nicht, ist eine reine Formalie im Bestätigungsverfahren*".

<sup>49</sup> C. THOLE, *Treuepflicht-Torpedo?*, cit., 1943.

<sup>50</sup> This assumption is consistent with those theories which trace an equivalence between management power and entrepreneurial risk. Shareholders, like creditors, are entitled to a financial claim, which differs from the creditors's only in its rank. Those who bear the entrepreneurial risk (in other words, those who are entitled to the *surplus* value of the business only after the repayment of the debt capital) have stronger incentives to an efficient management of the business. Hence the legitimation for the shareholders' control. Yet, in the case of the company's distress, this incentive weakens: once the risk capital has been lost, shareholders are encouraged to lean towards very-high-risk options since their investment is now worthless and they would benefit from the possible profits whereas the losses would be entirely burdened by creditors. In this context, creditors become the real providers of risk capital. If we want to follow the above-mentioned equation between risk bearing and management power, the corporation control must be transferred to the creditors, and they must be entitled to accrue the value generated by the reorganisation of the company in crisis until the full repayment of their original claim. L. STANGHELLINI, *Le crisi*, cit., 37 et seqq., esp. 41 and therein fn. 10. For the critical aspects of the Absolute Priority Rule and the analysis on how it should be applied exclusively to the liquidation context and not also to the reorganisation case, also with historical argumentations, see S. MADAUS, *Reconsidering the Shareholder's Role*, cit., 113 et seqq.; for opposing views see H. EIDENMÜLLER, A. ENGERT, *Perspektiven*, cit., 544 and seqq. on the topic see also CASEY, A. J., *The creditors' Bargain and Option-Preservation Priority in Chapter XI*, University of Chicago LW, 2011, 78, 3.

<sup>51</sup> For a detailed description of this case see LG Frankfurt a. M. in *NZI*, 2013, 981; D. LANG, V. MUSCHALLE, *Suhrkamp-Verlag – Rechtsmissbräuchlichkeit eines rechtmäßig eingeleiteten Insolvenzverfahrens?*, in *NZI*, 2013, 953.



purpose of the filing for insolvency was to put an end to the conflict between shareholders by reshaping – to his disadvantage – the inner balance of powers between the shareholders. According to the claimant, the composition deed – which provided for the transformation of the company from a limited partnership (Kommanditgesellschaft – KG) to a public company (Aktiengesellschaft – AG) – served the purpose of diluting his shareholdings rather than to solve the financial distress of the company.

The Surkamp Verlag case raised the issue of where to trace the fine line between strategic use and abuse of composition deeds and has reopened the debate over the means of safeguarding minority stakeholders within composition deed proceedings<sup>52</sup>. The main question concerns the content and extent of the shareholders' interests within reorganisation scenarios.

Many Authors believe that the opening of such a proceeding gathers creditors and shareholders in a new community of interests, aimed at assuring that the creditors' claims are best satisfied: the shareholder is considered as a *quasi-creditor*<sup>53</sup>. The only shareholder's interest that matters is the financial claim to return his original capital investment: among those who are entitled to a financial claim, they are ranked at the lowest level. However, some Scholars argue that a material distinction should be drawn between liquidation and reorganisation scenarios. The argument that the shareholders should receive nothing unless creditors are paid in full is premised on the rank of distribution in a liquidation proceeding. While this consideration is correct when the corporation assets are being liquidated, it would be incorrect to believe that what applies in one kind of proceedings should automatically apply to every other<sup>54</sup>.

Considering the shareholder only as entitled to the financial claim to the residual income from assets does not take into account that the shareholdings entail a number of rights and in-

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<sup>52</sup> On the topic OLG Frankfurt/M., in *EWiR* §225a InsO 2/13, 753 (comment B. BÄHR/D. SCHWARTZ); LG Frankfurt/M., in *EWiR* §169 HGB 2/13, 581 (comment J.F. FREIHERR von FALKENHAUSEN); LG Berlin, in *EWiR* 9/2014, 293 (comment P. FÖLSING); LG Frankfurt/M., in *EWiR* §225a InsO 1/13, 589 (comment G. HÖLZLE); S. MADAUS, *Schutzschirme für streitende Gesellschafter? Die Lehren aus dem Suhrkamp-Verfahren für die Auslegung des neuen Insolvenzrechts*, in *ZIP*, 2014, 500; M. BRINKMANN, *Der strategische Eigenantrag*, cit., 197; C. THOLE, *Treuepflicht-Torpedo?*, cit., 1940 and seqq.; H. F. MÜLLER, *Entrechtung der Gesellschafter im Insolvenzverfahren?*, in *DB*, 2014, 41; C. BRÜNKMANS, S. UEBELE, *Rechtsschutz gegen missbräuchliche Insolvenzanträge und insolvenzzweckwidrige Insolvenzpläne?*, in *ZInsO*, 2014, 265; C. BRÜNKMANS, *Der Rechtsschutz gegen den Bestätigungsbeschluss des Insolvenzplans vor dem Hintergrund des insolvenzrechtlichen Freigabeverfahrens nach § 253 Abs. 4 InsO*, in *ZInsO*, 2014, 993; C. SCHÄFER, *Insolvenzplan als Lösungsmittel für Mehrheits-/Minderheitskonflikte? – Lehren aus dem Fall Suhrkamp*, in *ZIP*, 2013, 2237; S. MEYER, *Streit um den Suhrkamp-Verlag – Überlegungen zum Stimmverbot des Gesellschafter-Geschäftsführers*, in *NJW*, 2013, 753.

<sup>53</sup> H. EIDENMÜLLER, *Der Insolvenzplan*, cit., 18; M. BRINKMANN, *Der strategische Eigenantrag*, cit., 201; A. MÖHLENKAMP, *Flucht*, cit., 2829; U. HAAS, *Mehr Gesellschaftsrecht*, cit., 964.

<sup>54</sup> L.W. PRENTICE, "The position of Equity in a Restructuring", (2003) *Annual Review of Insolvency Law*, Thomson & Carswell, 266.



terests other than the one to receive the residual income from the corporation assets<sup>55</sup>. A shareholder's interest in belonging to an enterprise and in being able to determine its activity seems to be sanctioned by the Constitution under the freedom of association (*Vereinigungsfreiheit*) (§ 9 Abs. 1 GG): the latter should yield to the creditor's interest only in a liquidation scenario<sup>56</sup>.

Some Authors have observed that capital transactions capable of impairing shareholders' rights (at least for public companies) require a shareholders' resolution pursuant to European law<sup>57</sup>.

6. – Authors who put forward reservations about the downgrading of the shareholder to a residual claimant within a reorganisation scenario (as opposed to a liquidation scenario) point to a significant difference between the US and the German legal framework (the latter, for this purpose, being similar to Italian law).

Within the U.S. constitutional framework, the limitation of the shareholder's interest to the mere financial outline seems to be legitimated by the "bankruptcy clause" (Art. I, sec. 8, clause 4). According to this provision, Congress shall be empowered to enact a uniform law on enter-

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<sup>55</sup> S. MADAUS, *Keine Reorganisation ohne Gesellschafter*, cit., 761 et seqq.; C. SCHÄFER, *Insolvenzplan*, cit., 2241 et seqq.; H.F. MÜLLER, *Gesellschaftsrechtliche Regelungen im Insolvenzplan*, in *KTS*, 2012, 427.

<sup>56</sup> The shareholder's safeguard is mentioned in § 9 Abs. 1 G.G., which not only establishes the freedom to join or to found an association (*Freiheit zur Gründung einer Vereinigung*), but also the freedom to determine its organisation (*Bestand*) as well as its inner operations (*Betätigung*). See S. MADAUS, *Keine Reorganisation*, 759 et seqq.; ID., *Schutzschirme*, cit., 504 et seqq.; however, the Author excludes that this rule applies to the inner relationships between shareholders (*im Innenverhältnis*); H. F. MÜLLER, *Entrechtung*, cit., 43; opposing views in J.D. SPLIEDT, *Debt-Equity-Swap*, cit., 465; H. EIDENMÜLLER, A. ENGERT, *Reformperspektiven*, cit., 545; D.A. VERSE, *Anteilseigner*, cit., 309 et seqq.; T. THIES, *sub § 225a InsO*, in *Hamb. Komm.*, cit., Rdn. 9 et seqq.; P. FÖLSING, *Eingriff in Gesellschafterrechte durch Insolvenzplan*, in *KSI*, 2014, 123.

<sup>57</sup> Pursuant to art. 25 EEC Directive 77/91 on public limited companies, capital increases require either a shareholders' resolution or the one of the administrative body entitled to this task (within certain quantitative and temporal limits). The point is rather controversial. The debate stems from the leading cases *Pafitis c. Banca Trapeza Kentrikis Ellados AE*, C-441/93; *Karella et al. C. Ypourgo Viomichanias, Energeias & Technologias*, C-19/90 and C-20/90; *Syndesmos Melon Tis Eleftheras Evangelikis Ekkliissias e altri c. Stato Greco et al.*, C-381/89. Some Scholars observe that the rationale of this Directive is to avoid the State aid measures on insolvent businesses; it would no longer be applicable when the business is undergoing a collective execution proceeding (*kollektive Zwangsvollstreckungsverfahren*) in the creditors' interests. In the case of an insolvency, the company's bodies, even if not terminated, change the goals of their activity, thus pursuing the creditors' best satisfaction. This approach, followed by the German legislature (BT-Druck 17/5712, 20) brings about the consequence that "*nicht nur das Gesellschaftsvermögen, sondern auch die Gesellschaft selbst wird dann zum Befriedigungsgegenstand*". Likewise H. EIDENMÜLLER, A. ENGERT, *Reformperspektiven*, cit., 548; T. RICHTER, *Reconciling the European Registered Capital Regime with a Modern Corporate Reorganisation Law: Experience from the Czech Insolvency Law Reform, in European Company and Financial Law Review, Vol. 6, No. 2/3, 2009*, accessible online at SSRN: <http://ssrn.com/abstract=1332972>; K. SCHMIDT, *Gesellschaftsrecht und Insolvenzrecht im ESUG-Entwurf*, in *BB*, 2011, 1603, 1609 et seqq.; opposing views can be found in S. MADAUS, *Keine Reorganisation*, cit., 768 et seqq.; J.D. SPLIEDT, *Debt-Equity-Swap*, cit., 466; L. STANGHELLINI, *Le crisi*, cit., 210, esp. fn. 49.



prise bankruptcy, sanctioning the enforcement of the Bankruptcy Code at a general and hierarchically higher level, to which not only the bankruptcy law but also the company law of each federal state would give way. Therefore, the provisions of the Bankruptcy Code postulating the limitation of the shareholder's interest to the mere financial dimension seems to have a constitutional backing<sup>58</sup>. Such a legitimation does not seem to be found under German law, where the right of property safeguarding the creditor (§ 14 GG) conflicts with the freedom of association (§ 19 GG), thus calling into question at least the undisputed priority of the former over the latter. This material difference seems to advise not importing *tout-court* Chapter XI into German law<sup>59</sup>.

The highlighted differences seem to be consistent with the ownership structure of the enterprises under consideration. A legislation that considers only the financial dimension of shareholdings is in line with an economic system driven by public companies with pulverized capital. In a system such as the United States the identification between enterprise and ownership is minimal and the shareholders' interests are limited to the return on investment. Therefore, while it is not surprising that the US law – at the moment of the company's distress – considers the shareholders as residual claimants, involving them in the reorganisation proceedings only for the purpose of avoiding information asymmetry, preventing the lodging of procedural objections and disputes on the valuation of the shareholdings within the cram down<sup>60</sup>, the situation is very different in economic systems with closely-held (Germany) and family-owned (Italy) businesses.

7. – Both models described in this paper provide for “co-determination” regulations consistent with the principle of privity of contract and freedom of contract. What legitimates the impairment of shareholders' rights is the right to vote on the capital transaction resolution within the shareholders' extraordinary meeting (exclusive model) or in the meeting of the interested parties (inclusive model).

The choice to include shareholders in the decision-making process of the composition deed has the advantage of simplifying the proceedings of corporate reorganisation, of making them impervious to shareholders' vetoes, and of diminishing the coordination issues with company law provisions concerning the power of the company bodies. In the view of a possible reform of insolvency law in systems which still provide for the intangibility of shareholders rights, the German law stands as an important reference model.

However, it is advisable to further ponder the shareholders' interests in reorganisation scenarios, in order to involve equity holders in the negotiation together with forms of cram down

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<sup>58</sup> S. MADAUS, *Keine Reorganisation ohne Gesellschafter*, cit., 760, esp. fn. 20; opposing views in C. THOLE, *Treuepflicht-Torpedo?*, cit., 1940.

<sup>59</sup> S. MADAUS, *Keine Reorganisation ohne Gesellschafter*, cit., 760.

<sup>60</sup> On this subject see v. L. STANGHELLINI, *Le crisi di impresa fra diritto ed economia*, cit., 56 et seqq.

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(and grounds for objection and claim) that take into account both the property and the participation aspects of the shareholding<sup>61</sup>.

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<sup>61</sup> On this matter S. MADAUS, *Keine Reorganisation*, cit., 772 et seqq., proposes to take action on the cram down rule by adding – within the best interest test – the verification whether the surplus value generated by the composition deed might be distributed without affecting the ownership structure. In this view, the Author considers the technical instrument of the debt-mezzanine-swap. The conversion of debt capital into bonus shares allotted free of charge, which give a dividend right but not a voting right, seems not to change the company's organisational structure and therefore could be imposed upon the shareholders during the cram down. Such a solution is the best means to safeguard the creditors' interests to return from their investments through the participation in the surplus value generated by the corporate reorganisation without asking for the shareholders' cooperation.