



UvA-DARE (Digital Academic Repository)

Insider guarantees in corporate finance

An economic analysis of Dutch, US and German law

Jonkers, A.L.

Publication date

2020

Document Version

Other version

License

Other

[Link to publication](#)

Citation for published version (APA):

Jonkers, A. L. (2020). *Insider guarantees in corporate finance: An economic analysis of Dutch, US and German law*. [Thesis, fully internal, Universiteit van Amsterdam].

General rights

It is not permitted to download or to forward/distribute the text or part of it without the consent of the author(s) and/or copyright holder(s), other than for strictly personal, individual use, unless the work is under an open content license (like Creative Commons).

Disclaimer/Complaints regulations

If you believe that digital publication of certain material infringes any of your rights or (privacy) interests, please let the Library know, stating your reasons. In case of a legitimate complaint, the Library will make the material inaccessible and/or remove it from the website. Please Ask the Library: <https://uba.uva.nl/en/contact>, or a letter to: Library of the University of Amsterdam, Secretariat, Singel 425, 1012 WP Amsterdam, The Netherlands. You will be contacted as soon as possible.

CHAPTER 6

German law on opportunism with the guarantee relationship

1 Introduction

Chapter 3 discussed the guarantee relationship from the perspective of opportunism. This chapter analyses how German law deals with the problems identified in chapter 3. The question addressed in this chapter is:

How does German law deal with opportunism with the guarantee relationship in the context of corporate finance?

Most legal systems contain specific rules on the internal relationship. Many of those rules are designed to protect the guarantor, who is often considered a weak party. After a short introduction of types of guarantees relevant to corporate finance, German law on the protection of weak parties will be discussed. The focus lies on the context of corporate finance, in which shareholders or directors often guarantee debts of their company and group companies often guarantee group debts. In the discussion of weak party protection, it will thus specifically be discussed to which extent shareholders/directors are protected as weak parties.

After discussion of the rules protecting weak parties, the regulation under German law of opportunism towards outsiders of the guarantee relationship (as identified in chapter 3 paragraph 3) will be analysed extensively.

2 Introduction to types of guarantees in German law

A guarantee relationship, in its simplest form consisting of a principal debtor, a creditor and a guarantor, can take different legal shapes. The guarantee relationship can for example be a suretyship in the sense of § 765 Bürgerliches Gesetzbuch (BGB) or an independent bank guarantee. Dependent on the type of guarantee, a different regime can apply. Independent guarantees are not specifically regulated by the German civil code itself, whereas there are many

specific statutory rules in the civil code on co-debtorship and suretyship. This paragraph discusses the basic types of guarantees under German law.

The archetype of a guarantee under German law is *Bürgschaft* (suretyship),¹⁰⁸⁴ which will be discussed extensively, after which a short overview of other common types follows. Important to note is that, like in the Netherlands, there is often a close relationship between a corporate lender and the principal bank (*Hausbank*).¹⁰⁸⁵ In this close relationship, it is common that the shareholders or directors of the business (usually a GmbH) assume personal liability for company debts.¹⁰⁸⁶

This paragraph serves to provide a basic understanding of German law on personal security rights in order to be able to discuss German law on opportunism in and with the relationship further below. The introduction to the types of guarantees should be read as an introduction and in no way aims to be comprehensive. A reader roughly familiar with German law on personal security rights can skip this introduction.

2.1 The archetype of personal security: suretyship ('Bürgschaft')

Suretyship ('*Bürgschaft*') is regulated in § 765 ff. BGB. Suretyship is defined in § 765(1) BGB as a contract in which the surety "*puts himself under a duty to the creditor of a third party to be responsible for discharging that third party's obligation*".¹⁰⁸⁷ By default, suretyship under German law is of subsidiary (§ 771-773 BGB) and accessory (§ 767 and 768 BGB) nature.

Although suretyship is regulated by the German civil code in § 765 ff. BGB, one would be wrong to think that German law on suretyship as it stands today can be meaningfully understood with reference to the BGB only. German suretyship law has been extensively developed by the courts, particularly in the field of consumer protection.¹⁰⁸⁸

2.1.1 The relationship creditor-guarantor

The relationship between creditor and guarantor usually flows from a contract between them, which contract is typified as a one-sided contract: only the guarantor takes on an obligation to perform.¹⁰⁸⁹ The creditor of the principal debt and of the suretyship debt must be the same person.¹⁰⁹⁰ The relationship between creditor and guarantor is first and foremost characterized

¹⁰⁸⁴ Ziemons and Jaeger, 2014; Knops, 2017, p. 1277 speaks of *Bürgschaft* as the '*Normalfall*' of a personal security right.

¹⁰⁸⁵ See extensively Brinkmann, 2016, para. D(ii)

¹⁰⁸⁶ Compare Vallender, 2015, p. 1049

¹⁰⁸⁷ Translation of par. 765 BGB provided by https://www.gesetze-im-internet.de/englisch_bgb/englisch_bgb.html (last visited 4 January 2018).

¹⁰⁸⁸ Förster, 2010, p. 28; Drobniig, Sagel-Grande and Snijders, 2003, p. 1.

¹⁰⁸⁹ Drobniig, 2003, p. 85 Esselun and Sickel, 2014, p. 30 Piekenbrock and Ludwig, 2016, pp. 15–16. Another possibility, though much less common in practice, is a contract between surety and principal for the benefit of the creditor (par. 328 BGB), see Knops, 2017, p. 1278; Piekenbrock and Ludwig, 2016, p. 16.

¹⁰⁹⁰ Knops, 2017, p. 1279; Knops, 2017, p. 1330.

by the principles of accessory and subsidiarity, both of which are strongly incorporated under German law.

a) Accessory

Suretyship under German law is of accessory nature (see inter alia § 765, 767 and 768 BGB).¹⁰⁹¹ The existence and extent of the obligation of the surety is thus dependent on the principal obligation. The principle of accessory is, in as far as parties wish to use suretyship, deemed to be of mandatory law and cannot be struck out by contract.¹⁰⁹² If parties wish to deviate from the principle of accessory, they should opt for another type of guarantee, the independent guarantee.¹⁰⁹³ There are also exceptions to the principle of accessory, most prominently § 765(2) BGB which provides for the possibility of guarantees for future debts.

The principle of accessory (or: dependency) is clearly reflected in § 767 BGB, which stipulates that the duty of the surety is the currently applicable amount of the obligation of the principal debtor. This also applies if the main obligation has changed after assumption of suretyship, but not if such change was due to fault or default by the principal debtor, and also not if the duty of the surety was extended because of a transaction undertaken by the main debtor (however, if the surety is in control of the debtor as a shareholder and director, this exception does not apply).¹⁰⁹⁴

The principle of accessory also echoes in § 768 BGB, which stipulates that the surety can, towards the creditor, invoke a defence that the principal has against the creditor, even when the principal debtor has waived such a defence. Furthermore, the surety can refuse to perform his obligation as long as the principal debtor has a right to avoid the transaction on which the main debt is based or has a right to set-off. German law thus strongly embraces the principle of accessory in statutory suretyship law.

b) Subsidiarity

By default, suretyship under German law is of subsidiary nature (§ 771-773 BGB). The principle of subsidiarity is strongly incorporated. Simple default by the debtor is not sufficient to be able to call on the surety, the creditor should make serious effort pursuing the debtor: the creditor has to obtain execution of judgment against the main debtor, otherwise the surety can invoke the defence of unexhausted remedies (§ 771 BGB).¹⁰⁹⁵ The creditor also has to attempt enforcement of judgment against the debtor, at least by trying to enforce against the moveables of the debtor located in his place of residence or his business locations (§ 772(1) BGB). If the creditor has real security rights on moveables of the debtor, the creditor should also first try to enforce these (§ 772(2) BGB). Some exceptions apply to this defence of unexhausted remedies (summed up in § 773 BGB). The principle of subsidiarity is not of mandatory nature (as

¹⁰⁹¹ Esselun and Sickel, 2014, p. 30; Förster, 2010, p. 31.

¹⁰⁹² Reinicke and Tiedtke, 2008, pp. 7–9; Knops, 2017, p. 1284.

¹⁰⁹³ Bülow, 2007, p. 266.

¹⁰⁹⁴ Rösler 2002, 834.

¹⁰⁹⁵ See also Bülow, 2007, p. 266.

explicitly recognized by § 773(1) BGB), is often struck out by contractual provisions and is thus actually of little importance in practice.¹⁰⁹⁶

2.1.2 The relationship guarantor-principal debtor

Usually the principal debtor will have asked the surety to stand surety for his debt towards the creditor, in which case the rules on mandate (§ 662 ff BGB) or management of affairs of another (§ 675 ff BGB) may apply, but the suretyship can also have been assumed by the surety without any knowledge of the principal debtor, in which case the rules on agency without specific authorization (§ 677 ff BGB) apply.¹⁰⁹⁷

In the case of a contractual relationship between surety and principal debtor, the surety can take recourse to the principal debtor for all expenses made, as far as he was legally obliged to render performance (§ 670 BGB).¹⁰⁹⁸ Moreover, also absent any relationship between surety and principal debtor, § 774 BGB stipulates that the claim of the creditor passes to the surety to the extent that the surety pays the creditor (subrogation), although this right may not be used to the disadvantage of the creditor in case of collusion. The surety can choose whether he asserts a right of recourse or the right stipulated in § 774 BGB.¹⁰⁹⁹ That choice can be relevant, for example because security rights connected to the claim can also be asserted by the surety when using § 774 BGB.

Interesting is the right of the surety to demand to be released from the suretyship (§ 775 BGB) under specific circumstances listed in § 775 BGB, such as the circumstance that the financial situation of the principal debtor has deteriorated substantially. Such release would be affected by the principal debtor paying the creditor, or providing different security to the creditor.¹¹⁰⁰ § 775 BGB is not of mandatory law and can thus be deviated from in the contract between surety and principal debtor.¹¹⁰¹ The article is not of great practical importance, because under the circumstances described in § 775 BGB, the creditor will often call on the surety and recourse to the principal debtor will probably not lead to much.¹¹⁰²

2.1.3 Co-suretyship, contribution

When more persons stand surety for the same debt, whether together in the same contract or separately, they are qualified as co-sureties ('Mitbürgen'), who are each liable for the whole as co-debtors (§§ 769 and 421 BGB).¹¹⁰³ The creditor can freely choose which of the co-sureties to call on first, for either the whole or part of the sum.¹¹⁰⁴ Voidness of one of the suretyships does

¹⁰⁹⁶ Schwartz, 2017, p. 375; Reinicke and Tiedtke, 2008, p. 217; Knops, 2017, p. 1321; Rott, 2010, pp. 254; 269; Bülow, 2007, pp. 317; 323; Zantow and Dinauer, 2011, p. 161.

¹⁰⁹⁷ Rösler, Mackenthun and Pohl, 2002, pp. 842–844; 853; see for an overview of the possible relations between principal and surety also Esselun and Sickel, 2014, p. 49.

¹⁰⁹⁸ Piekenbrock and Ludwig, 2016, pp. 82–83.

¹⁰⁹⁹ Esselun and Sickel, 2014, p. 49; Knops, 2017, p. 1331 ff.

¹¹⁰⁰ Esselun and Sickel, 2014, pp. 49–50; Piekenbrock and Ludwig, 2016, p. 87.

¹¹⁰¹ Piekenbrock and Ludwig, 2016, p. 87.

¹¹⁰² Piekenbrock and Ludwig, 2016, p. 84.

¹¹⁰³ See also Knops, 2017, p. 1329; Piekenbrock and Ludwig, 2016, p. 108; Knops, 2017, p. 1341.

¹¹⁰⁴ Rösler, Mackenthun and Pohl, 2002, p. 840.

not affect the obligation of the other co-sureties.¹¹⁰⁵ Co-sureties can take recourse amongst each other with application of § 426 BGB (see § 774 par 2 BGB). Amongst each other, they are liable for equal shares, but proportionally to their external liability towards the creditor.¹¹⁰⁶ If it is not possible to obtain contribution from one of the co-debtors, the remaining co-debtors will have to bear the deficit equally.

Courts have developed some specific rules for recourse amongst co-sureties in case one or more of the co-sureties are shareholders of the principal debtor. Amongst co-sureties who are shareholders of the debtor, recourse should take place proportional to the shareholding of each in the principal debtor. If one or more co-sureties are shareholders of the principal debtor and one or more others are not, the non-shareholders have full recourse to the shareholders, though of course limited to the amount of the liability of the shareholder towards the principal debtor.¹¹⁰⁷

2.2 Co-debtorship ('Schuldbeitritt') and Patronatserklärung

A guarantee relationship could, under German law, also take the shape of a co-debtorship ('*Schuldbeitritt*') governed by the general rules on joined debtors (§ 420 ff BGB).¹¹⁰⁸ *Schuldbeitritt* is not as such defined in the BGB. The rules on plurality of debtors can apply to both contractual and non-contractual obligations. In the case of a guarantee relationship the obligation will be contractual. § 427 BGB lays down a presumption for joint liability in the situation in which more than one person jointly binds himself by contract to render a divisible¹¹⁰⁹ performance. *Schuldbeitritt* can in principle take many shapes and is governed by the principle of freedom of contract, but exceptions do apply.¹¹¹⁰

The general form of a joint loan agreement as referred to in art. § 427 BGB can technically also be used, and is often used, in a situation in which the obligation of one of the joint debtors is only meant to secure that of the other debtor(s),¹¹¹¹ such as the situation in which a shareholder or director guarantees all the debts of his or her company. Even though such a situation seems to amount to a suretyship, parties may opt for a joint loan agreement.¹¹¹²

In this context, German (judge-made) law makes a distinction between real co-debtors (*Mitdarlehensnehmer*) and co-debtors that only serve for security purposes (*Mithaftender*). To protect altruistic sureties, courts are likely to apply the specific provisions on suretyship and immorality of suretyship in as far as the joint loan agreement is altruistic from the perspective of the surety.¹¹¹³

¹¹⁰⁵ Piekenbrock and Ludwig, 2016, p. 108; Piekenbrock and Ludwig, 2016, p. 108.

¹¹⁰⁶ Knops, 2017, p. 1341.

¹¹⁰⁷ Piekenbrock and Ludwig, 2016, p. 109.

¹¹⁰⁸ See also Piekenbrock and Ludwig, 2016, p. 110; Rösler, Mackenthun and Pohl, 2002, p. 858 ff

¹¹⁰⁹ If performance is not divisible, joint liability is not just the presumption, but always applies (par. 431 BGB).

¹¹¹⁰ Reinicke and Tiedtke, 2008, p. 13,

¹¹¹¹ Piekenbrock and Ludwig, 2016, p. 301.

¹¹¹² Madaus, 2001, p. 1.

¹¹¹³ Reinicke and Tiedtke, 2008, pp. 15–16; BGH, 11 November 2004 - IX ZB 258/03; see for an overview of application by analogy also Knops, 2017, p. 1298; see also Madaus, 2001, p. 321 ff.

Parties do not have a free choice to opt for either real co-debtorship or co-debtorship for security purposes. A court interpreting the contract will determine whether the contract is a real co-debtorship. The name used for the contract is not important in this context. Of significance is only the relationship between the co-debtors.¹¹¹⁴ The name given by the parties to the contract is only an indication for real co-debtorship in case, from the viewpoint of the creditor, concrete indications exist that the co-debtors each had their own interest in the loan and at the same time where equal partners in deciding over the use of the line of credit.¹¹¹⁵ This could for example be the case when a line of credit is extended to a group of companies and all these group companies act as co-debtors and can all draw under the line of credit. If the contract fails this test, courts will apply suretyship law by analogy.¹¹¹⁶

The principle of subsidiarity does not apply to a real joint loan. The creditor can call upon each and every debtor for the whole amount directly, in as far as payment is due. The principle of accessory does however to some extent apply to a joint loan, as fulfilment by a joint debtor also excuses the other debtors (§ 422 BGB).

§ 426 BGB stipulates that, by default and unless otherwise agreed, the joint debtors are liable, in their internal relationship, in equal fractions.¹¹¹⁷ This rule not only provides the basis for reimbursement, but also lays down a presumption of equal shares. § 426 BGB also stipulates that, if it is not possible to obtain contribution from one of the co-debtors, the remaining co-debtors will have to bear the deficit equally. § 426 (2) BGB provides a rule of subrogation.

Although consumer credit law (§ 491 ff BGB) does not apply to suretyship assumed by a consumer (see further paragraph 3 below),¹¹¹⁸ it may apply to co-debtorship, in as far as the co-debtor takes the debt on himself in the capacity of a consumer.¹¹¹⁹ Also private persons that are shareholders or shareholder/directors of GmbH's can often be qualified as consumers when they act as co-debtors with their corporation.¹¹²⁰

Another type of personal security that is not as such defined in the BGB is the *Patronatserklärung*, which is a statement by usually the shareholder that he will keep the legal person certain state, for example make sure the legal person stays sufficiently financed. The treatment of the *Patronatserklärung* has been developed in the literature and case law. Generally, such a statement is assumed not to create a joint and several liability, but, though depending on the statement, a separate liability of the person issuing the statement.¹¹²¹

¹¹¹⁴ Esselun and Sickel, 2014, p. 34; BGH, 16 June 2009 - XI ZR 539/07.

¹¹¹⁵ Piekenbrock and Ludwig, 2016, p. 244, with reference to case law; Esselun and Sickel, 2014, p. 33; Piekenbrock and Ludwig, 2016, p. 244.

¹¹¹⁶ Knops, 2017, p. 1283.

¹¹¹⁷ See also Piekenbrock and Ludwig, 2016, p. 244.

¹¹¹⁸ Rösler, Mackenthun and Pohl, 2002, p. 861.

¹¹¹⁹ Piekenbrock and Ludwig, 2016, p. 133.

¹¹²⁰ BGH 25 Oktober 2011, XI ZR 332/10; see also Esselun and Sickel, 2014, p. 302.

¹¹²¹ See further Oostrum, 2019, pp. 278–282

2.3 Independent guarantee

A contractual guarantee can also create a personal security right that is independent from the underlying obligation it aims to secure.¹¹²² Such independent guarantees are generally recognized under German law and practice, but the BGB does not specifically regulate this type of guarantee,¹¹²³ even though the instrument is probably not less common in practice than *Bürgschaft*.¹¹²⁴ The possibility to create such an independent guarantee is generally believed to be based on the principle of freedom of contract (§ 241 BGB).¹¹²⁵ The rules on suretyship and joint debtorship do generally not apply to independent guarantees.¹¹²⁶

The independent guarantee is less suited than *Bürgschaft* and *Schuldbeitritt* to be undertaken by an insider to secure a line of business financing. The reason why is not only that such an independent guarantee would put the guarantor into a difficult position, but also that the BGH only accepts the principle of independence in as far as the guarantee aims to insure against a specific adverse event.¹¹²⁷ Following this interpretation of the BGH, the independent guarantee is generally less suited for use in corporate finance, in which insiders often guarantee debts of a corporation they are involved in.¹¹²⁸ Arguably, the ‘specific event’ could be the default of the debtor for whatever reason, but whether this is specific enough for the principle of independence to be upheld seems open to challenge.

2.4 Group guarantees for accounting purposes

Intra-group guarantees can also be issued to be able to create consolidated annual accounts. Under rules that implemented the European Fourth Directive (on the annual accounts of certain types of companies)¹¹²⁹ subsidiaries can be exempted from the obligation to file and publish full annual accounts if their parent company issues a statement of several liability for the debts of the subsidiaries with which the accounts are consolidated. This in short allows for simplified annual accounts, but does (inter alia) require a guarantee for the debts of the subsidiary entered into from that moment (§ 264 (3) paragraph 2 HGB). The statute does not stipulate which type of guarantee should be used.

3 German law on opportunism towards parties inside the guarantee relationship

¹¹²² See also Esselun and Sickel, 2014, pp. 302–303; Zantow and Dinauer, 2011, p. 164; Rösler, Mackenthun and Pohl, 2002, p. 846.

¹¹²³ Heermann, 2003, p. 613; Zantow and Dinauer, 2011, p. 164.

¹¹²⁴ Schwartze, 2017, p. 377.

¹¹²⁵ Förster, 2010, p. 2.

¹¹²⁶ Rösler, Mackenthun and Pohl, 2002, p. 846.

¹¹²⁷ Rösler, Mackenthun and Pohl, 2002, p. 846; Knops, 2017, p. 1278; Förster, 2010, p. 56.

¹¹²⁸ Compare Piekenbrock and Ludwig, 2016, p. 217.

¹¹²⁹ Fourth Council Directive 78/660/EEC of 25 July 1978 based on Article 54 (3) (g) of the Treaty on the annual accounts of certain types of companies.

Chapter 3 paragraph 2 discussed opportunism in the internal relationship, particularly in the context of corporate finance. This paragraph will discuss in which way and to what extent German law protects parties in the guarantee relationship, again with a focus on the situation in which an insider of the corporation guarantees corporate debts towards one or more creditors. Guarantees are, in the German literature, qualified by some as one of the most dangerous contracts.¹¹³⁰ The protection of guarantors in the context of corporate finance is however rather limited, as will be discussed below.

German law protects the weak surety through some specific measures.¹¹³¹ First of all, a consumer suretyship (§ 350 HGB) is required to be in written form § 766 BGB (and § 780 and § 781 (1) and (2) BGB). Secondly, unfair terms control can strike out certain often-used unfair suretyship terms, which control is stronger for consumer suretyship contracts.¹¹³² More importantly, the well-known case law on immorality of certain suretyship contracts grants extensive protection to certain sureties. This however is mostly relevant in the case of family suretyships and plays a much smaller role in suretyships in corporate finance, such as suretyships assumed by directors and shareholders for the debts of their company. The case law on immorality will be discussed first below, followed by the written form requirement (par. 3.2), consumer credit law (par. 3.3) and doorstep sales law (par. 3.4). Although most of the aforementioned protective mechanisms only apply to consumer suretyship, this does not always exclude applicability to guarantees in the context of corporate finance, as shareholders or directors may under specific circumstances qualify as consumers. After these specific mechanisms of consumer protection, unfair terms control will be discussed in paragraph 3.5, the protection of the spouse in par. 3.6 and protection through bankruptcy law in par. 3.7.

3.1 Protection against immoral suretyship

The BGB itself offers very limited protection to consumer sureties.¹¹³³ The courts have however over roughly the last 25 years developed a vast and complicated body of case law over the band of § 138 (1) BGB on the issue of immoral suretyships, protecting the weakest sureties. Famously, in 1993 even the Constitutional Court (*Bundesverfassungsgericht*) stepped in to protect the surety. It is outside the scope of this book (which focuses on guarantees in the context of corporate finance) to set out the whole development in the case law since the late 1980s until now. However, to understand current German law on the protection of weak sureties in the context of corporate finance, it is necessary to discuss these well-known developments

¹¹³⁰ See Piekenbrock and Ludwig, 2016, pp. 218–221, also for other references.

¹¹³¹ Technically, German law does not distinguish between consumer and non-consumer suretyship as such, but makes a distinction between commercial and non-commercial suretyship, Knops, 2017, p. 1279. Commercial suretyships are those suretyships in which the surety is a merchant (*Kaufmann*) in terms of art. 1 ff HGB, and which belong to his business or trade (see § 343 HGB). Also some suretyships assumed by non-consumers are qualified as non-commercial under this definition, see also Rott, 2010, p. 255. Non-commercial suretyships are simply equated with consumer suretyships below, unless the difference is essential for the topics discussed.

¹¹³² Rott, 2010, p. 255.

¹¹³³ See also Rott, 2010, p. 255.

briefly,¹¹³⁴ followed by a brief description of the current state of the law in as far as it concerns protection against opportunistic behavior towards the guarantor in the context of corporate finance.

3.1.1 Development of case law on immoral suretyship

Until 1993 there was a split between the (3rd and) 9th Senate and the 11th Senate of the *Bundesgerichtshof* (hereinafter BGH) on the treatment of suretyships given by close relatives of the debtor.¹¹³⁵ Both were able to deliver judgments on suretyship-related issues, because while the 9th Senate had jurisdiction on suretyship law, the 11th Senate had jurisdiction on banking law (and the 3rd Senate had jurisdiction on some general private law issues).¹¹³⁶ The 3rd and 9th Senate firmly upheld a formalistic view of the principle of freedom of contract, ruling that even suretyships by close relatives of the debtor with no financial means to cover the often vast sums of liability should be enforced against these sureties, which stance was often met by fierce criticism in the literature.¹¹³⁷ The 11th Senate, in the years leading to 1993, cautiously took an approach more protective of the very weakest sureties, favouring some form of judicial control of such suretyship contracts.¹¹³⁸

In 1993, the German Constitutional Court (*Bundesverfassungsgericht*, hereinafter BVerfG) famously intervened in a suretyship case.¹¹³⁹ A surety that was held liable by a decision of the 9th Senate of the BGH had made a complaint at the BVerfG.¹¹⁴⁰ The intervention in such a private law matter was deemed possible because personal freedoms are protected by the German Constitution (*Grundgesetz*, hereinafter GG) in § 2 (1).¹¹⁴¹ Shortly put, the BVerfG ruled that a formalistic notion of freedom of contract cannot prevail in cases where the autonomy of private individuals as protected by § 2 (1) GG is not properly guaranteed, which can be the case in circumstances of unequal bargaining power.¹¹⁴² In cases where one party exploits the disadvantaged position of another party, the weak party needs to be protected by the law.¹¹⁴³

After the decision of the BVerfG, it was up to the civil courts to shape the protection of weak sureties. Because the civil courts had considerable freedom in shaping this protection, the split between the 9th and 11th Senate remained somewhat intact, with the 11th Senate offering more

¹¹³⁴ A more detailed description in English can be found in Cherednychenko, 2007, p. 272; Habersack and Zimmermann, 1999; Cherednychenko, 2007, chap. 6. There is of course also abundant German literature on the subject, see for example Rott, 2010, see for a (non-exhaustive) list of literature on the subject for example Reinicke and Tiedtke, 2008, p. 56 ff.

¹¹³⁵ The BGH currently consists of 12 departments in the area of private law (*Zivilsenate*). Each department is responsible for its own specific area of private law. See also Knops, 2017, pp. 1296–1297.

¹¹³⁶ See also Habersack and Zimmermann, 1999, p. 276 at fn 25.

¹¹³⁷ See also Habersack and Zimmermann, 1999, p. 276 at fn 25; Tiedtke, 2000, p. 677; Rott, 2010, p. 257.

¹¹³⁸ Cherednychenko, 2007, pp. 272–274; Habersack and Zimmermann, 1999, p. 276; Rott, 2010, pp. 256–257.

¹¹³⁹ BVerfG, 19 October 1993, NJW 1994, 36; see also Cherednychenko, 2007, pp. 272–274.

¹¹⁴⁰ Reinicke and Tiedtke, 2008, p. 58.

¹¹⁴¹ Habersack and Zimmermann, 1999, p. 276.

¹¹⁴² Rott, 2010, p. 257.

¹¹⁴³ Habersack and Zimmermann, 1999, pp. 276–277.

generous protection than the 9th Senate.¹¹⁴⁴ The split finally ended when the 11th Senate was granted jurisdiction on suretyship law in 2001.¹¹⁴⁵

3.1.2 Current state of the case law on the protection of weak sureties

The civil courts have shaped the protection of weak sureties over the band of § 138 (1) BGB:¹¹⁴⁶

“Ein Rechtsgeschäft, das gegen die guten Sitten verstößt, ist nichtig.”¹¹⁴⁷

Two criteria are leading in answering the question whether a contract of suretyship is *contra bonos mores* in the sense of § 138 (1) BGB: (1) there has to be a close emotional relationship or economic dependency between debtor and guarantor and (2) the financial obligation shouldered by the guarantor has to exceed his or her financial potential (‘gross disproportionality’).¹¹⁴⁸ In case both these criteria have been met, there is a rebuttable presumption that the contract of suretyship is void for being against good morals. The whole contract is null and void in that case, not just part of the contract; the surety fully escapes liability under the suretyship contract. Both criteria (close relationship and gross disproportionality) will be discussed further below. Also when the criteria do not both apply, a suretyship can be void as against good morals, but no presumption can be relied on in such a case. This will also be discussed further below.

3.1.2.1 Emotional relationship or economic dependency

The rebuttable presumption of immorality of the contract of suretyship is only applied by the courts in case both a close relationship, more specifically an emotional relationship or economic dependence,¹¹⁴⁹ exists between debtor and guarantor and there is a gross disproportionality between the obligation incurred by the guarantor and his or her financial means.¹¹⁵⁰ The background of the condition of a close relationship is that in such cases, the assumption can be made that the surety acted emotionally rather than rationally, and the creditor (often a bank) may have abused this emotional relationship, leading to an immoral contract.¹¹⁵¹

What qualifies as a close emotional relationship or economic dependency? A close relationship can be presumed to exist between spouses, between unmarried couples and between parents and children.¹¹⁵² Brothers and sisters or other family relatives may have a close relationship, but would have to prove this, as well as prove that the creditor had knowledge of the existence of

¹¹⁴⁴ Rott, 2010, p. 258; Reinicke and Tiedtke, 2008, pp. 58–61.

¹¹⁴⁵ Cherednychenko, 2007, p. 275.

¹¹⁴⁶ Rott, 2010, p. 258; Knops, 2017, p. 1298.

¹¹⁴⁷ Translation: “A legal transaction which is contrary to public policy is void” (translation by https://www.gesetze-im-internet.de/englisch_bgb/englisch_bgb.html#p0417, last visited on 1 April 2018). See also Habersack and Zimmermann, 1999, p. 281: “Contracts *contra bonos mores* are void”.

¹¹⁴⁸ Habersack and Zimmermann, 1999, p. 281; Knops, 2017, pp. 1298–1306.

¹¹⁴⁹ Cherednychenko, 2007, p. 278.

¹¹⁵⁰ Knops, 2017, p. 1302.

¹¹⁵¹ Reinicke and Tiedtke, 2008, p. 62.

¹¹⁵² Rott, 2010, p. 259.

this close relationship.¹¹⁵³ Close friends can also have such an emotional bond, but again would have to prove this.

Shareholders or directors that stand surety for their company are generally not seen as having an emotional relationship with their company.¹¹⁵⁴ The case law on immorality of suretyship therefore has limited relevance for guarantees in the context of corporate finance. However, the case law is deemed applicable to cases in which the debtor is a corporation and the surety is not a shareholder him- or herself but has a close emotional bond with the shareholder.¹¹⁵⁵ Although such cases certainly exist, they represent a much smaller group of cases than the cases in which the shareholder him or herself stands surety. The rebuttable presumption also applies to certain cases of economic dependency of the surety. Most notable in this category are employees that guarantee the debt of their employer.¹¹⁵⁶ Recently, the BGH has held that the case law on the protection of weak sureties can indeed extend to employees.¹¹⁵⁷

3.1.2.2 *Gross disproportionality*

The existence of a close emotional relationship between debtor and guarantor is not sufficient to establish immorality. The case law has developed the concept of gross disproportionality between the financial means of the guarantor and the obligation incurred (*krasser finanzieller Überforderung*). The wealth of the principal debtor and the chance that the principal debtor will not perform are not considered relevant in this context.¹¹⁵⁸ Various ways of establishing gross disproportionality have been applied over roughly the last two decades.¹¹⁵⁹ Currently, the courts seem to focus on the interest on the guaranteed debt: if the guarantor is, at the time of concluding the contract of guarantee, unable to (now or in the future) even service the interest on the guaranteed amount from his available income, gross disproportionality exists.¹¹⁶⁰ The reference date for the gross disproportionality test is the date that the suretyship was concluded. A prognosis has to be made whether it was, at that time, foreseeable that the guarantor would not be able to service the debt, though the actual income and property at the time of the creditor invoking the guarantee is often taken as the foreseeable income and property at the time of concluding the contract, unless evidence to the contrary exists.¹¹⁶¹ Gross disproportionality can also exist when the surety is unlikely to cover a substantial part of the principal debt.¹¹⁶² If the guarantor has substantial property such as a house, the proceeds of which could cover the guaranteed amount, gross disproportionality does not exist.¹¹⁶³

¹¹⁵³ Rott, 2010, p. 262.

¹¹⁵⁴ Rott, 2010, p. 262; see also Meier, 2004; BGH 15. January 2002 - XI ZR 98/01; Piekenbrock and Ludwig, 2016, p. 32; Knops, 2017, pp. 1302–1303.

¹¹⁵⁵ BGH 18 December 1997, IX ZR 271/96; see also Reinicke and Tiedtke, 2008, p. 63; Cherednychenko, 2007, p. 282.

¹¹⁵⁶ Rott, 2010, p. 262; Piekenbrock and Ludwig, 2016, p. 25.

¹¹⁵⁷ BGH 11 September 2018, ZIP 2018/2162

¹¹⁵⁸ Knops, 2017, p. 1305.

¹¹⁵⁹ See for an overview also Reinicke and Tiedtke, 2008, p. 61.

¹¹⁶⁰ Piekenbrock and Ludwig, 2016, pp. 27–32; Reinicke and Tiedtke, 2008, p. 61; Knops, 2017, pp. 1298–1299.

¹¹⁶¹ Rott, 2010, p. 259.

¹¹⁶² Reinicke and Tiedtke, 2008, p. 61.

¹¹⁶³ Knops, 2017, p. 1298; Reinicke and Tiedtke, 2008, p. 61.

3.1.2.3 Rebuttal of the presumption by the creditor

If both gross disproportionality and an emotional relationship or economic dependency are found to be present, the creditor is presumed to have abused the emotional bond of the guarantor which leads to the suretyship being immoral in the sense of § 138 (1) BGB.¹¹⁶⁴ The creditor can rebut this presumption, either by showing he was not aware of the gross disproportionality (though this will not be easy because the creditor does have a duty to investigate), or by showing that the guarantor was not just motivated by the emotional bond or economic dependency but rather by his or her own and direct economic interest.¹¹⁶⁵ Such an economic interest of course often exists in the context of corporate finance. Another option for the creditor is to argue that the guarantee was obtained only to prevent the close relatives from shifting assets between them, but this defence is only accepted if this aim was specified in the contract of suretyship and the liability under the guarantee is limited to achieving this particular aim.¹¹⁶⁶

3.1.2.4 Immorality outside cases of gross disproportionality or emotional relationships

Contracts of suretyship can also be immoral when there is no gross disproportionality between the financial means of the guarantor and the obligation incurred. In such cases, the presumption of immorality does not apply, but other circumstances could still lead to the conclusion that the creditor has abused his bargaining power.¹¹⁶⁷ Only particularly aggravating circumstances which are attributable to the creditor can generally lead to that conclusion.¹¹⁶⁸ Examples could be abuse of the inexperience of the guarantor, undue pressure on the guarantor, surprising the guarantor or downplaying the risks involved in assuming the guarantee.¹¹⁶⁹ The surety has the burden of proof. The creditor does not have an extensive duty to inform the well-off surety of the dangers involved. The surety can be expected to inform himself of those dangers.¹¹⁷⁰

Also absent an emotional relationship between creditor and debtor, a suretyship in which there is gross disproportionality could be *contra bonos mores* in the sense of § 138 (1) BGB. This is particularly relevant for the context of corporate finance, as shareholders and directors are not seen as having an emotional bond with their company. Again, only particularly aggravating circumstances which are attributable to the creditor can in such a situation lead to that conclusion. It is generally unlikely that such circumstances are found to be present in the situation of a shareholder or director acting as surety.¹¹⁷¹

¹¹⁶⁴ Rott, 2010, p. 261.

¹¹⁶⁵ See for examples Reinicke and Tiedtke, 2008, p. 62.

¹¹⁶⁶ Rott, 2010, pp. 262–263.

¹¹⁶⁷ Cherednychenko, 2007, p. 281.

¹¹⁶⁸ Reinicke and Tiedtke, 2008, p. 69.

¹¹⁶⁹ Cherednychenko, 2007, p. 284; Rott, 2010, p. 264.

¹¹⁷⁰ BGH, 15 April 1997 - IX ZR 112/96; see also Cherednychenko, 2007, pp. 284–287.

¹¹⁷¹ See for shareholders extensively Rott, 2010, p. 268 and for directors Meier, 2004.

3.1.3 Summary

In short, although the case law on immorality of suretyship offers extensive protection to certain (particularly family-) sureties, this case law has limited relevance for guarantees in the context of corporate finance. Shareholders and directors that guarantee corporate debts are not specifically protected.

3.2 Protection through the written form requirement

§ 766 BGB (and § 780 and § 781 (1) and (2) BGB), which only applies to consumer suretyship (non-commercial suretyship, see § 350 HGB),¹¹⁷² stipulates that a suretyship can only be in writing. The written-form requirement is meant to give the surety warning that he is signing a serious and potentially burdensome contract.¹¹⁷³ The consumer surety is thus somewhat protected. The BGB has interpreted the written form requirement rather extensively, ruling out blank declarations of suretyship that are filled in later, after signing by the surety.¹¹⁷⁴

Relevant to the context of corporate finance is that private persons who are a shareholder or director of a corporation are not qualified as ‘merchants’ under the HGB. As a result, the written form requirement can also apply to private persons that are a shareholder or director of the principal debtor.¹¹⁷⁵

3.3 Consumer credit law

The BGB has some specific rules on consumer credit agreements (§ 491 ff BGB). However, in line with the European Court of Justice judgement in *Berliner Kindl*,¹¹⁷⁶ the BGH has ruled that a consumer suretyship is not a consumer credit contract.¹¹⁷⁷ The Consumer Rights Directive 2011/83/EU has not brought any changes in this respect.¹¹⁷⁸

Although consumer credit law does not apply as such to suretyship assumed by a consumer,¹¹⁷⁹ it may apply to co-debtorship, in as far as the co-debtor takes the debt on himself in the capacity of a consumer, and even if the principal debtor is not a consumer.¹¹⁸⁰ This difference in the protection of co-debtors and sureties, which counterintuitively has led to more protection of co-

¹¹⁷² See also Meier, 2004.

¹¹⁷³ See also Habersack and Zimmermann, 1999, p. 291; Esselun and Sickel, 2014, p. 55.

¹¹⁷⁴ See BGH, 29 February 1996 - IX ZR 153/95: „*the surety must not only sign a document from which the will to be responsible for someone else's debt is apparent. At the same time the document has to specify the risk assumed and thus to make the surety aware of this risk at the moment of his declaration*” (translation by Habersack and Zimmermann, 1999, p. 290); see also Piekenbrock and Ludwig, 2016, p. 33.

¹¹⁷⁵ Knops, 2017, p. 1280.

¹¹⁷⁶ ECJ, 23 March 2000, Case C-208/98 *Berliner Kindl Brauerei AG v Andreas Siepert*.

¹¹⁷⁷ BGH 21 April 1998 – IX ZR 258/97; BGH 28 October 1999 – IX ZR 364/97; see further Rott, 2010, p. 255; Knops, 2017, pp. 1318–1319; Piekenbrock and Ludwig, 2016, p. 33.

¹¹⁷⁸ Mertins, 2014, pp. 398–399.

¹¹⁷⁹ Piekenbrock and Ludwig, 2016, p. 43.

¹¹⁸⁰ Piekenbrock and Ludwig, 2016, pp. 43, 133; BGH, 5 June 1996 – VIII ZR 151/95; Esselun and Sickel, 2014, p. 302.

debtors, has attracted fierce criticism in the literature. It has been argued that consumer sureties should be granted this protection as well.¹¹⁸¹

Also shareholders or shareholder and directors of GmbH's can often be seen as consumers when they act as co-debtors with their corporation.¹¹⁸² Thus, § 491 ff BGB on consumer credit agreements can apply to shareholders and directors acting as co-debtor with their company.

Especially relevant for consumer credit agreements are §§ 491 and 492 BGB on form requirements and information rights, and § 495 (1) BGB on the right of withdrawal:

“Dem Darlehensnehmer steht bei einem Verbraucherdarlehensvertrag ein Widerrufsrecht nach § 355 zu.”¹¹⁸³

That right of withdrawal is further specified in § 355 BGB:

“(1) Wird einem Verbraucher durch Gesetz ein Widerrufsrecht nach dieser Vorschrift eingeräumt, so sind der Verbraucher und der Unternehmer an ihre auf den Abschluss des Vertrags gerichteten Willenserklärungen nicht mehr gebunden, wenn der Verbraucher seine Willenserklärung fristgerecht widerrufen hat. Der Widerruf erfolgt durch Erklärung gegenüber dem Unternehmer. Aus der Erklärung muss der Entschluss des Verbrauchers zum Widerruf des Vertrags eindeutig hervorgehen. Der Widerruf muss keine Begründung enthalten. Zur Fristwahrung genügt die rechtzeitige Absendung des Widerrufs.

(2) Die Widerrufsfrist beträgt 14 Tage. Sie beginnt mit Vertragsschluss, soweit nichts anderes bestimmt ist.

(...)”¹¹⁸⁴

Put shortly, the consumer has a right of withdrawal within fourteen days after concluding the co-debtorship.

3.4 Doorstep sales law

The question whether the special protection offered to consumers when concluding doorstep and distance contracts is also applicable to consumers concluding guarantees, has been and still is surrounded by a lot of uncertainty. The question is relevant, as § 312g (1) BGB gives the consumer that concluded a doorstep or distance sale contract a right of withdrawal:

¹¹⁸¹ See e.g. Mertins, 2014, p. 398; Mertins, 2014.

¹¹⁸² Rott, 2010, p. 267.

¹¹⁸³ Translation: “In the case of a consumer credit agreement, the borrower has a right of withdrawal under section 355.” translation by https://www.gesetze-im-internet.de/englisch_bgb/englisch_bgb.html#p1804

¹¹⁸⁴ Translation: “(1) If a consumer is given, by statute, a right of withdrawal according to this provision, then the consumer and the trader are no longer bound by their declarations of intention to conclude the contract if the consumer withdraws from his declaration of intention within the period specified. The withdrawal is effected by a declaration being made to the trader. The declaration must unambiguously reflect the consumer’s decision to withdraw from the contract. The withdrawal does not have to provide any grounds. Dispatch of the withdrawal in good time is sufficient to comply with the time limit.

(2) The withdrawal period is fourteen days. Unless otherwise provided, it begins upon the contract having been concluded.” Translation by: https://www.gesetze-im-internet.de/englisch_bgb/englisch_bgb.html#p1286, last visited on 1 April 2018.

“Dem Verbraucher steht bei außerhalb von Geschäftsräumen geschlossenen Verträgen und bei Fernabsatzverträgen ein Widerrufsrecht gemäß § 355 zu.”¹¹⁸⁵

That right of withdrawal is further specified in § 355 BGB, which was cited above (paragraph 3.3) and (put shortly) stipulates that the consumer would have a right of withdrawal within fourteen days after concluding the suretyship.

After the European Court of Justice (ECJ) decision in *Dietzinger*,¹¹⁸⁶ the 9th Senate of the BGH has, in line with *Dietzinger*, held that doorstep sales law is only applicable to a suretyship contract if both principal debtor and surety are consumers and both principal debtor and the surety have concluded the contract in a doorstep sales situation.¹¹⁸⁷ Later however, the 11th Senate of the BGH has held that doorstep sales law applies to all consumer suretyships concluded in a doorstep situation, irrespective of whether the principal debtor is a consumer and irrespective of whether the principal debtor has concluded the contract in a doorstep situation (see on the opposing views of the 9th Senate and the 11th Senate generally also paragraph 3.1 above).¹¹⁸⁸ In reaching that decision, the BGH has pointed to the minimum harmonisation goal of the Doorstep Selling Directive (art. 8, 85/577/EEC), and thus the jurisdiction of the BGH to offer wider protection.¹¹⁸⁹ Currently, some uncertainty again exists on this point, because the Consumer Rights Directive 2011/83/EU, which has been adopted in German law in 2014, is now applicable to doorstep sales and has a full harmonisation scope.¹¹⁹⁰ One may therefore question whether the case law of the BGH still holds.

Important to notice in the context of corporate finance is that the definition of consumer in this context is broad (§ 13 BGB) and can also encompass merchants, craftsmen, the free professions and shareholders of a corporation, as long as the suretyship is concluded for purposes that predominantly are outside his trade, business or profession.¹¹⁹¹

3.5 Protection through unfair standard terms control

Professional creditors such as banks often use standard terms in contracts of suretyships,¹¹⁹² also in suretyships assumed by shareholders or directors for the debts of their corporation. Standard terms (*Allgemeiner Geschäftsbedingungen*) are extensively controlled under German law. The standard terms used often aim to reduce the rights of the surety and improve the position of the creditor. Even if those terms are not contrary to mandatory law, the question remains whether the use of such terms is in accordance with the law on such standard terms as laid down in § 305 ff BGB. If not, the term can be struck out. Unfair terms control in that sense

¹¹⁸⁵ Translation: “In the case of off-premises contracts and of distance contracts, the consumer has a right of withdrawal pursuant to section 355.” translation by: https://www.gesetze-im-internet.de/englisch_bgb/englisch_bgb.html#p1102, last visited 1 April 2018.

¹¹⁸⁶ ECJ 17 March 1998, case C 45/96 (Bayerische Hypotheken- und Wechselbank AG v Edgard Dietzinger)

¹¹⁸⁷ BGH 14 May 1998 - IX ZR 56/95; Esselun and Sickel, 2014, pp. 302–303; Piekenbrock and Ludwig, 2016, p. 44.

¹¹⁸⁸ BGH, 10 January 2006 - XI ZR 169/05; see also Mertins, 2014, p. 397; Piekenbrock and Ludwig, 2016, p. 44.

¹¹⁸⁹ Mertins, 2014, p. 398.

¹¹⁹⁰ Piekenbrock and Ludwig, 2016, pp. 44–45.

¹¹⁹¹ Piekenbrock and Ludwig, 2016, p. 46.

¹¹⁹² Piekenbrock and Ludwig, 2016, p. 49.

only offers limited protection to the surety: an unfair term will be struck out but the rest of the contract is normally left intact (§ 301 (1) BGB).¹¹⁹³

Standard terms are defined in § 305(1) BGB as:

*“(...) alle für eine Vielzahl von Verträgen vorformulierten Vertragsbedingungen, die eine Vertragspartei (Verwender) der anderen Vertragspartei bei Abschluss eines Vertrags stellt. Gleichgültig ist, ob die Bestimmungen einen äußerlich gesonderten Bestandteil des Vertrags bilden oder in die Vertragsurkunde selbst aufgenommen werden, welchen Umfang sie haben, in welcher Schriftart sie verfasst sind und welche Form der Vertrag hat. Allgemeine Geschäftsbedingungen liegen nicht vor, soweit die Vertragsbedingungen zwischen den Vertragsparteien im Einzelnen ausgehandelt sind.”*¹¹⁹⁴

In short, terms that are used by one party and that have been formulated to be used repeatedly in such contracts are seen as ‘standard terms’, irrespective of where or how they are placed in the contract. Only actual bargaining on the specific term disqualifies such a term as a standard term. § 305 (2) BGB stipulates that standard terms only become part of the contract if certain conditions have been met, which conditions make sure the counterparty is informed about the terms.¹¹⁹⁵ Even if the counterparty was informed of the standard terms, certain standard terms are not allowed or can be struck out. Especially relevant are § 305c (1) BGB (on surprising standard terms) and § 307 (1) BGB (on unfair standard terms).

Pursuant to § 307 BGB, unfair standard terms can be struck out. The courts have generally held deviations from the principle of accessory, which is considered a core principle of suretyship law, to be unfair.¹¹⁹⁶ A standard term containing a contractual waiver of the defences of the surety is thus held to be unfair.¹¹⁹⁷ Moreover, terms that expose the guarantor to liability greater than that of the principal debtor (which would also amount to a deviation of the principle of accessory) are often held to be unfair.¹¹⁹⁸ Other unfair standard terms include the exclusion of the right of the surety to refuse to satisfy the creditor in as far as the debtor has a right to set-off, as stipulated in § 770 (2) BGB,¹¹⁹⁹ a contractual duty of the surety to issue real security rights on the request of the creditor,¹²⁰⁰ exclusion of recourse between co-sureties,¹²⁰¹ and under circumstances also the exclusion of the release of the surety when a creditor waives another security right (§ 776 BGB).¹²⁰² In contrast, standard terms deviating from the principle of subsidiarity (§ 771 BGB) are generally upheld (see also § 773 BGB).¹²⁰³

¹¹⁹³ See also Meier, 2004.

¹¹⁹⁴ Translation: “all contract terms pre-formulated for more than two contracts which one party to the contract (the user) presents to the other party upon the entering into of the contract. It is irrelevant whether the provisions take the form of a physically separate part of a contract or are made part of the contractual document itself, what their volume is, what typeface or font is used for them and what form the contract takes. Contract terms do not become standard business terms to the extent that they have been negotiated in detail between the parties.” translation by https://www.gesetze-im-internet.de/englisch_bgb/englisch_bgb.html#p0915, last visited 1 April 2018.

¹¹⁹⁵ See also Reinicke and Tiedtke, 2008, p. 217.

¹¹⁹⁶ Reinicke and Tiedtke, 2008, p. 217; Reinicke and Tiedtke, 2008, p. 218.

¹¹⁹⁷ Rott, 2010, pp. 269–270.

¹¹⁹⁸ Reinicke and Tiedtke, 2008, p. 218.

¹¹⁹⁹ Rott, 2010, pp. 269–270.

¹²⁰⁰ Reinicke and Tiedtke, 2008, p. 219.

¹²⁰¹ Reinicke and Tiedtke, 2008, p. 221.

¹²⁰² Reinicke and Tiedtke, 2008, pp. 221–222.

¹²⁰³ Reinicke and Tiedtke, 2008, pp. 219–220; Reinicke and Tiedtke, 2008, p. 217; Knops, 2017, p. 1321; Rott, 2010, pp. 254; 269; Bülow, 2007, pp. 317; 323; Zantow and Dinauer, 2011, p. 161.

Surprising standard terms can also be struck out (§ 305c (1) BGB). Courts have, in this context, held that standard terms that turn the suretyship liability into a '*Globalbürgschaft*' (terms that extend the suretyship liability to all current and future debts of the principal debtor towards the creditor, not just to the loan granted at that moment) are not allowed. The surety probably has an idea of his liability under the suretyship, based on the amount of the loan extended to the principal debtor at that moment (if that is indeed the context in which a suretyship was requested, which will often be the case). Standard terms that extend the suretyship to other liabilities would be surprising to the surety.¹²⁰⁴ The test whether a clause was surprising to the surety, has a strong subjective element.¹²⁰⁵ If the surety was not surprised, for example because he did not have a different idea about his liability, or because the creditor had specifically explained that liability extended to all debts, the term is not surprising.¹²⁰⁶ *Globalbürgschaft* is generally not held to be surprising for shareholders when guaranteeing a debt of 'their' company.

Standard terms that extend suretyship to 'all debts' can under circumstances also be struck out based on § 307 BGB. Such extension can unduly burden the guarantor, which would be contrary to good faith, thus ineffective pursuant to § 307 (1) BGB.¹²⁰⁷ The test is more objective in this case: irrelevant of what the guarantor believed, it has to be transparent to which liabilities of the principal debtor the suretyship extends.¹²⁰⁸ § 307 BGB in principle also applies to commercial suretyships, but global guarantees (suretyship for all debts) are generally held to be effective against managing directors, sole proprietors or majority shareholders for liabilities of their company.¹²⁰⁹ The idea behind not applying § 305c (1) BGB and § 307 (1) BGB to the situation of a shareholder or director guaranteeing all company debts is that the shareholder and director are deemed to be able to have insight in and influence over the extent of the debt of the company towards the creditor, and thus do not need protection.¹²¹⁰

3.6 Protection of the spouse

Spouses do not enjoy specific protection under German law, other than the protection offered by the case law on immoral suretyship when they stand surety themselves, protecting against suretyship with a gross disproportionality between their financial ability and the suretyship liability.¹²¹¹ They are however not specifically protected against the possible consequences of an over-burdening suretyship of their spouse.

¹²⁰⁴ See further Rösler, Mackenthun and Pohl, 2002, pp. 842–844; 853; Reinicke and Tiedtke, 2008, pp. 225–226.

¹²⁰⁵ Knops, 2017, p. 1289.

¹²⁰⁶ Knops, 2017, pp. 1289–1290; Piekenbrock and Ludwig, 2016, p. 54.

¹²⁰⁷ Reinicke and Tiedtke, 2008, pp. 226–228.

¹²⁰⁸ Knops, 2017, p. 1290.

¹²⁰⁹ Knops, 2017, p. 1290, with reference to case law.

¹²¹⁰ Knops, 2017, p. 1291.

¹²¹¹ See also Rott, 2010, pp. 269–270.

3.7 Protection through bankruptcy law

The creditor with a claim on a surety can also submit this claim in the insolvency proceedings of a surety, even when the principal debt is not yet due (see § 38 and 41 Insolvenzordnung (InsO)).¹²¹² A surety that is liable for a large amount is somewhat protected by the protection that bankruptcy law offers against life-long over-indebtedness, by discharging debts under certain conditions.¹²¹³ The granting of a fresh start is however not self-evident under German law and it will in any case take a very long time before such a fresh start is granted, if it is. Article 1 InsO directly sets the tone by stipulating that only *honest* debtors are offered a fresh start:¹²¹⁴

*„(...) Dem redlichen Schuldner wird Gelegenheit gegeben, sich von seinen restlichen Verbindlichkeiten zu befreien.“*¹²¹⁵

The procedure can briefly be described as follows. The debtor first has to try to work out a repayment plan with his creditors. If this fails, he has to produce a certificate signed by a relevant authority that an unsuccessful attempt to settle the debts out of court has been made.¹²¹⁶ This certificate is one of the preconditions to be allowed in the procedure (§ 305 (1) 1 InsO). The debtor also has to produce a record of income, assets and debts (§ 305 (1) 3 InsO). The court performs, shortly put, a sort of good faith test, both on the behavior of the debtor in the past years and on the list of income, assets and debts (§ 290 InsO).

If the debtor is allowed entry, a six (!) year period starts,¹²¹⁷ in which the debtor basically works for his creditors (§ 287 (2) InsO). Any income, if any, above a certain threshold will be used to pay creditors in this six-year period. Only after that period, a fresh start is granted. Subject to certain conditions stipulated in § 300 InsO, the debtor may however be granted a fresh start after three (this does not happen often due to the strict conditions) or five years (this is more common). The debtor has various obligations during this period, stipulated in § 295 InsO, including the obligations to be employed or seek employment; to transfer half the value of any property acquired by way of succession to the administrator, or half the value of his possible future status as heir; to keep trustee and court informed of relevant circumstances and to provide all payments to the administrator and not to individual creditors.

The long period of six years makes, according to some, little sense. On the one side, those debtors that have just gone bankrupt because of some economic shock do not need six years to show their good conduct or resocialization, whereas those individuals with more structural problems are usually also not helped by it.¹²¹⁸ Because of the long period of six years and the strict requirements both regarding access to the proceedings and regarding behavior during the proceeding, the ‘protection’ that bankruptcy law offers against over-indebtedness because of guarantee obligations is very limited.

¹²¹² Rott, 2010, p. 270.

¹²¹³ See extensively Vallender, 2015

¹²¹⁴ See also Piekenbrock and Ludwig, 2016, p. 106, who also mentions that this is the only occurrence of ‘honest’ in the insolvency statute.

¹²¹⁵ Translation: “*Honest debtors shall be given the opportunity to achieve discharge of residual debt.*” translation by https://www.gesetze-im-internet.de/englisch_inso/englisch_inso.html#p0013, last visited on 1 April 2018.

¹²¹⁶ See extensively on the out of court settlement Lechner, 2011.

¹²¹⁷ See also Vallender, 2015, p. 1062

¹²¹⁸ See extensively Killborn, 2004.

3.8 Summary of German law on opportunism With the internal relationship

Although the famous German case law on immorality of suretyship offers extensive protection to certain (particularly family-) sureties, this case law has limited relevance for guarantees in the context of corporate finance. Shareholders and directors that guarantee corporate debt are not specifically protected. Some specific areas of law that may offer some protection to the surety have furthermore been discussed. Of relevance can be consumer credit law, doorstep sales law and unfair terms control, which may in specific cases extend to shareholders or directors that guarantee corporate debts.

4 German law on opportunism towards parties outside the guarantee relationship

Until this point, only the relations between the parties in the guarantee relationship, being the creditor, the principal debtor and the guarantor, have been discussed. Generally, in scholarly discussions on the guarantee relationship, the focus is primarily on these relations. Guarantees can however, as has been extensively described in chapter 3 paragraph 3, also influence the positions of outsiders. This chapter examines the current regulation under German law of such influence on outsiders and the protection of the interests of these outsiders against possible opportunistic use of the guarantee relationship by insiders.

Chapter 3 paragraph 3 identified various types of opportunistic behavior with guarantees towards outsiders in two categories: opaque priority structures (*ex ante* opportunism) and covert insider dealing (*ex post* opportunism). Taking these types of opportunistic behavior as a starting point, or in comparative law terms as *tertium comparationis*, German law will be discussed.

The discussion will mostly focus on the context of financing of closely held corporations, because guarantees by shareholders or group companies are by far most common in this setting. Some reference will be made to the setting of public companies, especially where indirectly relevant to the closely held corporation.

4.1 Regulatory approaches to Opaque priority structures (ex ante opportunism)

Guarantees can serve as a device instrumental in creating a structure in which one creditor or insider guarantor has priority over another creditor, especially in the context of corporate finance. In essence, guarantees can be used as a functional equivalent to real security rights by creating a perforated limited liability shield. This is not directly apparent, because it seems that the guaranteed creditor has recourse to an alternative source of payment with the guarantee and thus is not prioritized above other creditors of the debtor, but when one zooms out from the

entity level, the priority granted by guarantees and the externalities that come with it in the context of corporate finance, become apparent.

Chapter 3 paragraph 3.1 discussed whether such priority structures could as such be justified as efficient. Although guarantees can certainly perform efficient functions by preventing asset stripping, the analysis also showed that such piercing guarantees lead to various inefficient dynamics. It was concluded from the analysis of the literature on the efficiency of limited liability that the efficiency case for limited liability in small companies and within corporate groups is generally weak and even weaker when guarantees are used to selectively pierce the limited liability shield. Legal systems should thus be wary of such contractually perforated shields. Also the analysis of the literature on the efficiency of secured credit has shown that the efficiency case for guarantees piercing a limited liability shield is weak. Justification of secured credit based on efficiency grounds is already very problematic and the efficiency case for the priority that guarantees grant is even more problematic, as such priority is often more covert and thus misleading and deceptive. This paragraph will discuss to which extent German law upholds such perforated limited liability structures.

Three regulatory approaches by which a legal system could address the inefficiencies created by pierced limited liability structures as such will be discussed: (1) not upholding limited liability ('tearing down the walls'), (2) not upholding the guarantee itself; (3) subordinating loans guaranteed by shareholders (somewhat reinforcing the walls, though only to protect the patrimony of the debtor) and (4) disallowing double proof (again, somewhat reinforcing the walls). To which extent German law adopts these approaches is discussed below in the aforementioned order.

4.1.1 Annulling limited liability

To recall, chapter 3 paragraph 3.1.2 discussed that incorporation combined with a guarantee that pierces the limited liability shield (or entity shield) that incorporation creates is hard to justify theoretically from the policy arguments that support limited liability. In essence, such a combination of incorporation and a piercing guarantee allows the guaranteed creditor and guarantor together to use limited liability of the debtor as a shield against non-guaranteed creditors. Such a shield cannot be justified from the arguments generally supporting limited liability. This paragraph analyzes to what extent German law has any sensitivity to these dynamics or addresses the problems identified by tearing down the limited liability walls under certain circumstances.

a) *Veil-piercing under statutory group law (Konzernrecht)*

German law is famous for its highly regulated and extensively codified approach to corporate groups.¹²¹⁹ This regime is codified in the *Aktiengesetz* (AktG) and applies to the *Aktiengesellschaft* (AG, the German type of a publicly owned corporation). The *Aktiengesetz* provides some regulation for the case in which one entity (which could take any form) controls an AG. In such a case, the *Aktiengesetz* qualifies the entities together as a *Konzern* (§ 17 and 18

¹²¹⁹ Lechner, 2011; compare also Hopt, 2015, p. 9; Tröger, 2014, pp. 4–5.

AktG). A distinction is made between control on a contractual basis (the contractual *Konzern*) and control on a circumstantial basis (defacto *Konzern*).¹²²⁰

Two types of contracts are distinguished in relation to the contractual *Konzern*, the domination agreement (*Beherrschungsvertrag*) and the profit transfer agreement (*Gewinnabführungsvertrag*) (§ 291 AktG). Simply put, the first allows the controlling entity to give instructions to the controlled AG, the second entitles it to the profits. In return, the creditors and minority shareholders of the controlled AG are protected through the provision in 302 AktG which stipulates that the controlling entity's obligation should compensate for net losses of the controlled entity, and through the provision in § 303 AktG which stipulates that the controlling entity should keep up a reserve for payments to be made. When the domination or profit transfer agreement is ended, the dominating company has to provide security or a guarantee to the current creditors (§ 303(3) AktG).¹²²¹ Though the rules are complex, one could thus, somewhat simplifying, state that the dominating entity in a contractual *Konzern* should answer for risks of the creditors of the dominated AG (compare also Bülow, p. 360-361). It should be noted that contractual groups are rare in practice.¹²²²

The obligation to answer for risks of the creditors does to a lesser extent also exist in the defacto *Konzern*.¹²²³ The existence of such a group is not based on a contract, but on the simple fact that a majority shareholder has control over an AG through shareholder and voting rights (§ 16 AktG).¹²²⁴ The controlling entity is prohibited from inducing measures that would disadvantage the controlled entity or, if it does take or induce such measures, it should fully compensate the controlled entity (§ 311 AktG). The controlled entity itself, the shareholders and creditors (under certain conditions) can each sue the controlling entity to provide such compensation to the controlled entity (§ 309 and § 317 AktG).

Both in a contractual concern and in a de facto *Konzern* the corporate veil is essentially pierced extensively, which effectively neutralizes the opaque priority structure that a guarantee to a single creditor can create. The German statutory *Konzernrecht* is thus effective in addressing the problems with opaque priority structures with guarantees, as identified in chapter 3.

The detailed rules in the *Aktiengesetz* however only apply in as far as the controlled entity is an AG (the identity of the controlling entity does not matter). Case law has in the past, under certain circumstances, applied some of the rules to the situation in which the controlled entity is a private company (GmbH), but courts have abandoned this approach. Application of *Konzernrecht* to a contractual GmbH *Konzern* is not controversial,¹²²⁵ but also not that relevant in practice as the upsides of creating such a contractual *Konzern* are limited in practice¹²²⁶ and contractual groups are rare in practice.¹²²⁷ More relevant is the question whether the rules on the *Konzern* can also be applied to the situation in which the controlled entity is a GmbH and no contractual concern has been created. Courts have held this to be the case in the past, such as in the famous *Autokran* case,¹²²⁸ though only under certain circumstances (mainly relating to the intensity of

¹²²⁰ Miller, 1998, p. 83; Hopt, 2015, p. 10.

¹²²¹ See also Tröger, 2014, pp. 6–7.

¹²²² Rösler, Mackenthun and Pohl, 2002, p. 867.

¹²²³ Hopt, 2015, p. 10.

¹²²⁴ Rösler, Mackenthun and Pohl, 2002, pp. 869–870.

¹²²⁵ Tröger, 2014, p. 7 fn 22; Wooldridge, 2010, p. 22.

¹²²⁶ Bülow, 2007, pp. 361–362.

¹²²⁷ Wooldridge, 2010, p. 22.

¹²²⁸ BGH, 16 September 1985 - II ZR 275/84.

control that the shareholder had over the GmbH),¹²²⁹ but have since abandoned applying the *Aktiengesetz* to controlled GmbH's.¹²³⁰ In *Bremer Vulkan*¹²³¹ the BGH held, put shortly, that the *Konzernrecht* is no ground for holding shareholders of a GmbH liable for debts of the GmbH.¹²³² With that decision the BGH has moved away from liability only connected to control and independent of fault to a fault-based liability for shareholders.¹²³³ Therefore, the opaque priority structures that can be created with guarantees are not addressed with the *Konzernrecht* as far as GmbH's are concerned.

b) Direct veil-piercing (Durchgriffshaftung)

Outside the statutory *Konzernrecht* and the (now abandoned) application by the German courts of that *Konzernrecht* to controlled GmbH's, veil-piercing (*Durchgriffshaftung*) can also be applied in cases which include factors such as commingling of assets, total domination and failure to follow formalities.¹²³⁴ Commingling of assets is the most relevant theory in the context of opaque priority structures with guarantees. As explained in chapter 2 paragraph 3.2, guarantees are, from the perspective of the professional lender that requests a guarantee from a shareholder, a solution to the problem of comingling of assets. At the same time, such a guarantee supports comingling, because the guaranteed creditor does not have much interest in monitoring for such comingling, exactly because of the guarantee. The simple use of guarantees by a parent for the debts of a subsidiary is under German law however not considered an important factor to support liability on a theory of comingling of assets. For veil-piercing on the basis of comingling of assets, the records and liabilities of a parent and subsidiary must be such a mess that the subsidiary can hardly be said to have its own separate identity.¹²³⁵

c) Shareholder tort liability for undercapitalization?

Could shareholders be held liable in tort for damage to other creditors as a result of setting up a structure, using shareholder guarantees for third-party loans, in which the guaranteed creditor enjoys a superior position? In itself, that would not suffice for shareholder liability, but shareholder liability grounded on a theory of undercapitalization would be relevant in this context, as indirect financing with guarantees may be instrumental in setting up an undercapitalized structure in which the main financier gets security inter alia through the guarantee, but the other creditors do not.

¹²²⁹ Hopt, 2015, p. 10; however, in the *Video* case, the BGH held such control to be present on the basis that the shareholder was the sole shareholder, see BGH, 23 September 1991 - II ZR 135/90 (*Video*).

¹²³⁰ Bülow, 2007, p. 362; Schmidt, 2015, pp. 1148–1150

¹²³¹ BGH, 17 September 2001 - II ZR 178/99.

¹²³² Wooldridge, 2010.

¹²³³ Schmidt, 2015, pp. 1148–1150; Compare Altmeyden and Roth, 2015, sec. 13 GmbHG nr 73.

¹²³⁴ Ziemons and Jaeger, 2014; Altmeyden and Roth, 2015, sec. 13 GmbHG nr 131 ff.

¹²³⁵ Presser, 2016, para. 5:9; Altmeyden and Roth, 2015, sec. 13 GmbHG nr 136; Presser, 2016, para. 5:9.

However, although the literature has often pleaded for liability of shareholders in case of material undercapitalisation,¹²³⁶ the BGH has never recognized such a theory of liability in general.¹²³⁷ In the *Gamma* case,¹²³⁸ the BGH held, put shortly, that undercapitalization as such does not constitute an offence by the shareholders.¹²³⁹ However, undercapitalization can still be a relevant aspect in the context of a tort claim by a creditor against the shareholder.¹²⁴⁰ If there is a qualified case of undercapitalization, in which the use of the corporation has harmed creditors in a special way, a tort claim may offer a solution.¹²⁴¹

In other words, if the corporation is setup in such a way that it is inherently loss-making at the expense of creditors and to the benefit of shareholders according to a pre-designed plan, tort liability of the shareholders because of undercapitalization can be accepted. This will however be hard to prove in practice, as such an assessment is strongly based on subjective criteria and can only be made under particularly grave circumstances. As discussed above, guarantees could be instrumental in such an undercapitalized structure. However, German (case) law or commentaries on German law do not clearly mention the use of guarantees as a directly relevant objective factor that has weight in this context.

In short, German law offers little possibility to challenge opaque priority structures with guarantees as such by annulling limited liability, but does offer some possibility to, with the use of tort law in combination with a theory of undercapitalization, challenge the most offensive priority structures that were undeniably designed to prejudice creditors. Such a determination is however strongly based on subjective criteria, which will be hard to prove in practice.

4.1.2 Not upholding the guarantee itself

An alternative legal response to tearing down the limited liability walls in order to address the inefficiencies of certain perforated limited liability structures is to reinstate the walls by not upholding the guarantee itself. In the German literature, there has especially been some attention to *upstream* guarantees (guarantees issued by a subsidiary for debts of a parent) or other upstream security rights in this context. Upstream security can under circumstances arguably lead to the conclusion that the subsidiary has been extorted, which could make the contract of guarantee unlawful in the sense of § 134 BGB.¹²⁴² Outside extreme circumstances, this will however usually not be unlawful, especially not when the subsidiary profits directly or indirectly from the credit granted to the parent.¹²⁴³ It has also been argued that the creditor could have acted against good morals in the sense of § 138 BGB if security has been granted to that creditor to an extent that is at odds with § 30 GmbHG on capital requirements. Again, this will generally not be considered against good morals in the sense of § 138 BGB and the literature is even divided on the question whether this such a liability should exist at all.¹²⁴⁴

¹²³⁶ See for an overview of the discussion for example Ziemons and Jaeger, 2014.

¹²³⁷ Altmeppen and Roth, 2015, sec. 13 GmbHG nr 142 ff; Schmidt, 2015, p. 1148

¹²³⁸ BGH 28 April 2008, II ZR 264/06 (*Gamma*), par. 22-25.

¹²³⁹ See also Altmeppen and Roth, 2015, sec. 13 GmbHG nr 144.

¹²⁴⁰ Ziemons and Jaeger, 2014.

¹²⁴¹ Altmeppen and Roth, 2015, secs 13 GmbHG nr 144-145.

¹²⁴² Oostrum, 2019, pp. 290–291

¹²⁴³ See extensively Möller, 2015, pp. 38–46. See also Oostrum, 2019, pp. 289–291.

¹²⁴⁴ Möller, 2015, pp. 43–46; c

Thus, the guarantee itself will usually not be void and receiving the guarantee will not constitute behaviour against good morals by the creditor. However, upstream or cross-stream security can be at odds with § 30 GmbHG on capital requirements,¹²⁴⁵ which can lead to shareholder liability (§ 31 GmbHG) or director liability (§ 43(3) GmbHG). Moreover, issuing upstream or cross-stream security could under circumstances qualify as a payment to a shareholder which could lead to director liability in the sense of § 64 third sentence GmbHG.¹²⁴⁶

“ (...) Die gleiche Verpflichtung trifft die Geschäftsführer für Zahlungen an Gesellschafter, soweit diese zur Zahlungsunfähigkeit der Gesellschaft führen mussten, es sei denn, dies war auch bei Beachtung der in Satz 2 bezeichneten Sorgfalt nicht erkennbar.(...)”¹²⁴⁷

This does not lead to invalidity of the guarantee ex post, but could of course lead to shareholders or directors deciding not to (influence the subsidiary to) issue guarantees at all or limiting such guarantees to stay within the boundaries of § 30 GmbHG and § 64 GmbHG and is thus relevant in the context of this paragraph on regulation of opaque priority structures. Indeed, parties often seem to limit guarantees to stay within the boundaries of § 30 GmbHG and § 64 GmbHG.¹²⁴⁸

Not entirely clear is when upstream or cross-stream guarantees are at odds with § 30 GmbHG and § 64 GmbHG, more specifically at which moment this should be measured.¹²⁴⁹ If, at the moment of issuing the guarantee, it is already clear that claiming on the guarantee by the creditor would inevitably lead to problems in terms of § 30 GmbHG, the guarantee is rather obviously problematic. Often this would on paper be remedied by the recourse the guarantor has on the debtor or on other guarantors. However, as extensively discussed in chapter 3 paragraph 3.1.4, such recourse is often illusory as the fate of the guarantor as a subsidiary will usually be highly correlated with the fate of the parent or shareholder (and other group companies).

Because of the often correlated fate between guarantor and debtor in a group, the guarantor will often be called on to pay when insolvent. The question then becomes what relevance can be attached to § 30 GmbHG in insolvency. Can a director be liable for payments made on the guarantee when the GmbH was already insolvent? The fact that the insolvency trustee makes this payment could lead to a negative conclusion, though the insolvency trustee is simply bound by the guarantee that was issued before insolvency by the director(s) representing the GmbH. Arguably, the directors therefore ‘made’ this payment. The case law however seems to point in the direction that director liability would not be possible for such payments after insolvency.¹²⁵⁰

In short, though German law is somewhat unsettled on the issue, the rules on capital requirements (§ 30 GmbHG) and director liability for payments to shareholders (§ 64 GmbHG) certainly seem to influence the use of guarantees in opaque priority structures. If guarantees for group debts lead to payments by the GmbH that are at odds with § 30 GmbHG or § 64

¹²⁴⁵ Möller, 2015, p. 118

¹²⁴⁶ See extensively Möller, 2015, pp. 47–234; See on § 64 GmbHG more generally Schmidt, 2015, p. 1109 ff; see on § 64 third sentence GmbHG Schmidt, 2015, p. 1152 ff

¹²⁴⁷ Translation: *“The same obligation shall affect the directors in regard to payments to shareholders if these led to the company becoming illiquid, unless this was not recognisable whilst observing the due care referred to in the second sentence.”*, translation by: https://www.gesetze-im-internet.de/englisch_gmbhg/englisch_gmbhg.html#p0416, last visited on 1 April 2018.

¹²⁴⁸ Oostrum, 2019, pp. 305–306

¹²⁴⁹ Oostrum, 2019, pp. 299–301; 306–307

¹²⁵⁰ See Oostrum, 2019, pp. 306–307, with reference to case law of the OLG Frankfurt am Main.

GmbHG, directors can under circumstances be liable, though maybe not when these payments are only made when insolvent. Because of this liability risk, recourse under guarantees for group debts are in practice often limited to stay within the boundaries of § 30 GmbHG and § 64 GmbHG.

4.1.3 Subordinating claims guaranteed by shareholders

Shareholders often finance the companies they hold shares in with loans. Such shareholder loans are an alternative to providing share capital. By financing with loans instead of share capital, a shareholder may be able to substantially or even fully reduce his share capital investment in the company, whilst still providing the company with the necessary funds. Using such loans instead of share capital may have various reasons, such as tax benefits, but also simply to limit downside risks for the shareholder. An indirect way for the shareholder to provide such a loan could be to get a third person to provide the loan and to guarantee the loan towards the third person, possibly even backed by real security rights provided by the shareholder to the third person. This can be referred to as an indirect shareholder loan. Again, this can be an alternative to providing share capital. If the legal system qualifies such constructions as (equivalent to) shareholder loans and subordinates the loan of the outsider creditor to other claims in the bankruptcy proceedings of the debtor, the opaque priority structure created by a combination of incorporation and the guarantee is weakened somewhat, though not completely. The creditor still has an alternative source of collection (the guarantor's patrimony), but is somewhat limited from claiming directly on the debtor in the bankruptcy of the debtor, by which the other creditors of the debtor are somewhat protected. In other words: the pierced limited liability walls would be somewhat reinforced by subordinating claims guaranteed by shareholders. See extensively on these dynamics chapter 3 paragraph 3.1.5. Does German law take such an approach?

German law has detailed rules on shareholder loans. § 39(1) nr 5 InsO treats shareholder loans generally as subordinate to other claims in insolvency in as far as the shareholder holds more than 10% of the shares (or holds less and is a managing-partner) (§ 39(5) InsO) and the shares were not obtained in a rescue operation (§ 39(4) InsO).¹²⁵¹ An indirect participation can also count in this context and the BGH seems keen to interpret this broadly.¹²⁵² This strict treatment of shareholder loans is flanked by the rules on loans by third persons that are guaranteed by shareholders.¹²⁵³ Without such rules, the rules on shareholder loans could too easily be evaded. A central place in that regime is taken by § 44a InsO:

In dem Insolvenzverfahren über das Vermögen einer Gesellschaft kann ein Gläubiger nach Maßgabe des § 39 Abs. 1 Nr. 5 für eine Forderung auf Rückgewähr eines Darlehens oder für eine gleichgestellte Forderung, für die ein Gesellschafter eine Sicherheit bestellt oder für die

¹²⁵¹ See extensively on this regime for example Laspeyres, 2014; Koutsós, 2011; Ziemons and Jaeger, 2014.

¹²⁵² BGH 15 November 2018, ZIP 2019/182; see also Strothmann, 2019, p. 40.

¹²⁵³ Also, the recourse claim of a non-shareholder third-party guarantor that has guaranteed a shareholder loan is given the same rank as a shareholder loan, see Nikolas T. Koutsós, 2017.

*er sich verbürgt hat, nur anteilmäßige Befriedigung aus der Insolvenzmasse verlangen, soweit er bei der Inanspruchnahme der Sicherheit oder des Bürgen ausgefallen ist.*¹²⁵⁴

In essence, this provision stipulates that a claim guaranteed by a shareholder of the bankrupt company (or for which the shareholder provided real security rights) can only be submitted in the insolvency proceedings in as far as the guarantee falls short or recourse against the guarantor fails. After paying the creditor in full, the shareholder could in theory submit his recourse claim in the insolvency proceedings (§ 91 InsO does not preclude this, as long as the legal relationship from which the recourse claim flows already existed before insolvency),¹²⁵⁵ but this recourse claim is subordinated pursuant to art. 39(1) nr. 5 InsO.¹²⁵⁶ The rule can be understood as part of the set of rules that limits pari-passu ranking of shareholder loans in insolvency: a guarantee by a shareholder is seen as an indirect shareholder loan.¹²⁵⁷ § 44a InsO also applies to debts secured with guarantees of subsidiary nature, even when the subsidiary nature is explicitly stipulated by the contract of guarantee.¹²⁵⁸ § 44a InsO is mandatory law.¹²⁵⁹ Interestingly, bankruptcy of the principal debtor thus fully reverses the subsidiary nature, *de facto* making the claim on the principal debtor subsidiary to the claim on the guarantor. Shareholder guarantees can thus be characterised by *reversed subsidiarity*.

However, pursuant to case law on the precursor to § 44a InsO (32a GmbHG)¹²⁶⁰ the rule only applies to *personal* claims of the creditor on the principal debtor. The creditor is, according to this interpretation, not barred from asserting real security rights against the bankrupt principal debtor.¹²⁶¹ German law thus protects a professional creditor such as a bank somewhat from adverse effects of the enforcement of the strict rules on indirect shareholder loans: the shareholders themselves are primarily addressed.¹²⁶² There has been some discussion on the application of the old case law in the context of art. 32a GmbHG to the new § 44a InsO. Some have argued, inter alia based on the goal and spirit of the *Gesetz zur Modernisierung des GmbH-Rechts und zur Bekämpfung von Missbrauchen* (MoMiG), that § 44a InsO should be analogously applied to the situation in which the creditor has both obtained real security rights from the principal debtor (the corporation) and real or personal security rights from its shareholders, in such a way that the creditor would be required to first pursue the real or personal security

¹²⁵⁴ Translation: “In the insolvency proceedings concerning the assets of a company, a creditor may, in accordance with section 39 subsection (1) no. 5, only request proportionate satisfaction from the insolvency estate for a claim for restitution of a loan or for a claim of equal rank for which a partner has provided security or for which he is liable as guarantor insofar as he is no longer able to claim the security or to be liable as guarantor.” translation by https://www.gesetze-im-internet.de/englisch_inso/englisch_inso.html#p0250, last visited on 1 April 2018.

¹²⁵⁵ Nikolas T. Koutsós, 2017.

¹²⁵⁶ Holzmann, 2016; Hess, 2012, sec. 44a InsO; Piekenbrock and Ludwig, 2016, p. 165; Andres, Dahl and Leithaus, 2014, p. 171.

¹²⁵⁷ Uhlenbruck and Hirte, 2010, sec. 44a InsO nr 1.

¹²⁵⁸ Nerlich, Römermann and Abeltshauser, 2017, sec. 44a InsO.

¹²⁵⁹ Piekenbrock and Ludwig, 2016, p. 164.

¹²⁶⁰ § 32a GmbHG was rescinded and replaced by § 44a InsO in the MoMiG, see RegE Momig.

¹²⁶¹ BGH, 25 November 1985 - II ZR 115/85; Uhlenbruck and Hirte, 2010, sec. 135 InsO nr 17; Meyer-Landrut *et al.*, 1987, p. 359; Piekenbrock and Ludwig, 2016, p. 164; Andres, Dahl and Leithaus, 2014, p. 171; Jianan Yu, 2017, p. 161; Koutsós 2017, p. 978; see for criticism Georg, 2011, p. 205.

¹²⁶² Müller and Rautmann, 2012, p. 192; Piekenbrock and Ludwig, 2016, p. 164; Benjamin Schilpp, 2017, p. 70.

rights granted by the shareholders.¹²⁶³ The BGH has however not followed this approach so far.¹²⁶⁴

If the creditor indeed chooses to pursue his real security rights granted by the bankrupt principal debtor and if this would be deemed allowed, the insolvency administrator will have recourse to the shareholder-guarantor pursuant to analogous application of § 135(2) and 143(3) InsO (see for a further discussion of §§ 135 and 143 InsO paragraph 4.2.1 below).¹²⁶⁵

Another point of discussion has been the treatment of security for subordinated shareholder loans and the derivative issue of treatment of security for subordinated recourse claims (either subordinated because the recourse creditor is a shareholder as defined in § 39 (1) nr 5 and (4) and (5) InsO or because the claim of the main creditor was subordinated pursuant to that provision).¹²⁶⁶ Under the old law before the MoMiG it was unanimously agreed that security rights for subordinated shareholder loans were not enforceable, even without the insolvency administrator having to rely on transaction avoidance to avoid such security rights.¹²⁶⁷ Thus, also security rights granted outside the ten-year period for transaction avoidance of security rights for shareholder loans (§ 135(1) nr. 1 InsO) were not enforceable. Since the introduction of the MoMiG, the opinion on whether security rights for shareholder loans can be enforceable has been somewhat split, some regard these as enforceable as long as they were granted outside the ten-year period of § 135 (1) nr. 1 InsO,¹²⁶⁸ others argue enforceability should be denied.¹²⁶⁹ The same would apply to security granted for subordinated recourse claims.¹²⁷⁰

There has also been some discussion around the question of the applicability of § 142 InsO to security given for shareholder loans. § 142 InsO stipulates (shortly put) that if the property of the debtor directly benefitted from consideration given for a performance by the debtor and there is a close temporal connection between this benefit and the performance, the performance by the debtor can only be attacked by relying on § 133 InsO (willful disadvantage, see further on § 133 InsO paragraph 4.2.1 below). This can be compared to the safe harbour that US preference law grants to transfers for ‘substantially contemporaneous exchange’. Generally, security rights granted at the time a loan is advanced will profit from the safe harbor of § 142 InsO.¹²⁷¹ If at the start of a shareholder loan the shareholder is granted security rights, one may thus at first sight deem § 142 InsO applicable. This has also been defended by some in the literature, whilst others have held that § 142 InsO should not apply to security for shareholder loans.¹²⁷² The BGH has meanwhile decided that § 142 InsO is not applicable to the situation in which the shareholder

¹²⁶³ Jianan Yu, 2017, p. 158; Hess, 2012, sec. 44a InsO; Müller and Rautmann, 2012, pp. 190–192; Nerlich, Römermann and Abeltshauser, 2017, sec. 135 InsO par 51; Nikolas T. Koutsós, 2017, p. 978 also for more references.

¹²⁶⁴ Uhlenbruck and Hirte, 2010, secs 44a InsO nr 7–8; Müller and Rautmann, 2012, pp. 190–192.

¹²⁶⁵ Uhlenbruck and Hirte, 2010, secs 44a InsO nr 7–8); BGH, 1 December 2011, IX ZR 11/11; Gotthard 2014, p. 84-85; Hess, 2012, sec. 44a InsO; Piekenbrock and Ludwig, 2016, p. 164; Jianan Yu, 2017, p. 161; Georg, 2011, p. 205; Müller and Rautmann, 2012, p. 190; Andres, Dahl and Leithaus, 2014, p. 171.

¹²⁶⁶ Nerlich, Römermann and Abeltshauser, 2017, sec. 135 InsO par 51.

¹²⁶⁷ Holzmann, 2016.

¹²⁶⁸ Holzmann, 2016.

¹²⁶⁹ Brinkmann, 2017, p. 724 ff

¹²⁷⁰ Nikolas T. Koutsós, 2017, pp. 975–976.

¹²⁷¹ Brinkmann, 2017, p. 719

¹²⁷² See for an overview of the debate Brinkmann, 2017, pp. 719–724; See also Bitter, 2019, at footnote 2.

gets security in return for a shareholder loan, because application would not be in line with the sense and purpose of this article.¹²⁷³

§ 39 (1) nr 5 InsO also applies to loans, and § 44a InsO to guarantees for loans that can be equated with shareholder loans.¹²⁷⁴ There has been some discussion around the question which parties could be qualified as equivalent to a shareholder in this context.¹²⁷⁵ To qualify as a party that can be equated to a shareholder one should focus on who participates in and has a say over the (enjoyment of) assets and earnings, directly or indirectly.¹²⁷⁶ Such parties could include indirect shareholders and other persons that effectively control the company.¹²⁷⁷ An unconnected third-party lender could theoretically also qualify as such, but usually would not have sufficient control over the corporation.¹²⁷⁸ In any case, indirect shareholders with sufficient control,¹²⁷⁹ horizontal connections in which the same shareholder has sufficient control in both,¹²⁸⁰ trustees and usufructuaries can qualify as such.¹²⁸¹ Important to note is that family members or other relations of shareholders can, in the context of § 39 (1) nr 5 InsO, not be equated with shareholders on the basis of their (family) relationship as such, but only if they are in economic terms also equivalent to a shareholder of the company.¹²⁸² § 138 InsO cannot be applied analogously to the interpretation of art. 39 par 1 nr 5 InsO (see further on § 138 InsO paragraph 4.2.1 below).¹²⁸³

Because of this limited conception of parties that can be equated with shareholders, some dubious arrangements may still be able to escape scrutiny. See for example Gotthard, explaining that the spouse of a shareholder could guarantee the loan, thus possibly escaping application of § 44a Inso and § 39 (1) nr 5 InsO.¹²⁸⁴

Although equal treatment or even priority of an indirect shareholder loan is thus not entirely ruled out, German law generally treats indirect shareholder loans as at least indirectly and partially subordinated, thus weakening, though not fully, the opaque priority structure that can be created using a combination of incorporation and a guarantee. Notable is that the rules on subordination of indirect shareholder loans are set up in such a way that the priority position of the creditor through the guarantee structure is not or at most minimally affected, whereas the position of the shareholder is strongly affected.

4.1.4 Disallowing Double proof

Chapter 3 paragraph 3.1.4 discussed the opaque priority structure created by the mechanism of double proof with guarantees. Double proof occurs when a creditor is able to make more than

¹²⁷³ BGH, 14 February 2019 – IX ZR 149/16, ZIP 2019, 666; see also Bitter, 2019

¹²⁷⁴ Holzmann, 2016; Majic, 2013, p. 70; Georg, 2011, pp. 188–189.

¹²⁷⁵ Nikolas T. Koutsós, 2017, pp. 958–959.

¹²⁷⁶ Georg, 2011, pp. 188–189; Barth, 2001, pp. 92–93.

¹²⁷⁷ Nikolas T. Koutsós, 2017, pp. 958–959.

¹²⁷⁸ Wackerbarth and Eisenhardt, 2013, p. 115.

¹²⁷⁹ Nikolas T. Koutsós, 2017, pp. 959–962.

¹²⁸⁰ Nikolas T. Koutsós, 2017, pp. 962–963.

¹²⁸¹ Nikolas T. Koutsós, 2017, p. 963; Georg, 2011, p. 189.

¹²⁸² Nikolas T. Koutsós, 2017, p. 963.

¹²⁸³ Nikolas T. Koutsós, 2017, p. 965.

¹²⁸⁴ Gotthardt, 2014, p. 99.

one claim in relation to a single debt. Double proof (or: ‘double dipping’) can, especially in the context of corporate groups, have the effect of ‘squeezing down’ ordinary creditors.¹²⁸⁵ The opaque priority position created by a combination of incorporation and a guarantee is thus given a further boost. This paragraph discusses to which extent German law allows double proof. Of course the problem of double proof would not occur if either limited liability would not be upheld (see on the possibilities, paragraph 4.1.1 above) or the guarantee would not be upheld (paragraph 4.1.2 above). As we shall see, the question whether double proof is allowed is, as far as shareholder guarantees are concerned, related to the question addressed above on pari-passu ranking of indirect shareholder loans.

Art. 43 InsO allows strong form double proof in general. The only limit is that the creditor may not receive more than 100% of his claim.¹²⁸⁶

“Ein Gläubiger, dem mehrere Personen für dieselbe Leistung auf das Ganze haften, kann im Insolvenzverfahren gegen jeden Schuldner bis zu seiner vollen Befriedigung den ganzen Betrag geltend machen, den er zur Zeit der Eröffnung des Verfahrens zu fordern hatte.”¹²⁸⁷

As already discussed from another perspective, German law only limitedly allows double proof in one important other category: shareholder guarantees. A creditor with shareholder guarantees should first pursue the shareholder according to the rule laid down in § 44a InsO. Unclear is so far however whether a creditor that receives partial satisfaction from the shareholder can still share in the insolvency proceedings of the principal debtor on the basis of his full claim, or only on the basis of his deficiency claim.¹²⁸⁸ Most commentaries seem to assert that the creditor can share in the proceedings on the basis of his full claim, because the goal of § 44a InsO would, in that view, not entail weakening the position of the third-party creditor, but this is not entirely clear.¹²⁸⁹ Even if the creditor can only share on the basis of a deficiency claim (which does not seem to be the majority opinion), double proof is not ruled out completely. In case of various bankrupt co-guarantors, the creditor would still be allowed to double proof the deficiency claim.

Other relevant mechanisms, already discussed in paragraph 4.1.2 above, are § 30 GmbHG and the liability of directors connected to this and § 64 GmbHG. As discussed in that paragraph, this may push directors to withstand large guarantees for group debts or to limit such guarantees to the limits of § 30 GmbHG and § 64 GmbHG. Arguably, this somewhat limits the problem of double proof, though not by addressing double proof directly but by leading to less or smaller guarantees for group debts.

¹²⁸⁵ See extensively chapter 3, paragraph 3.1.1.

¹²⁸⁶ See the text of § 43 InsO, see also Kronfeld, 2012; Reinicke and Tiedtke, 2008, p. 215.

¹²⁸⁷ Translation: “A creditor holding claims against several persons for the whole of one single payment may file the full amount in insolvency proceedings against any debtor until he is fully satisfied if he had a claim to such full amount on the date when the insolvency proceedings were opened.” translation by: https://www.gesetze-im-internet.de/englisch_inso/englisch_inso.html#p0245 , last visited on 1 April 2018.

¹²⁸⁸ Piekenbrock and Ludwig, 2016, p. 106; Nerlich, Römermann and Abeltshauser, 2017, sec. 44a InsO; Andres, Dahl and Leithaus, 2014, p. 170, also for references to sources.

¹²⁸⁹ Uhlenbruck and Hirte, 2010, sec. 44a InsO nr 1; Nerlich, Römermann and Abeltshauser, 2017, sec. 44a InsO.

4.1.5 Summary of German law on opaque priority structures with guarantees

This section discussed how German law deals with opaque priority structures with guarantees. Notable in this context is firstly the German statutory group law (*Konzernrecht*), which effectively deals with some of the problems associated to guarantees as creating an opaque priority structure. However, application of the *Konzernrecht* is limited to AG's (public companies) controlled by another entity and does not (at least not anymore) extend to the more common GmbH (private company). In the context of the GmbH, German law offers little possibility to challenge opaque priority structures with guarantees as such, but does offer some possibility to, with the use of tort law in combination with a theory of undercapitalization, challenge the most offensive priority structures that were undeniably designed to prejudice creditors. Such a determination is however strongly based on subjective criteria, which will be hard to prove in practice.

The rules on capital requirements for the GmbH and the rules on director liability do however limit the use of (full) guarantees within groups somewhat, which arguably diminishes the problem of opaque priority structures with the use of guarantees.

More specifically, German law does target indirect shareholder loans as generally subordinated to other claims in insolvency, without any reference to subjective factors, which weakens the priority structure of a shareholder guarantee somewhat. The protection is however not perfect, especially not because security for third-party loans guaranteed by shareholders can probably still be enforced against the debtor and because security rights for recourse claims by shareholders are still enforceable. Notable is that the rules on subordination of indirect shareholder loans are setup in such a way that the priority position of the creditor through the guarantee structure is not or at most minimally affected, whereas the position of the shareholder is strongly affected.

Lastly, German law is somewhat unclear on double proof. Although double proof through guarantees is generally allowed, this may be different in the case of shareholder guarantees, but the opinion on this is split. Even if the interpretation of the law should lead to the conclusion that such double proof is not allowed in the context of shareholder guarantees, some holes exist in the protection.

4.2 Regulatory approaches to covert insider dealing (ex post opportunism)

Paragraph 4.1 above discussed to which extent German law upholds opaque priority structures in which guarantees are used to create externalities for outsiders ('ex ante opportunism'). Not unrelated, but clearly distinguishable from such opportunistic behavior is the opportunistic behavior that the guarantee incentivizes after ('ex post') concluding the guarantee. Whereas paragraph 4.1 thus discussed regulatory approaches to the selectively pierced structures as such, this section discusses to which extent adverse dynamics that are created by such structures are regulated.

Chapter 3 paragraph 3.2 discussed that insider guarantees are likely to create externalities for other creditors by giving incentive for insider dealing whilst at the same time covering up such insider dealing. This paragraph will discuss how German law deals with this. Various mechanisms under German law that may be relevant in this context are discussed below: first and foremost preference law, but also shareholder liability, director liability and lender liability.

4.2.1 Avoidance of payments on guaranteed loans

Transaction avoidance law may deter the control that a lender can obtain through a guarantee, thereby deterring the incentive for insider dealing. If a principal debtor is in financial trouble, he or persons involved in the principal debtor (if the principal debtor is a company) may have incentive to give preference to a guaranteed lender above other creditors, as extensively explained in chapter 3 paragraph 3.2. This could happen in the context of group finance, in which a parent company may prefer its subsidiary to pay creditors guaranteed by the parent before other creditors when the subsidiary is approaching bankruptcy, or in the case of small-business finance, in which owners and managers that guaranteed corporate debt may have the same inclination. The motivation to pay guaranteed debt first is driven by the fact that the guarantor indirectly profits from such payments, because his exposure under the guarantee is reduced with the same amount (see extensively chapter 3 paragraph 3.2)

German law makes a clear distinction between normal loans and shareholder loans and in this context also has attention for and special rules on indirect shareholder loans, such as loans granted by third parties but guaranteed by shareholders (see paragraph 4.1.3 above). Payments in the year before insolvency on such guaranteed loans can more easily be avoided by the insolvency administrator than payments on normal loans. German law is characterised by strict treatment of payments in the period before insolvency, also outside the context of shareholder guarantees. Treatment of payments on shareholder-guaranteed loans is discussed first below. After that, the treatment of other insider benefits through guarantees will be discussed.

a) Avoidance of payments on insider-guaranteed loans towards the guarantor

German law on the avoidance of payments that benefit insider guarantors is characterized by a detailed statutory regime, at least as far as the insiders are shareholders in the debtor company. This detailed regime can be understood as a refinement of the detailed regime on shareholder loans, discussed in paragraph 4.1.3 above. To recall, § 39 (1) sub 5 InsO treats shareholder loans generally as subordinate to other claims in insolvency.¹²⁹⁰ Furthermore, § 44a InsO stipulates that a claim guaranteed by a shareholder of the bankrupt company (or for which the shareholder provided real security rights) can only be submitted in the insolvency proceedings in as far as the guarantee falls short or recourse against the guarantor fails. § 44a InsO can be understood as part of the set of rules that limits pari-passu ranking of shareholder loans in insolvency: a guarantee by a shareholder is seen as an indirect shareholder loan.¹²⁹¹

¹²⁹⁰ See extensively on this regime for example Baird, 1994a, p. 2262 ff; Laspeyres, 2014; Koutsós, 2011.

¹²⁹¹ Uhlenbruck and Hirte, 2010, sec. 44a InsO nr 1.

In § 135 InsO German law has a special regime for payments on shareholder loans in the year before insolvency and on security granted for such loans in the ten years before insolvency, which regime flanks § 39 (1) sub 5 InsO:

"§ 135 Gesellschafterdarlehen

(1) Anfechtbar ist eine Rechtshandlung, die für die Forderung eines Gesellschafters auf Rückgewähr eines Darlehens im Sinne des § 39 Abs. 1 Nr. 5 oder für eine gleichgestellte Forderung

1. Sicherung gewährt hat, wenn die Handlung in den letzten zehn Jahren vor dem Antrag auf Eröffnung des Insolvenzverfahrens oder nach diesem Antrag vorgenommen worden ist, oder

*2. Befriedigung gewährt hat, wenn die Handlung im letzten Jahr vor dem Eröffnungsantrag oder nach diesem Antrag vorgenommen worden ist."*¹²⁹²

All payments on shareholder loans in the year before insolvency and all security granted for such loans in the ten years before insolvency can thus be avoided by the bankruptcy administrator. This rule is fully based on objective criteria. The bankruptcy administrator does not have to prove any subjective criteria such as bad faith or knowledge of approaching insolvency. The simple fact that a shareholder loan was made and has been repaid in the year before insolvency (or in the case of security rights granted for that loan: in the ten years before insolvency) suffices.

As discussed, German law is also sensitive to indirect shareholder loans (see § 44a InsO). The regime on indirect shareholder loans laid down in § 44a InsO is flanked by § 135(2) InsO:¹²⁹³

*§ 135 (2) InsO: "Anfechtbar ist eine Rechtshandlung, mit der eine Gesellschaft einem Dritten für eine Forderung auf Rückgewähr eines Darlehens innerhalb der in Absatz 1 Nr. 2 genannten Fristen Befriedigung gewährt hat, wenn ein Gesellschafter für die Forderung eine Sicherheit bestellt hatte oder als Bürge haftete; dies gilt sinngemäß für Leistungen auf Forderungen, die einem Darlehen wirtschaftlich entsprechen."*¹²⁹⁴

§ 135(2) InsO discourages the incentive to, just before insolvency, have the principal debtor make payments on guaranteed loans in order to limit the exposure of the shareholder under the guarantee. Such payments limiting the exposure of the shareholder-guarantor can be attacked

¹²⁹² Translation: "Section 135 Loans Replacing Equity Capital

(1) A transaction may be contested which, in consideration of a partner's claim to restitution of his loan replacing equity capital within the meaning of section 39 subsection (1) no. 5 or in consideration of an equivalent claim,

1. provided a security if such transaction was made during the last ten years prior to the request to open insolvency proceedings or subsequent to such request; or

2. provided satisfaction if such transaction was made during the last year prior to the request to open insolvency proceedings or subsequent to such request." translation by: https://www.gesetze-im-internet.de/englisch_inso/englisch_inso.html#p0575 , last visited on 1 April 2018.

¹²⁹³ See also Jianan Yu, 2017, p. 158; Koutsós, 2011.

¹²⁹⁴ Translation: "A transaction may be contested by means of which a company has provided satisfaction to a third party for a claim to restitution of a loan within the period quoted in subsection (1) no. 2 if a partner has provided security for the claim or was liable as guarantor; this shall apply correspondingly to benefits which correspond in economic terms to a loan." Translation by: https://www.gesetze-im-internet.de/englisch_inso/englisch_inso.html#p0575 , last visited on 1 April 2018.

by the insolvency administrator, enforcing the rule in § 44a InsO that the creditor should first turn to the shareholder-guarantor.¹²⁹⁵ Like § 135 (1) InsO, § 135(2) InsO is based on objective criteria, which makes relying on the rule easy and practical for the bankruptcy administrator. § 143(3) InsO protects the creditor from the effects of avoidance based on § 135 (2) InsO, by stipulating that the insolvency administrator should turn to the shareholder-guarantor for repayment, which duty to repay is limited to the amount of the guarantee.¹²⁹⁶

*143 (3) InsO: Im Fall der Anfechtung nach § 135 Abs. 2 hat der Gesellschafter, der die Sicherheit bestellt hatte oder als Bürge haftete, die dem Dritten gewährte Leistung zur Insolvenzmasse zu erstatten. Die Verpflichtung besteht nur bis zur Höhe des Betrags, mit dem der Gesellschafter als Bürge haftete oder der dem Wert der von ihm bestellten Sicherheit im Zeitpunkt der Rückgewähr des Darlehens oder der Leistung auf die gleichgestellte Forderung entspricht. Der Gesellschafter wird von der Verpflichtung frei, wenn er die Gegenstände, die dem Gläubiger als Sicherheit gedient hatten, der Insolvenzmasse zur Verfügung stellt.*¹²⁹⁷

Although §§ 135 (2) and 143 (3) InsO somewhat discourage the incentive to, just before insolvency, have the principal debtor make payments on guaranteed loans in order to limit the exposure of the shareholder under the guarantee, this discouraging effect should be relativized somewhat for two reasons: (1) preference law generally does not have a strong deterrent effect because generally the strongest sanction means returning a benefit gained with the contested transaction and (2) wealth transfers can remain covert, especially in cases where the wealth transfer is not a payment but another fact pattern that prefers the guaranteed creditor, such as a delayed bankruptcy filing or accelerated processing of raw materials (see extensively chapter 3 paragraph 3.2.2). Because § 135(2) InsO only applies to a legal act (*Rechtshandlung*), such covert wealth transfers escape the scrutiny of § 135(2) InsO. *Rechtshandlung* can be interpreted broadly in this context:

*“Der Begriff der Rückzahlung ist weit zu fassen. Er umfasst jede wirtschaftlich zu Lasten der Gesellschaft gehende Befriedigung des Kreditgebers (...). Die Befriedigung muss aber in jedem Fall durch eine Rechtshandlung iSv § 129 Abs 1 erfolgen”.*¹²⁹⁸

Important to note, especially in relation to Dutch law, is that *Rechtshandlung* has a rather broad meaning under German law. Under Dutch law, for the act to qualify as a legal act (*rechtshandeling*), the party performing the act should in principle also have intended the legal consequence(s). German law does not require such intent for an act to qualify as

¹²⁹⁵ See also Nerlich, Römermann and Abeltshausen, 2017, sec. 135 InsO nr 50; Nikolas T. Koutsós, 2017, p. 319.

¹²⁹⁶ See also Uhlenbruck and Hirte, 2010, sec. 135 InsO nr 15; Nerlich, Römermann and Abeltshausen, 2017, secs 135 InsO nr 52, Section 143 InsO nr 64 a-d.

¹²⁹⁷ Translation: “In the case of a contestation pursuant to section 135 subsection (2), the partner who provided the security or was liable as guarantor shall return the benefit granted the third party to the insolvency estate. The obligation shall only exist up to that amount to which the partner was liable as guarantor or which corresponds to the value of the security he provided at the point of the restitution of the loan or the performance on the claim of the same rank. The partner shall be free of the obligation if he makes the object which served the creditor as security available to the insolvency estate.” translation by: https://www.gesetze-im-internet.de/englisch_inso/englisch_inso.html#p0610 , last visited on 1 April 2018. See also Uhlenbruck and Hirte, 2010, secs 143(3) InsO nr 56a–56b.

¹²⁹⁸ Nikolas T. Koutsós, 2017, p. 977.

Rechtshandlung. German transaction avoidance law thus has an application broader than Dutch law (see chapter 4 paragraph 4.2.1), but narrower than US law (see chapter 5 paragraph 4.2.1).¹²⁹⁹

At first sight, German law leaves a wide gap in the protection against acts that favour the shareholder-guarantor: in contrast to § 135(1) InsO, § 135(2) InsO only makes *Befriedigung* (satisfaction) of debts guaranteed by shareholders contestable, not also security given for such debts by the company. Although *Befriedigung* can be interpreted broadly and for example also encompasses set-off, the granting of security rights, which can de facto have the same effect, is excluded from the scope of § 135(2) InsO.¹³⁰⁰ The granting of security rights by the debtor company to secure a third-party claim that is backed by a shareholder guarantee can therefore only be challenged with the general rules on transaction avoidance (see on these rules further below) not with the specific rules on preferences in the context of shareholder loans. However, as already shortly pointed out in paragraph 4.1.3 above, when the creditor enforces his real security rights granted by the (now bankrupt) principal debtor, the insolvency administrator will have recourse to the shareholder-guarantor (in as far as the shareholder-guarantor benefitted) pursuant to analogous application of § 135(2) and 143(3) InsO.¹³⁰¹ Even though the granting of security rights itself can thus not be contested with § 135(2) InsO, the enforcement of such security rights when the debtor is bankrupt will lead to a claim of the insolvency administrator on the shareholder that guaranteed the debt in as far as that shareholder profited from such enforcement of security rights by limiting his exposure under the guarantee.

This approach makes clear that (1) the granting of the security right itself is, in relation to the creditor, unproblematic from the perspective of § 135(2) InsO and (2) it doesn't matter when the security right was granted: if the security right is enforced in bankruptcy and the guarantor's exposure under the guarantee is limited by such enforcement, the guarantor will have to reimburse the insolvent estate, which applies equally to security rights granted a day before insolvency and security rights granted 15 years before insolvency.

Both towards payments on shareholder-guaranteed loans and towards security rights granted for shareholder-guaranteed loans, the German law approach clearly addresses the shareholder that indirectly benefits from such payments or security rights, whilst keeping the third-party creditor as much as possible out of the firing line. The creditor can receive and benefit from payments on and security rights granted for shareholder-guaranteed loans, just as he can from payments on and security rights granted for any other loan.

This approach is easy to place considering the background of the rules laid down in § 44a and 135(2) InsO. These rules can be understood as rules flanking the rules on subordination of shareholder loans. If the shareholder is not allowed to directly rank *pari-passu* with other creditors for his own claims on the company, he is also not allowed to indirectly do so by having a third party make the loan and guaranteeing that loan. In that sense, German law is not

¹²⁹⁹ See also De Weijs, 2010a, p. 48.

¹³⁰⁰ Uhlenbruck and Hirte, 2010, secs 135 InsO nr 10, 17.

¹³⁰¹ Uhlenbruck and Hirte, 2010, secs 44a InsO nr 7–8; BGH, 1 December 2011, IX ZR 11/11; Gotthard 2014, p. 84-85; Hess, 2012, sec. 44a InsO; Piekenbrock and Ludwig, 2016, p. 164; Jianan Yu, 2017, p. 161; Koutsós 2017, p. 978; Georg, 2011, p. 205; Müller and Rautmann, 2012, p. 190; Andres, Dahl and Leithaus, 2014, p. 171.

necessarily in general sensitive to indirect preferences through guarantees, but is, because of a particular sensitivity to shareholder loans, also sensitive to indirect shareholder loans.

b) Avoidance of payments on shareholder-guaranteed loans towards the non-insider lender

As discussed above, successful avoidance (*'anfechtung'*) of payments on shareholder-guaranteed loans pursuant to § 135 (2) InsO results in a direct claim of the insolvency administrator on the shareholder-guarantor (§ 143 (3) InsO) and not in a claim on the creditor. The RegE (explanatory memorandum) to the MoMiG explains why:

“Die derzeit in § 143 enthaltenen Regelungen zu den Rechtsfolgen der Anfechtung passen nicht für den Fall des neu eingefügten § 135 Abs. 2, da hier – parallel zur Rechtslage beim bisherigen § 32b GmbHG – nicht der Drittgläubiger das von der Gesellschaft Erlangte zurückgewähren soll, sondern vielmehr der durch die Leistung der Gesellschaft frei gewordene Gesellschafter, der als Bürge haftete oder die Sicherung bestellt hatte. Dabei wird in dem neuen Absatz 3 auch die Regelung des § 32b Satz 3 GmbHG übernommen.”

This reasoning is not hard to follow. However, the liability of a shareholder under a guarantee for the debts of his company is not unlikely to be greater than his personal wealth. This fact, combined with the fact that, especially in the small-business context, a substantial amount of wealth and prospects for future earnings of the shareholder will have been tied up in the company, either as share capital or otherwise, generally makes the shareholder of a bankrupt corporation that also guaranteed a corporate loan not likely to provide much recourse. Moreover, an amount paid to the guaranteed creditor in the period before bankruptcy, which the bankruptcy administrator may try to contest, will not directly have ended up with the guarantor (the only benefit for the guarantor was that his exposure was reduced by this payment). All in all, the shareholder-guarantor is not always very likely to be able to perform his duty under § 143 (3) InsO. More importantly however, the benefit that the shareholder-guarantor has had in terms of limiting his exposure under a guarantee could be (much) lower than the actual payment made, because guarantees by shareholders are often given for a limited amount. In such cases, § 143 (3) InsO only allows to claw back that limited benefit that the shareholder had, not the whole payment to the creditor, even though that payment was arguably incentivized by the guarantee.

For that reason, a possible claim of the insolvency administrator on the creditor remains relevant. § 135 (2) InsO cannot be used to this extent, but the payment can possibly be avoided relying on §§ 130, 131 or 133 InsO against the creditor. Reliance on §§ 130, 131 or 133 InsO can also be relevant in case an insolvency administrator wishes to contest a payment on a loan guaranteed by an insider not being a shareholder, as such payments cannot be contested using § 135 (2) InsO. A short discussion of these possibilities follows.

§ 130 (1) InsO, on congruent coverage, allows for avoidance of due payments made during the last three months prior to the (request to open) insolvency if the debtor was illiquid (*Zahlungsunfähig*) on the date of the transaction and the creditor was aware of this on that date. Guaranteed creditors tend to be larger creditors such as banks that are close to the debtor. In such a case, it is not unlikely that the bank has, in the three months prior to insolvency, some awareness of the troubles the debtor is probably already in. Payments on the guaranteed loan can in such a case also be avoided towards the creditor, but the guarantee itself does not play a role in this avoidance action.

§ 131 (1) InsO, on incongruent coverage, allows for avoidance of undue payments. If the payment made on the guaranteed debt was not yet due, § 131(1) InsO may be helpful. Incongruent payments in the month before (the request to open) insolvency can be contested without further requirements. Incongruent payments in the second and third month before (the request to open) insolvency can also be contested, but either the debtor had to be illiquid at that point (§ 131 (2) InsO) or the creditor had to have been aware of the disadvantage to the insolvency creditors (§ 131 (2) InsO). Again, the fact that an insider guarantee played a background role in making the (now contested) payment happen is irrelevant under § 131 InsO.

§ 133 (1) and (2) InsO allow for the contestation of payments on loans in the four years before (the request to open) insolvency, if the debtor had the intention to disadvantage its creditors with the act and the creditor knew of this intention. Such knowledge is presumed to exist on the side of the creditor if he knew insolvency was looming and he knew that the act discriminated against other creditors. Payments on guaranteed loans in the four years prior to (the request to open) insolvency can be contested on this basis, but only in as far as the administrator can prove the subjective elements of the intention to disadvantage and knowledge of that intention at the counterparty. Knowledge of the intention on the side of the guarantor does not suffice. And again, the fact that an insider guarantee played a background-role in making the contested payment happen is not directly relevant under § 133 InsO, although the existence of the guarantee may help to prove knowledge of an intention to prejudice.

§§ 130 (on congruent coverage), 131 (incongruent coverage) and 133 (willful disadvantages) InsO do make application of the avoidance rules laid down in those articles easier in the case of transactions with persons close to the debtor as defined in § 138 InsO. §§ 130(3), 131(2) and 133 (4) InsO help the insolvency administrator with a presumption when the counterparty of the debtor is a person close to the debtor. Persons close the debtor are defined as follows:

“§ 138 Nahestehende Personen

(1) Ist der Schuldner eine natürliche Person, so sind nahestehende Personen:

1.

der Ehegatte des Schuldners, auch wenn die Ehe erst nach der Rechtshandlung geschlossen oder im letzten Jahr vor der Handlung aufgelöst worden ist;

1a.

der Lebenspartner des Schuldners, auch wenn die Lebenspartnerschaft erst nach der Rechtshandlung eingegangen oder im letzten Jahr vor der Handlung aufgelöst worden ist;

2.

Verwandte des Schuldners oder des in Nummer 1 bezeichneten Ehegatten oder des in Nummer 1a bezeichneten Lebenspartners in auf- und absteigender Linie und voll- und halbbürtige Geschwister des Schuldners oder des in Nummer 1 bezeichneten Ehegatten oder des in Nummer 1a bezeichneten Lebenspartners sowie die Ehegatten oder Lebenspartner dieser Personen;

3.

Personen, die in häuslicher Gemeinschaft mit dem Schuldner leben oder im letzten Jahr vor der Handlung in häuslicher Gemeinschaft mit dem Schuldner gelebt haben sowie Personen, die sich auf Grund einer dienstvertraglichen Verbindung zum Schuldner über dessen wirtschaftliche Verhältnisse unterrichten können;

4.

eine juristische Person oder eine Gesellschaft ohne Rechtspersönlichkeit, wenn der Schuldner oder eine der in den Nummern 1 bis 3 genannten Personen Mitglied des Vertretungs- oder Aufsichtsorgans, persönlich haftender Gesellschafter oder zu mehr als einem Viertel an deren Kapital beteiligt ist oder auf Grund einer vergleichbaren gesellschaftsrechtlichen oder dienstvertraglichen Verbindung die Möglichkeit hat, sich über die wirtschaftlichen Verhältnisse des Schuldners zu unterrichten.

(2) Ist der Schuldner eine juristische Person oder eine Gesellschaft ohne Rechtspersönlichkeit, so sind nahestehende Personen:

1.

die Mitglieder des Vertretungs- oder Aufsichtsorgans und persönlich haftende Gesellschafter des Schuldners sowie Personen, die zu mehr als einem Viertel am Kapital des Schuldners beteiligt sind;

2.

eine Person oder eine Gesellschaft, die auf Grund einer vergleichbaren gesellschaftsrechtlichen oder dienstvertraglichen Verbindung zum Schuldner die Möglichkeit haben, sich über dessen wirtschaftliche Verhältnisse zu unterrichten;

3.

*eine Person, die zu einer der in Nummer 1 oder 2 bezeichneten Personen in einer in Absatz 1 bezeichneten persönlichen Verbindung steht; dies gilt nicht, soweit die in Nummer 1 oder 2 bezeichneten Personen kraft Gesetzes in den Angelegenheiten des Schuldners zur Verschwiegenheit verpflichtet sind.*¹³⁰²

¹³⁰² Translation: "(1) If the debtor is a natural person, persons with a close relationship to the debtor shall be:

1. the debtor's spouse, even if the marriage was contracted only after the transaction or was dissolved during the last year prior to the transaction;

1a the debtor's civil partner, even if the civil partnership was contracted only after the transaction or was dissolved during the last year prior to the transaction;

2. the ascendants or descendants of the debtor or of the spouse designated at no. 1, or the civil partner designated at no. 1a, the debtor's full and half-blood siblings, or the spouse designated at no. 1, or the civil partner designated at no. 1a, and the spouses of such persons;

3. persons living in the debtor's household or having lived in the debtor's household during the last year prior to the transaction, as well as persons who can provide information on the debtor's financial circumstances on the grounds of a relationship based on a contract of employment or service with the debtor.

4. a legal person or a company without legal personality if the debtor or one of the persons referred to at nos. 1 to 3 is a member of the body representing or supervising the debtor, a general partner or persons holding more than one quarter of the debtor's capital, or is able, on the basis of a comparable relationship under company law or a contract of employment or service, of providing information regarding the debtor's financial circumstances.

(2) If the debtor is a legal person or a company without legal personality, the persons with a close relationship to the debtor shall be:

1. the members of the body representing or supervising the debtor, as well as his general partners and persons holding more than one quarter of the debtor's capital;

2. a person or a company having on the basis of a comparable association with the debtor under company law or under a service contract the opportunity to become aware of the debtor's financial circumstances;

3. a person having a personal relationship detailed at subsection (1) with a person named at no. 1 or 2; this shall not apply if the persons named at no. 1 or 2 are legally bound to secrecy regarding the debtor's affairs."

translation by: https://www.gesetze-im-internet.de/englisch_inso/englisch_inso.html#p0589, last visited on 1 April 2018.

Although this definition of persons close to the debtor seems comprehensive enough, the text of §§ 130 (3), 131 (2) and 133 (4) InsO does limit application of this definition in § 138 InsO to the direct counterparty of the transaction. Whether a person close to the debtor as defined in § 138 InsO indirectly benefits, such as in the case a guarantor close to the debtor indirectly benefits from a payment to a creditor not close to the debtor, does not seem to be taken into account in this context, or at least the presumptions of §§ 130(3), 131(2) and 133 (4) InsO will not apply. The circumstance that an insider guaranteed a debt could of course still indirectly help in the establishment whether certain requirements, such as an intention of the debtor to disadvantage other creditors and knowledge of the creditor of such intention, have been met. An insider guarantee can motivate such intention, but the guarantee alone will probably not suffice to establish such intention and the burden of proof lies with the insolvency administrator.

c) Summary on insider preferences

German law is characterised by a detailed regime policing indirect preferences through shareholder guarantees. This regime can be understood as a refinement of the treatment of (most) shareholder loans as subordinated to other claims in insolvency proceedings. Given the background of the rules on indirect preferences through shareholder guarantees, the specific focus on indirect preferences through particularly *shareholder* guarantees can be understood, as well as the fact that these rules and their interpretation by the courts leave the guaranteed creditor out of the firing line as much as possible.

Although German law thus offers a detailed regime policing indirect preferences through shareholder guarantees, it leaves a gap in three respects: (1) no clear remedy is offered against indirect benefits to insider guarantors that are not shareholders of the debtor and (2) no specific remedy (other than general preference law) is offered against *creditors* that profit from payments on shareholder guarantees, which is especially problematic when the shareholder does not provide recourse or when the benefit to the non-insider is much larger than the benefit to the guarantor. Moreover, it should be borne in mind, as discussed in chapter 3 paragraph 3.2.2, that the reach of transaction avoidance law is limited in two respects: (1) preference law does not have a strong deterrent effect and (2) wealth transfers can remain covert, especially in cases where the wealth transfer is not a payment but another fact pattern that prefers the guaranteed creditor, such as a delayed bankruptcy filing. Because § 135 (2) InsO only applies to a legal act (*Rechtshandlung*) such covert wealth transfers may escape the scrutiny of preference law. However, other than under Dutch law, 'legal act' is defined broadly, also encompassing acts of which the legal consequence was not intended. Thus, German transaction avoidance law is able to capture some more covert wealth transfers than Dutch law is.

4.2.2 Shareholder liability for unlawful withdrawals outside preference law

The discussion above showed that German preference law is rather well-developed in addressing indirect benefits of shareholders through guarantees. However, protection against such indirect benefits is not complete. The question addressed in this paragraph is whether other instruments such as the famous German *Konzernrecht*, veil-piercing (*Durchgriffshaftung*) or tort law could result in a claim on the shareholder in such cases.

a) *Shareholder liability under specific group law (Konzernrecht)*

Paragraph 4.1.1 discussed the German statutory *Konzernrecht* for the Aktiengesellschaft as laid down in the *Aktiengesetz*. If a contractual or de facto *Konzern* exists, distributions to the shareholder in the twilight zone before insolvency serve little point, as the shareholder in such a group relationship to a large extent (though more in the contractual concern than in the de facto concern) has to warrant the financial position of the controlled entity. It should again be reiterated that this only applies in as far as the controlled entity is an AG. The rules in the *Aktiengesetz* do not apply to controlled GmbH's.¹³⁰³

b) *Veil-piercing (Durchgriffshaftung) and tort law*

Outside the statutory *Konzernrecht* and the (now abandoned) application by the German courts of that *Konzernrecht* to controlled GmbH's, veil-piercing (*Durchgriffshaftung*) can also be applied in cases which include factors such as commingling of assets, undercapitalization, total domination and failure to follow formalities.¹³⁰⁴ The *Bremer Vulkan* case cited in paragraph 4.1.1 indeed explicitly recognized the possibility of holding shareholders liable based on their obligation to safeguard capital requirements and the continued existence of the company.¹³⁰⁵ Especially the theories connected to domination and undercapitalization may be relevant in the context of liability for indirect distributions to shareholders. However, both the literature and the case law show an incoherent picture, from which various theories for shareholder liability emerge.¹³⁰⁶

In *KBV* the BGH recognized the possibility of a claim against the shareholder on the basis of a theory of liability for 'causing insolvency' (*Existenzvernichtungshaftung*).¹³⁰⁷ This theory holds that a shareholder can be liable for the full shortfall in the bankruptcy of a corporation if the shareholder influenced the company to make open or concealed payments to him or her that substantially prejudiced the ability of the company to fulfill current obligations.¹³⁰⁸ To rely on the theory the plaintiff would have to show that the shareholder interfered with the assets of the company in a way that prejudiced other stakeholders, while there was a serious insolvency risk.¹³⁰⁹ Such interference could consist of straightforward dividend payments, but also of other fact patterns, which could also include payment of shareholder-guaranteed debts.¹³¹⁰ The shareholder would then have to show that such interference did not cause the downfall or deepening of insolvency, or that avoidance of specific transactions would suffice as a remedy, thus escaping full veil piercing.¹³¹¹ In short, there seem to be two central criteria for relying on the theory of causing insolvency: the shareholder must have deprived the company of its assets without (full) consideration, and this must have prejudiced the creditors by causing the

¹³⁰³ BGH, 17 September 2001 - II ZR 178/99 (*Bremer Vulkan*); see further paragraph 4.1.1.

¹³⁰⁴ Rott, 2010, p. 274.

¹³⁰⁵ See also Presser, 2016, para. 5:9.

¹³⁰⁶ Wooldridge, 2010, p. 23; Casper, 2008, p. 1133.

¹³⁰⁷ BGH, 24 June 2002 - II ZR 300/00.

¹³⁰⁸ See also Vanderkerckhove, 2007.

¹³⁰⁹ Wooldridge, 2010, p. 23; Altmeppen and Roth, 2015, sec. 13 GmbHG nr 82.

¹³¹⁰ Compare Ziemons and Jaeger, 2014, sec. 13 GmbHG.

¹³¹¹ Barneveld, 2014, p. 303.

company to fail to pay its debts.¹³¹² Planned ‘*Selbstbedienung*’ (self-service) at the expense of creditors is the central concept.¹³¹³ Payments on shareholder guaranteed debts can qualify as self-service.

In a later case, *Trihotel*,¹³¹⁴ the BGH grounded the theory of *Existenzvernichtungshaftung* yet again on a different legal basis: § 826 BGB,¹³¹⁵ which is part of general tort law and stipulates:

“§ 826 *Sittenwidrige vorsätzliche Schädigung*

Wer in einer gegen die guten Sitten verstoßenden Weise einem anderen vorsätzlich Schaden zufügt, ist dem anderen zum Ersatz des Schadens verpflichtet.”¹³¹⁶

Thus, the BGH seems to want to stay away from (direct) veil-piercing, preferring to keep shareholders accountable based on general tort law. The veil is not pierced or lifted, but shareholders are just held liable when they behave unlawfully towards other stakeholders, just as any (legal) person can be held liable for the damage caused by tortious behaviour. The burden of proof lies with the company or insolvency administrator that pursues the claim against the shareholder.¹³¹⁷ The theory of *Existenzvernichtungshaftung* is, other than the name suggests, not only applicable when a distribution to a shareholder has *caused* insolvency, but also when it has *deepened* the shortfall in insolvency.¹³¹⁸ In the second situation the shareholder is only liable for the extent to which the shortfall has been deepened, not for the whole shortfall.

Also ‘*Sittenwidrigkeit*’ (immorality) in the sense of § 826 BGB is interpreted broadly by the courts. Already the interference with company assets that would otherwise have been available to creditors can lead to immorality.¹³¹⁹ There is one important limit to the protective effect towards creditors of liability of shareholders based on the theory of *Existenzvernichtungshaftung*: in as far as the behavior of the shareholder has damaged the corporation itself, only the corporation itself (or the bankruptcy administrator) can claim, because the loss by creditors is only a ‘reflex’ of the loss by the company itself.¹³²⁰ In other words, it is an internal liability.¹³²¹ Of course, creditors could indirectly profit from such a claim by the corporation or (more likely) the bankruptcy administrator. It should however be kept in mind that only damage to the company because of causing insolvency or deepening insolvency can be claimed, which is not necessarily the total sum of missing capital that would have otherwise been there for the satisfaction of the creditors.¹³²² Furthermore, the shareholder must have been able to foresee insolvency at the moment of the interference.¹³²³

¹³¹² Wooldridge, 2010, p. 24.

¹³¹³ Wooldridge, 2010, p. 24.

¹³¹⁴ BGH, 16 July 2007 - II ZR 3/04 (*Trihotel*).

¹³¹⁵ Altmeppen and Roth, 2015, sec. 13 GmbHG nr 90; Altmeppen and Roth, 2015, sec. 13 GmbHG nr 83 ff.

¹³¹⁶ Translation: “A person who, in a manner contrary to public policy, intentionally inflicts damage on another person is liable to the other person to make compensation for the damage.” translation by: https://www.gesetze-im-internet.de/englisch_bgb/englisch_bgb.html#p3497, last visited on 1 April 2018.

¹³¹⁷ Ziemons and Jaeger, 2014, sec. 13 GmbHG.

¹³¹⁸ Ziemons and Jaeger, 2014, sec. 13 GmbHG; Altmeppen and Roth, 2015, secs 13 GmbHG nr 78-79, 98.

¹³¹⁹ Ziemons and Jaeger, 2014, sec. 13 GmbHG.

¹³²⁰ BGH, 16 July 2007 - II ZR 3/04 (*Trihotel*); Ziemons and Jaeger, 2014, sec. 13 GmbHG.

¹³²¹ Ziemons and Jaeger, 2014, sec. 13 GmbHG.

¹³²² Ziemons and Jaeger, 2014, sec. 13 GmbHG.

¹³²³ Ziemons and Jaeger, 2014, sec. 13 GmbHG.

In the situation of certain factual behavior that somehow has benefitted a certain creditor, or security rights that have benefitted a certain creditor and indirectly the shareholder that extended a guarantee to that creditor, it is, just as in the situation of direct payment on shareholder-guaranteed loans, rather unlikely that this has caused or deepened insolvency. Rather, one creditor (the guaranteed creditor) is preferred above others. The theory of *Existenzvernichtungshaftung* is not helpful in such a case.

However, in such cases, shareholders can still be held liable by creditors directly towards creditors because of tortious behavior of the shareholder under § 826 BGB.¹³²⁴ A one-sided pursuit by the shareholder of his own interests, while it should have occurred to him that this could damage the creditors, and which has not damaged the company itself, could indeed also lead to tort liability directly towards creditors.¹³²⁵ The burden of proof lies with the creditor who claims damages, which will often be a heavy burden given the strongly subjective elements that have to be shown.

c) *Shareholder liability in case of lack of management*

When the corporation lacks proper management, the shareholders have the obligation discussed above to timely request insolvency, unless they can show that they were not aware of the insolvency or overindebtedness or the lack of management:

§ 15a (3) InsO: *“Im Fall der Führungslosigkeit einer Gesellschaft mit beschränkter Haftung ist auch jeder Gesellschafter (...) zur Stellung des Antrags verpflichtet, es sei denn, diese Person hat von der Zahlungsunfähigkeit und der Überschuldung oder der Führungslosigkeit keine Kenntnis.”*¹³²⁶

The common opinion is that in such a case of *Führungslosigkeit* (lack of management), the liability of § 64 GmbHG (discussed below in relation to directors) also rests on the shareholders.¹³²⁷ Thus, the discussion below on director liability on the basis of § 64 GmbHG can be deemed to also apply to shareholders in case of *Führungslosigkeit*.

4.2.3 Director liability for insider preferences

An important deterrent force on insider dealing with guarantees in the context of corporate finance may come from director liability rules for such behavior. Under Dutch and US law a rough distinction was made between the situation in which (a) payment of the guaranteed debt has prejudiced other creditors but has not done damage to the balance sheet of the debtor company and (b) payment of the guaranteed debt has damaged the company, for example by leading to acute liquidity problems. Under German law that distinction cannot be made as clearly, as will be explained below.

¹³²⁴ Ziemons and Jaeger, 2014, sec. 13 GmbHG; Altmeppen and Roth, 2015, secs 13 GmbHG nr 77-79.

¹³²⁵ Ziemons and Jaeger, 2014, sec. 13 GmbHG.

¹³²⁶ Translation: *“Where a private limited company lacks a management, each partner (...) is also obligated to file a request, unless that person is not aware of the insolvency or over-indebtedness or the lack of management.”* translation by: https://www.gesetze-im-internet.de/englisch_inso/englisch_inso.html#p0106, last visited on 1 April 2018.

¹³²⁷ Altmeppen and Roth, 2015, sec. 13 GmbHG nr 145.

German law is characterized by a very strict regime of director liability.¹³²⁸ Covert insider dealing, such as indirect preferences given to insiders through guarantees as discussed in this chapter, is arguably deterred by such strict rules on director liability, also when shareholder and director are separate persons or entities, because the directors could choose not to give in to pressure of the shareholder to engage in insider dealing. Relevant in this context is that the board, also that of a GmbH, has to consist of natural persons (§ 6(2) GmbHG). A legal person, such as a parent corporation, cannot be on the board of a GmbH.

German law has clearly adopted a stakeholder model of corporate governance.¹³²⁹ The duties of directors are owed to the enterprise and to the stakeholders, including creditors, employees, customers, shareholders and society at large. Although the directors are supposed to serve the interests of the stakeholders equally, they in practice often align with banks and shareholders.¹³³⁰

A central place in the regime of director liability is taken by § 64 GmbHG, sentence 1 and 2¹³³¹:

§ 64 GmbHG: *“Die Geschäftsführer sind der Gesellschaft zum Ersatz von Zahlungen verpflichtet, die nach Eintritt der Zahlungsunfähigkeit der Gesellschaft oder nach Feststellung ihrer Überschuldung geleistet werden. Dies gilt nicht von Zahlungen, die auch nach diesem Zeitpunkt mit der Sorgfalt eines ordentlichen Geschäftsmanns vereinbar sind. (...)”*¹³³²

In short, directors are obliged to compensate for payments that have been made when the corporation was over-indebted (*Überschuldung*) or illiquid (*Zahlungsunfähigkeit*), unless such payments were consistent with the due care of a prudent businessperson. This also applies to payments that are not detrimental to the company as such, for example because they are made to meet current liabilities, but that are only detrimental to non-paid creditors.¹³³³ ‘Payment’ in § 64 GmbHG, first sentence, should be understood broadly and in a non-technical way, encompassing all benefits from assets of the debtor that reduce the insolvency estate of the debtor.¹³³⁴ If a director wishes to rely on the exemption that a certain payment was consistent with the due care of a prudent businessperson, he or she has the burden of proof.¹³³⁵

This liability of directors for payments made while the corporation was over-indebted or illiquid is closely connected to the duty of directors to timely request insolvency, as laid down in § 15a (1) InsO:

¹³²⁸ See for example also Schmidt, 2015, p. 1113

¹³²⁹ Ziemons and Jaeger, 2014, sec. 64 GmbHG; Hopt, 2013, p. 2.

¹³³⁰ Wood, 2007, p. 153.

¹³³¹ This applies to the GmbH, see for partnership § 130a HGB and for the *Aktiengesellschaft* § 92 & 93 AktG.

¹³³² Translation: *“The directors shall be obligated to compensate the company for payments made after the company has become illiquid or after it is deemed to be over-indebted. This shall not apply to payments which, after this point in time, are compatible with the due care of a prudent businessman.”* translation by: https://www.gesetze-im-internet.de/englisch_gmbhg/englisch_gmbhg.html#p0416, last visited on 1 April 2018.

¹³³³ See extensively Wood, 2007, p. 153, explaining that the general opinion in the literature is that § 64 GmbHG is not strictly a liability for damages (*Schadensersatzanspruch*), because payment of debts does not damage the debtor as such, but a liability to compensate for damage by third persons; Weiß, 2016, pp. 20–24.

¹³³⁴ Ziemons and Jaeger, 2014, sec. 64 GmbHG.

¹³³⁵ Ziemons and Jaeger, 2014, sec. 64 GmbHG.

*“Wird eine juristische Person zahlungsunfähig oder überschuldet, haben die Mitglieder des Vertretungsorgans oder die Abwickler ohne schuldhaftes Zögern, spätestens aber drei Wochen nach Eintritt der Zahlungsunfähigkeit oder Überschuldung, einen Eröffnungsantrag zu stellen. (...)”*¹³³⁶

§ 15a InsO stipulates that directors should request insolvency within three weeks¹³³⁷ after the corporation has become over-indebted or illiquid, unless they resolve the over-indebtedness or illiquidity in those three weeks. This obligation is, in § 15a InsO itself, backed up with the sanction of imprisonment up to three years or a fine (§ 15a (4) and (5) InsO). Creditors can hold directors liable on the ground of § 15a InsO in combination with § 823 (2) BGB. This ground of director liability has however become overshadowed by the liability of directors under § 64 GmbHG (and § 92 & 93 AktG).¹³³⁸

The liability of directors under § 64 GmbHG can be understood in this context. This also explains the fact that German law does not clearly distinguish between payments that have been detrimental to the company itself (such as withdrawals of capital) and payments that have only been detrimental to certain creditors (preferences). When the company is over-indebted or illiquid, directors should request insolvency and should stop *all* payments, unless a payment is consistent with the due care of a prudent businessperson.

The liability of directors under § 64 GmbHG is in the first place an ‘*Innenhaftung*’ (internal liability) towards the company, which can, in bankruptcy, be claimed by the bankruptcy administrator. At the same time §§ 15a InsO and 64 GmbHG can be seen as a rules that protect creditors.¹³³⁹ Although those rules do not directly give standing to creditors to sue, acting against these rules can be unlawful towards creditors based on § 823 BGB.¹³⁴⁰ Old creditors can, if the damage is under the applicable circumstances for whatever reason not compensated by a claim of the bankruptcy administrator, claim so called ‘*Quotenschaden*’; new creditors can claim the full amount of their claim, as far as the claim remains unpaid.¹³⁴¹

¹³³⁶ Translation: Where a legal person becomes illiquid or over-indebted, the members of the board of directors or the liquidators shall file a request for the opening of proceedings without culpable delay, at the latest, however, three weeks after the commencement of insolvency or over-indebtedness. Translation by: https://www.gesetze-im-internet.de/englisch_inso/englisch_inso.html, last visited on 11 February 2019.

¹³³⁷ It should be noted that this three week grace period does not apply to liability of directors under § 64 GmbHG.

¹³³⁸ Brinkmann, 2018, pp. 94–95

¹³³⁹ Ziemons and Jaeger, 2014, sec. 64 GmbHG; Müller and Axhausen, 2009, p. 296; Andres, Dahl and Leithaus, 2014, sec. 15a InsO nr 1; Nerlich, Römermann and Abeltshauser, 2017, secs 15a InsO nr 3–4;

¹³⁴⁰ This is the general basis for tort liability:

“§ 823 Schadensersatzpflicht

(1) Wer vorsätzlich oder fahrlässig das Leben, den Körper, die Gesundheit, die Freiheit, das Eigentum oder ein sonstiges Recht eines anderen widerrechtlich verletzt, ist dem anderen zum Ersatz des daraus entstehenden Schadens verpflichtet.

(2) Die gleiche Verpflichtung trifft denjenigen, welcher gegen ein den Schutz eines anderen bezweckendes Gesetz verstößt. Ist nach dem Inhalt des Gesetzes ein Verstoß gegen dieses auch ohne Verschulden möglich, so tritt die Ersatzpflicht nur im Falle des Verschuldens ein.”

See further Weiß, 2016, pp. 127–128; 143; Andres, Dahl and Leithaus, 2014, sec. 15a InsO nr 1.

¹³⁴¹ Weiß, 2016, pp. 127–132; see extensively Müller and Axhausen, 2009, p. 296.

Of key importance are of course the definitions of illiquidity (*Zahlungsunfähigkeit*) and over-indebtedness (*Überschuldung*). These are defined in the InsO:

§ 17 (2) InsO: *“Der Schuldner ist zahlungsunfähig, wenn er nicht in der Lage ist, die fälligen Zahlungspflichten zu erfüllen. Zahlungsunfähigkeit ist in der Regel anzunehmen, wenn der Schuldner seine Zahlungen eingestellt hat.”*¹³⁴²

§ 19 (2) InsO: *“Überschuldung liegt vor, wenn das Vermögen des Schuldners die bestehenden Verbindlichkeiten nicht mehr deckt, es sei denn, die Fortführung des Unternehmens ist nach den Umständen überwiegend wahrscheinlich. (...)”*¹³⁴³

Illiquidity exists when the debtor is not able to fulfill due payments, over-indebtedness is a balance sheet test and exists when total debts outreach total assets. Important to note is that over-indebtedness exists in such a case *unless* the continuity of the business is, given the circumstances, predominantly likely. Therefore, a company that is balance sheet insolvent but does generate a good cash flow and has a reasonably positive outlook for the future does not qualify as ‘over-indebted’ in the sense of § 19 (2) InsO.¹³⁴⁴ Illiquidity is, by far, the most important ground for insolvency requests in practice. Only a small percentage of the insolvency requests for GmbH’s is exclusively based on over-indebtedness.¹³⁴⁵

The liability of a director for payments made when the company is over-indebted or illiquid is highly relevant in the context of payments on guaranteed loans. As extensively discussed, insider guarantees, particularly those given by shareholders, can incentivize preferential payments, particularly in the twilight zone before insolvency. § 64 GmbHG works as an effective but indiscriminate instrument in this context: the director is liable for *any* payment (in as far as not consistent with the due care of a prudent business person), not just for payments that benefit insiders. In fact, whether such a payment benefits an insider is in the context of the first two sentences of § 64 GmbHG cited above not directly relevant.

Particularly important in the context of payments on guaranteed loans in the twilight zone is however the additional liability of directors for payments to shareholders as laid down in the third sentence of § 64 GmbHG:

*“ (...) Die gleiche Verpflichtung trifft die Geschäftsführer für Zahlungen an Gesellschafter, soweit diese zur Zahlungsunfähigkeit der Gesellschaft führen mussten, es sei denn, dies war auch bei Beachtung der in Satz 2 bezeichneten Sorgfalt nicht erkennbar.(...)”*¹³⁴⁶

¹³⁴² Translation: *“The debtor shall be deemed illiquid if he is unable to meet his mature obligations to pay. Insolvency shall be presumed as a rule if the debtor has stopped payments.”* translation by: https://www.gesetze-im-internet.de/englisch_inso/englisch_inso.html#p0114, last visited on 1 April 2018.

¹³⁴³ Translation: *“Over-indebtedness shall exist if the debtor's assets no longer cover his existing obligations to pay, unless it is highly likely, considering the circumstances, that the enterprise will continue to exist.(...)”*, translation by: https://www.gesetze-im-internet.de/englisch_inso/englisch_inso.html#p0121, last visited on 1 April 2018.

¹³⁴⁴ See extensively on *Zahlungsunfähigkeit* and *Überschuldung*: Weiß, 2016, pp. 127–132.

¹³⁴⁵ See for some figures for example Ziemons and Jaeger, 2014, sec. 64 GmbHG.

¹³⁴⁶ Translation: *“The same obligation shall affect the directors in regard to payments to shareholders if these led to the company becoming illiquid, unless this was not recognisable whilst observing the due care referred to in the second sentence.”*, translation by: https://www.gesetze-im-internet.de/englisch_gmbhg/englisch_gmbhg.html#p0416, last visited on 1 April 2018.

In other words, if payments to shareholders have *led to* illiquidity, the director is also liable for compensation of those payments, unless this was not apparent even with the due care of a prudent businessperson. This rule, first implemented with the MoMiG in 2008, specifically has the goal of preventing a plundering of the resources of the company by the shareholders in the twilight zone before insolvency.¹³⁴⁷ It is often seen as the introduction of a solvency test in German law, and is specifically geared towards transactions such as leveraged buy-outs that seriously endanger the liquidity position of the company.¹³⁴⁸ The rule closely resembles *Existenzvernichtungshaftung* (already discussed in paragraph 4.1.1 above), with the difference that § 64 third sentence GmbHG addresses the director, whereas *Existenzvernichtungshaftung* addresses the shareholder.¹³⁴⁹ In comparison to the first sentence of § 64 GmbHG, the prohibition to pay already applies at an earlier point in time, before illiquidity has occurred. Already when illiquidity is to be expected in the future, payments to shareholders are not allowed (in as far as not consistent with the due care of a prudent business person).¹³⁵⁰ Payments to shareholders are only not allowed when there is a close causal connection between such payments and the following illiquidity, also without the addition of further causal factors, and this should have been foreseeable *ex ante*.¹³⁵¹ The background of the rule in § 64 third sentence GmbHG is also different from § 64 first sentence GmbHG. Whereas the first is related to the capital requirements of § 30 GmbHG, the latter is related to § 15a InsO on timely requesting insolvency.¹³⁵²

Does this rule apply unabridged to indirect benefits to shareholders, such as in the case in which the company pays debts, or grants security for debts, guaranteed by a shareholder? The answer is yes, with some strong reservations. Clear is firstly that indirect benefits to shareholders, such as the indirect benefit a shareholder receives when his exposure under a guarantee is reduced when the company pays the guaranteed creditor, can be seen as payments to shareholders in this context.¹³⁵³ Clear is also that the granting of security rights or other benefits can be seen as a payment, as long as such a benefit indeed threatens the liquidity position of the company.¹³⁵⁴

There has however been some discussion on the question whether paying a due and payable debt to the shareholder can, in principle, *lead to* illiquidity (*'Zahlungsunfähigkeit'*), or whether paying such due debts can in itself not lead to illiquidity and thus not be problematic under sentence 3 of § 64 GmbHG, but can only be problematic under the first two sentences of § 64 GmbHG (payments made after a state of illiquidity or over-indebtedness has started).¹³⁵⁵ This goes back to the definition of illiquidity, which exists when the company cannot pay its due debts with the available liquidity. Payment of a due debt can in that sense never actually lead to illiquidity. Rather, if after payment of such a due debt the assessment is made that the company is illiquid in the sense that it cannot pay its remaining due debts from liquid funds, this situation must logically already have existed before the payment. Of course, payment of a due debt means that there is less cash available, which means that it becomes less likely that the afterwards still

¹³⁴⁷ Weiß, 2016, p. 182.

¹³⁴⁸ Ziemons and Jaeger, 2014, sec. 64 GmbHG.

¹³⁴⁹ See further on this comparison Weiß, 2016, p. 174.

¹³⁵⁰ Weiß, 2016, pp. 180–183; 199 ff.

¹³⁵¹ Ziemons and Jaeger, 2014, sec. 64 GmbHG.

¹³⁵² Schmidt, 2015, pp. 1152–1153.

¹³⁵³ Ziemons and Jaeger, 2014, sec. 64 GmbHG.

¹³⁵⁴ Ziemons and Jaeger, 2014, sec. 64 GmbHG.

¹³⁵⁵ Ziemons and Jaeger, 2014, sec. 64 GmbHG.

existing creditors get paid in full, but the payment in itself cannot have *caused* illiquidity.¹³⁵⁶ Some have however argued that due and payable shareholder claims should not be taken into account when calculating illiquidity, which would mean that payment of such shareholder claims could lead to illiquidity.¹³⁵⁷ This reasoning is arguably however less applicable to payment of shareholder-guaranteed debts and is in any case not followed by the BGH.¹³⁵⁸

A further small (though highly relevant in practice) reservation that should be made relates to the safe haven in § 64 GmbHG for transactions that are consistent with the due care of a prudent businessperson. Payments to third-party creditors that indirectly benefit shareholders are more likely to qualify as payments consistent with the due care of a prudent businessperson than direct payments to shareholders. If for example the third-party creditor is a bank, as is often the case with guaranteed lending, the bank is likely to have bargained for strict credit terms. If that bank threatens to foreclose on a credit line unless due payments are made immediately, or unless further security is garnished, it seems prudent to make such payments. The fact that the shareholder indirectly profits by reduced exposure under the guarantee does not change that assessment. The idea behind this safe haven, for which the burden of proof lies with the director, is that it can be necessary in order to keep the company from collapsing completely to make certain payments, which can also be in the interest of the joint creditors, as a completely collapsed business may be worth less in a liquidation procedure than a going concern business.¹³⁵⁹ Payments that can fall into this category are especially payments that ensure that production can be continued, which could include payments that are necessary to keep a line of financing that ensures production open.¹³⁶⁰ However, this safe haven is not a general licence to directors to continue making payments as ‘normal’ under the pretext of an intended reorganisation.¹³⁶¹ The safe haven has a narrow scope and if the director wishes to rely on the safe haven, he or she has to convincingly and conclusively show, based on facts and on a solid restructuring plan, that such payments were indeed strictly necessary.¹³⁶²

4.2.4 Lender liability as de facto director

Lenders can be liable towards their debtor (and indirectly towards the creditors of that debtor) on the basis of § 64 GmbHG when they act as de facto director. Lenders will not quickly qualify as de facto directors. Decisive is the nature of and extent to which the lender has assumed management tasks and the extent to which these tasks are significant to the company.¹³⁶³ The simple fact that a lender has possibly strong influence over management through a guarantee of a director or shareholder will not suffice: qualification as de facto director requires actions by that de facto director with objective external effect, influencing management is not enough.¹³⁶⁴

¹³⁵⁶ Weiß, 2016, pp. 178–179.

¹³⁵⁷ See for references Weiß, 2016, pp. 189–192.

¹³⁵⁸ BGH, 9 October 2012 - II ZR 298/11; see also Weiß, 2016, pp. 192–193.

¹³⁵⁹ Ziemons and Jaeger, 2014, sec. 64 GmbHG.

¹³⁶⁰ Ziemons and Jaeger, 2014, sec. 64 GmbHG.

¹³⁶¹ Ziemons and Jaeger, 2014, sec. 64 GmbHG.

¹³⁶² Ziemons and Jaeger, 2014, sec. 64 GmbHG.

¹³⁶³ BGH, 21 March 1988 - II ZR 194/87; Ziemons and Jaeger, 2014, sec. 64 GmbHG.

¹³⁶⁴ BGH, 21 March 1988 - II ZR 194/87; Ziemons and Jaeger, 2014, sec. 64 GmbHG.

4.2.5 Specific dynamics in reorganization

Guarantees can play an important role in restructurings in bankruptcy. As discussed in chapter 3 paragraph 3.2.5, the principal debtor may be under pressure because of the guarantee, even in bankruptcy. Various complicated questions as to voting on and the scope of a reorganization plan can also arise in this context. German law simply stipulates in § 254 (2) InsO that a reorganization plan has no influence on rights of the creditor against third parties such as co-debtors and sureties:¹³⁶⁵

“Die Rechte der Insolvenzgläubiger gegen Mitschuldner und Bürgen des Schuldners sowie die Rechte dieser Gläubiger an Gegenständen, die nicht zur Insolvenzmasse gehören, oder aus einer Vormerkung, die sich auf solche Gegenstände bezieht, werden durch den Plan nicht berührt. Der Schuldner wird jedoch durch den Plan gegenüber dem Mitschuldner, dem Bürgen oder anderen Rückgriffsberechtigten in gleicher Weise befreit wie gegenüber dem Gläubiger.”¹³⁶⁶

Creditors with rights towards third parties are thus still allowed to enforce their claims, also when they have lost (part of) their claim because of a restructuring plan and also when those rights on third parties are strictly accessory to the lost rights.¹³⁶⁷ As § 254 (2) InsO also stipulates, the plan does work against the recourse claim of a co-debtor or surety. In short, German law forbids third-party release through a restructuring plan.

4.2.6 Summary of German law on covert insider dealing

German law is well-developed in dealing with covert insider dealing through guarantees in the sense that it has an extensive statutory regime for dealing with insider preferences through shareholder guarantees, which regime strongly relies on objective factors that are easy and practical to rely on for the bankruptcy administrator. This regime can be understood as a refinement of the treatment of (most) shareholder loans as subordinated to other claims in insolvency proceedings. Given that background of the rules on indirect preferences through shareholder guarantees, the specific focus on indirect preferences through particularly *shareholder* guarantees can be understood, as well as the fact that these rules and their interpretation by the courts leave the guaranteed creditor as much as possible out of the firing line. The protection is mostly limited to that specific background. German law leaves a gap in the protection in three respects: (1) no clear remedy is offered against indirect benefits to insider guarantors that are not shareholders of the debtor and (2) no specific remedy (other than general preference law) is offered against creditors that profit from payments on shareholder guarantees, which is especially problematic when the shareholder does not provide recourse or when the benefit to the non-insider is much larger than the benefit to the guarantor. Moreover, it

¹³⁶⁵ See also Rösler, Mackenthun and Pohl, 2002, p. 832; Vallender, 2015, p. 1050

¹³⁶⁶ Translation: *“The plan shall leave unaffected the rights entitling the insolvency creditors against the debtor's co-obligors and guarantors as well as the rights of such creditors to objects not forming part of the insolvency estate or deriving from a priority notice covering such objects. The debtor, however, shall be discharged by the plan of his co-obligor's, guarantor's or any other redressing party's claims against himself in the same way as he is discharged of the claims of the insolvency creditors.”* translation by: https://www.gesetze-im-internet.de/englisch_inso/englisch_inso.html#p1038, last visited on 1 April 2018.

¹³⁶⁷ See also Giancristofano, 2016, p. 112.

should be borne in mind that the reach of transaction avoidance law is limited in two respects: (1) preference law does not have a strong deterrent effect and (2) wealth transfers can remain covert, especially in cases where the wealth transfer is not a payment but another fact pattern that prefers the guaranteed creditor, such as a delayed bankruptcy filing. Because § 135(2) InsO only applies to a legal act (*Rechtshandlung*), such covert wealth transfers may escape the scrutiny of preference law, even though ‘legal act’ can be understood broadly.

Outside preference law, shareholder liability law for insider preferences offers little protection. Director liability law is however famously strict. Although insider guarantees do not play a strong role in the assessment of director liability in this context, director liability rules can generally still prevent such insider preferences by the far-reaching liability rules that directors are confronted with when having made payments in a situation of de facto insolvency or illiquidity.

5 Conclusion

The question addressed in this chapter was:

How does German law deal with opportunism with the guarantee relationship in the context of corporate finance?

After a short introduction of types of guarantees relevant to corporate finance, German law on opportunism in the internal guarantee relationship has been discussed, most notably opportunism towards the weak guarantor. The discussion showed that, although the famous German case law on immorality of suretyship offers extensive protection to certain (particularly family) sureties, this case law has limited relevance for guarantees in the context of corporate finance. Shareholders and directors that guarantee corporate debt are not specifically protected. Spouses (of shareholders or directors) who stand surety themselves do however under certain circumstances enjoy protection, but spouses of sureties are not offered specific protection. Some specific areas of law that may offer some protection to the surety have furthermore been discussed. Of relevance can be consumer credit law, doorstep sales law and unfair terms control. Generally put, German law offers some, but especially in the context of corporate finance very limited, protection to weak guarantors.

After discussion of the rules protecting weak parties, the regulation under German law of opportunism towards outsiders of the guarantee relationship has been analysed extensively. First, opaque priority structures have been discussed. Notable in this context is firstly the German statutory group law (*Konzernrecht*), which effectively deals with some of the problems associated to guarantees as creating an opaque priority structure. However, application of the *Konzernrecht* is limited to AG's (public companies) controlled by another entity and does not extend to the more common GmbH (private company). In the context of the GmbH, German law offers little possibility to challenge opaque priority structures with guarantees as such, but does offer some possibility to, with the use of tort law in combination with a theory of undercapitalization, challenge the most offensive priority structures that were undeniably designed to prejudice creditors. Such a determination is however strongly based on subjective criteria which will be hard to prove in practice.

The rules on capital requirements for the GmbH and the rules on director liability do however limit the use of (full) guarantees within groups somewhat, which arguably diminishes the problem of opaque priority structures with the use of guarantees.

More specifically, German law does target indirect shareholder loans as generally subordinated to other claims in insolvency, without any reference to subjective factors, which weakens the priority structure of a shareholder guarantee somewhat. The protection is however not perfect, especially not because security for third-party loans guaranteed by shareholders can probably still be enforced against the debtor. German law is furthermore somewhat unclear on double proof. Although double proof through guarantees is generally allowed, this may be different in the case of shareholder guarantees, but the opinion on this is split. Even if the interpretation of the law should lead to the conclusion that such double proof is not allowed in the context of shareholder guarantees, some holes exist in the protection. The overall assessment is that German law has some interesting instruments in dealing with opaque priority structures created by guarantees, especially specifically related to indirect shareholder loans and double proof of claims, but the protection remains patchy and the extent of the protection is often unclear and under discussion in the literature.

Secondly, covert insider dealing under German law has been discussed. German law is well-developed in dealing with covert insider dealing through guarantees in the sense that it has an extensive statutory regime for dealing with insider preferences through shareholder guarantees, which regime strongly relies on objective factors that are easy and practical to rely on for the bankruptcy administrator. The protection is however not perfect. German law leaves a gap in three respects: (1) no clear remedy is offered against indirect benefits to insider guarantors that are not shareholders of the debtor and (2) no specific remedy (other than general preference law) is offered against creditors that profit from payments on shareholder guarantees, which is especially problematic when the shareholder does not provide recourse or when the benefit to the non-insider is much larger than the benefit to the guarantor. Outside preference law, shareholder liability law for insider preferences offers little protection. Director liability law is however famously strict. Although insider guarantees do not play a strong role in the assessment of director liability in this context, director liability rules can generally still prevent such insider preferences by the far-reaching liability rules that directors are confronted with when having made payments in a situation of de facto insolvency or illiquidity.