Cross-border Insolvency Protocol Agreements between Insolvency Practitioners and their Effect on the Rights of Creditors

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A. Introduction

Protocols in cross-border insolvency cases continue to become increasingly popular. While they have already been used between the US, Canada and England in recent years, they have now reached continental Europe and Germany as well. Most of these protocols were created by office holders between common law-based countries. The question now, is how civil law-countries and in particular a German insolvency administrator can rely on the law, and whether such an administrator is able to effectively sign a protocol which will have an impact on the rights of creditors.

This article will not discuss cooperation or information protocols between administrators, trustees, or insolvency practitioners throughout the world. It will not discuss protocols reached between judges or courts located in different countries. Instead, the issue to be considered is how a German insolvency practitioner can legally sign a protocol with a foreign counterpart which will affect the estate, as well as the rights and claims of creditors.

This analysis will focus specifically on the treatment of unsecured creditors in the proceedings. Who do not have any specific right or interest in any specific assets as such.

Experience shows that the stipulation of protocols between office holders under the supervision of the courts, has proven to be extraordinarily effective. This practice is now regarded as a highly valuable method of cooperation. For English courts the ‘Protocol’ is in essence a way to structure procedures. However, experience with such protocols is almost exclusively limited to Anglo-American cases, and it is far from obvious how these could be integrated directly into German insolvency proceedings.

The purpose of this article is to analyze how to achieve practical and legal certainty in the execution of a protocol, without jeopardizing the practitioner’s professional indemnity insurance.

B. Relevant Examples

In order to highlight some of the relevant protocols which have been entered into in the past, a couple of examples should be briefly mentioned here.

I. Maxwell
The most successful example of a protocol between the US and the UK courts was that established in the *Maxwell Communication* case. On 16 December 1991, Maxwell Communication Corporation plc ("Maxwell"), filed a Chapter 11 petition in the US Bankruptcy Court. One day later, the UK High Court of Justice appointed joint administrators under English law. In the Maxwell case, Judge Tina Brozman appointed an examiner. An examiner may be appointed according to section 1104 of the United States Bankruptcy Code, and although his role is usually investigative, he may have any role and powers that the court designates. Judge Brozman required the examiner to act to harmonize the US Chapter 11 case and the UK administration for the benefit of all of Maxwell’s creditors, shareholders and other interested parties and in order to maximize the prospects for rehabilitation and reorganization.

Both Courts authorized the examiner and joint administrators to enter into a protocol, which governed their relationship. The protocol required the joint administrators to notify, consult or obtain consent from the examiner before taking specific actions. Actions that required consultation or consent of the examiner included, amongst others, borrowing money, selling or charging assets and filing a plan of reorganization.

In *re Maxwell Communication*, Justice Hoffman commented,

"These parallel proceedings in the English and American courts have resulted in a high level of international cooperation and a significant degree of harmonization of the laws of the two countries. The affected parties agreed to the plan and the scheme despite differences in the two nations’ bankruptcy laws. The distribution mechanism established by them – beyond addressing some of the most obvious substantive and procedural incongruities – allowed Maxwell’s assets to be pooled together and sold as going concerns, maximizing the return to creditors...these accomplishments – which, we think, are attributable in large measure to the cooperation between the two courts overseeing the dual proceedings – are well worth preserving and advancing. This collaborative effort exemplifies the 'spirit of cooperation' with which tribunals, guided by comity, should approach cases touching the laws and interests of more than one country."

*a. IWG Services Ltd.*

The *IWG* case involved parallel insolvency proceedings pending in the Grand Court of the Cayman Islands, the High Court of Justice in England and in a proceeding filed against the Company by the US Security and Exchange Commission. The operations of the company were divided among the companies

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1 In *re Maxwell Communications Corp* (93 F 3d 1036 2d Cir (1996)).
2 In *re IWG Services Ltd.* (Case No. 99-53169-C, Bankr.W.D.Tex.)
in the group. The liquidators and other responsible parties were required to act for the benefit of all creditors. The protocol in the case stipulated two phases in the three insolvency cases. The first phase related to the liquidation of assets including the investigation and prosecution of causes of action. The second phase consisted of claims administration, allowance of claims filed by the creditors, as well as the payment and distribution of the assets to the creditors. The protocol in the *IWG Services* case also dealt with potential conflicts among the creditors. It made clear that the disposition of any assets governed by the joint protocol would not prejudice any investors or any other third party's right to assert claims against specific assets or the proceeds from the disposition of such assets.

b. AIOC

In the *AIOC Corporation* case a cross-border liquidation protocol was entered into. AIOC Corporation and AIOC Resources AG were multinational business entities engaged in the purchase and sale of metals. An involuntary petition was filed against the debtors in New York on April 11th 1996 and an order for relief was entered on April 23rd 1996. Between these dates, on April 13th 1996, involuntary insolvency proceedings were commenced in Zug, Switzerland, and a bankruptcy officer for administration was appointed. The representatives of the US and the Swiss-based debtor agreed to consult and obtain the consent of the other party before disposing of any assets.

c. Lehman

In the case of the *Lehman Brothers*, various trustees, administrators and receivers of numerous entities around the world, reached an agreement to enter into a cross-border insolvency protocol that, amongst other things, sets out an efficient claims process which includes a consistent and measured approach towards intercompany claims.

In terms of claims, the guideline is that if there are two or more proceedings pending for the same debtor, consisting of one or more main proceedings and or one or more secondary or ancillary proceedings, a claim should be filed only in the proceeding that is designated by the official representative of the debtor. The official representative is the appointed administrator or liquidator, etc., or the debtor in possession. Certain official representatives may be required to make such a designation in accordance with applicable law. Furthermore, the official representative should adjust the distribution to the creditor so that a creditor who has received payment with respect to its claim in one proceeding may not

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3. *AIOC Corporation* (Case No. 96-B-41895, Bankr.S.D.N.Y)
4. *Lehman Brothers* (Case-No. 08-13555 Bankr.S.D.N.Y)
receive a payment for the same claim in another proceeding involving the same debtor, so long as the payment to the other creditors of the same class is less than the payment that the creditor has already received. In addition, the official representative should endeavor to coordinate notice procedures and establish the same deadlines for the filing of claims in the relevant proceedings.

When it comes to intercompany claims and the difficulty in assessing all relevant information, cross-border insolvency protocol provides that the official representatives will agree on the common financial accounting records to form the basis of intercompany claims, and that these financial records will be deemed valid unless there is proof a transaction was recorded in error. The protocol further stipulates that as soon as the procedures committee determines the set of financial accounting records and has agreed on its accounting procedures and derivative methodology, the official representatives shall, to the extent required under applicable law, seek consent or approval from their respective courts, committees or tribunals for the use of the accounting procedures and methodology in their respective intercompany proceedings.

C. Legal Background in Chapter 11 Cases

The validity of cross-border insolvency protocols involving the United States dates back to the Maxwell protocol.

However, in US bankruptcy proceedings the bankruptcy court has the authority to approve protocols under Section 105 of the Bankruptcy Code. Pursuant to that section, the court may issue any order, process or judgment that is necessary or appropriate in order to carry out the provisions of the Bankruptcy Code. Section 105 is an omnibus provision phrased in general terms so as to be the basis for a broad exercise of powers in the administration of bankruptcy cases. Casse vs Key Nat’l Bank Ass’n\(^5\) established that it is appropriate to use the court power under section 105 to approve such protocols. Furthermore, Section 1525 requires foreign courts and representatives to cooperate to the maximum extent possible. Section 1527 provides that the cooperation referred to in sections 1525 and 1526 may be implemented by any appropriate means, which indicates that the purpose is to provide courts with the authority to approve cross-border protocols. Courts have approved these protocols under Section 105 of the Bankruptcy Code, with the case of Nortel Networks Inc.\(^6\) being the most recent example.

\(^5\) In re Casse v. Key Nat’l Bank Ass’n, 198 F. 3rd 327, 336 (2nd Circuit, 1999)
\(^6\) Nortel Networks Inc. (Case no. 109-10138 (KG) Bankr.D.Del., 2009)
D. Authority of German Insolvency Administrators

In Anglo-American insolvency proceedings, insolvency administrators, office holders, trustees or debtors-in-possession will seek the authorization from the relevant court to allow them to utilize cross-border insolvency protocols. Under common law it may not seem unusual to use 'private' agreements like 'Protocols' to overcome the lack of international treaties or specific conflict of laws rules. However, the same cannot be said for countries without a common law background. Judges are generally bound by their national laws and have only limited room for maneuvering, especially in a typical civil law country like Germany.

From a German perspective it is necessary to understand that the German court plays a less active role in the insolvency proceedings. The insolvency administrator is not obliged to seek court approval for his activities. Instead, a German insolvency administrator is largely free to make any decision within the authority granted to them under insolvency law. The insolvency code merely identifies certain cases and conditions where the administrator is required to seek approval from the creditors' committee, the creditors' meeting or the court.

It should be noted that German insolvency law and jurisprudence, do not provide any statutory authority or discretionary power by which the German insolvency court is able to approve the decisions or activities of the insolvency administrator.

A brief overview of the functions of the court, the administrator and the creditors in the German insolvency process, is important in this analysis.

I. Functions of Courts and Administrators in German proceedings

1. The German Insolvency Court

Although the local jurisdiction of the insolvency court is defined in the insolvency code, the primary jurisdiction to be applied is under the European Insolvency Regulation’s rules. The pivotal concept in European law is that of the "centre of main interest". In the event that the centre of main interest or the focus of economic activity is not in a country in the European Union (excepting Denmark), the legal norms relating to jurisdiction of the insolvency law apply. In practice, an application for a declaration of insolvency is filed at the company's registered place of business, with divergent jurisdictions accepted only in exceptional cases. The most important ruling the judge makes in the proceedings is that relating to the commencement of the proceedings. As soon as proceedings are opened, jurisdiction passes from the judge to the registrar (Rechtspfleger), with the judge permitted to reserve the right to continue the proceedings himself under
exceptional circumstances. This does not change the fact, however, that the essential duty of the insolvency judge is the analysis of the case during the preliminary proceedings, often relying on an expert report prepared by the proposed insolvency administrator. These analyses involve a review to determine whether proceedings should be opened at all. Such a review will focus on whether valid reasons exist for the insolvency and whether the expense of the proceedings are covered. With respect to the final insolvency proceedings, the duty of legal supervision still remains with the judge. However, the current tendency is to enlarge and expand the registrars’ duties and to curtail the judge’s involvement in the proceedings.

The insolvency court has the right to supervise the insolvency administrator. This supervisory duty exists for the entire duration of the insolvency proceedings and ensures that the insolvency proceedings proceed in accordance with the law: Section 59(1) of the German Insolvency Code (Insolvenzordnung, InsO). The insolvency court decides in its discretion the extent to which it exercises this right. The creditors’ committee likewise supervises the insolvency administrator: § 59 InsO. Its appointment does not affect either the manner or the extent of the supervisory obligation exercised by the insolvency court.

This supervisory duty also exists if the insolvency administrator creates an insolvency Plan: § 261, Section 1 s. 2 InsO. It also exists for the provisional insolvency administrator (§ 21 Section 2 No. 2 InsO), the agent in the case of self-administration (§ 274 Section 1 InsO ), the trust appointed in a proceedings for residual debt discharge (§ 292 Section 3 s. 2 InsO) and the trustee appointed in consumer insolvency proceedings (§ 313 Section 1 s. 3 InsO).

The Court’s right of supervision is limited to points of law. Therefore, the court may not examine the practicality of the proceedings. Exceptions are regulated in §§ 149 Section 1, 151 Section 1, 158 Section 2, 161, 163, 198 and 314 InsO. An exception also exists if a measure objectively damages the estate.

The insolvency court will normally take action if so-called “dealings” on the part of the insolvency administrator exist that “oppose the purpose of the insolvency proceedings”. The measures taken by the insolvency court are mainly of an informative nature. The insolvency administrator’s obligation to provide information only exists with respect to the insolvency court and not to individual parties. Exceptions to this are regulated in §§ 156, 167 and 168 InsO. Parties to the proceedings have the right to take part in creditors’ assemblies and inspect records: § 4 InsO. Supervision by the insolvency court can be exercised by requesting information or a report on the status and management of the property. All forms of information which the court deems appropriate are admissible. Examples include reports, the presentation of documents and the cash audit. A written report at regular intervals is normal (usually every 6 to 12
months). Information given orally by the insolvency administrator or his assistant is also sufficient.

The court can prescribe an administrative penalty to ensure that the insolvency administrator performs his duties, which is limited in individual cases to an amount of €25,000.00.

The insolvency court is obligated ex officio to conduct the supervision. Neither the creditors’ committee nor the creditors’ assembly can force the court to take action. There is no right to appeal the insolvency court’s decisions.

2. The German Insolvency Administrator

Working under the supervision of the court, the pivotal role in the constructive part of the proceedings is played by insolvency administrators. Their duties include designing the realization process and the required restructuring measures. The administrator is appointed by the court, and in virtually every case the provisional insolvency administrator will also be appointed to act as the final insolvency administrator.

Preliminary insolvency proceedings almost always precede the final insolvency proceedings, especially when the business is to be continued. The provisional insolvency administrator is often a so-called “weak” provisional insolvency administrator because he is ultimately not the disposer. It is the debtor himself who continues to hold the right of disposition, but he requires the provisional administrator’s consent for dispositions to be effective. A so-called “strong” provisional insolvency administrator is sometimes found in cases involving fraud and other special circumstances. Such as when the court withdraws the power of disposition from the debtor as a security measure and when the provisional insolvency administrator already holds the power of disposition at the preliminary stages of the proceedings. The drawback of this procedure which was initially intended by the legislator to be the standard course of procedure, is the issue of the estate’s liabilities which arise through the appointment of a provisional insolvency administrator. The “weak” insolvency administrator, on the other hand, is unable to create estate liabilities. The liabilities which the debtor creates with the consent of the insolvency administrator are primarily insolvency claims because they arise before insolvency proceedings are commenced. The practical continuation of the proceedings often give the other parties enough confidence to continue proceedings toward a successful end.

Unlike in many other countries, the claim registration forms are sent directly to the insolvency administrator who carries out a preliminary review of the claims.
The insolvency administrator must decide whether the claims will be recognized or disputed, keeping the available assets involved in the proceedings in mind. Special procedures for self-administration or self-management were incorporated into the Insolvency Code in 1999, under which the debtor continues to hold the power of disposition even during the insolvency proceedings. The actual role of the insolvency administrator, especially the realization of the assets involved in the insolvency proceedings, is then placed upon the debtor himself. This makes sense when insolvency plans involving a restructuring are submitted. When self-administration is permitted, a trustee is appointed in place of an insolvency administrator. This trustee has a controlling function and the courts often entrust him with special duties and the realization of certain assets. His principal field of activity is in contesting the actions of the debtor, since it is unlikely that the debtor will analyze and contest their own actions.

3. Creditors

The representative body of the creditors is the meeting of creditors, also known as the creditors' assembly where both the unsecured creditors and the creditors holding security rights convene to vote. The meeting of creditors is convened under the registrar after the court has opened the insolvency proceedings. The insolvency administrator reports on the progress of the proceedings and the meeting of creditors decides on the continued course of the proceedings. The meeting of creditors is free to appoint a creditors' committee, a step which is almost always taken in major insolvency proceedings. In major proceedings, a creditors' committee is often formed by the court in the course of the opening proceedings, with the court acting on the recommendation of the insolvency administrator. The creditors' committee, appointed after the opening of insolvency proceedings, but before the meeting of creditors, is officially called the provisional creditors' committee. During provisional insolvency proceedings and before the opening of the insolvency, a similar body is often informally constituted in advance in major proceedings which, at this stage, consults with the insolvency administrator on the further course of the proceedings.

The assets involved in the insolvency proceedings, minus their costs and the estate liabilities, are distributed to all creditors. The yardstick for the distribution is the insolvency schedule. When insolvency proceedings open, the insolvency creditors will be asked to register their claims with the insolvency administrator. The administrator then reviews these claims, giving consideration to the available assets involved in the insolvency proceedings, and submits the result of his review to the court at the judicial verification meeting. The insolvency schedule is kept by the insolvency court but, in practice, most of the activities today are carried out by the insolvency administrator. After one or more verification meetings, the distribution is made at the end of the proceedings in a final meeting on the
strength of the determined claims. In the event of protracted proceedings, part payments are also possible.

Certain time periods are specified for registering claims, although there are no statutory exclusion periods. Delayed registrations of claims can be made throughout the entire proceedings right up to the final meeting. However, a cost contribution for the subsequent verification date is charged for delayed registrations. As the first verification meeting is usually held relatively soon after the opening of the insolvency proceedings, a popular technique employed by some insolvency administrators is known as a “provisional” contestation. This involves stating that a thorough review has not yet been possible. The creditors involved can apply for a declaratory judgment against a provisional contestation in an ordinary court of justice.

II. Authorization through Court Order

Having examined the functions of the insolvency court, administrators and creditors, the question to consider now is whether the court is in a position to authorize a cross-border insolvency protocol to be entered into by the insolvency administrator. It is a fact that different insolvency regimes have different procedural concepts.

This article is intended to describe the issues to be considered when administrators plan to enter into a cross-border insolvency protocol. Regardless of whether insolvency courts are supposed to cooperate or whether international treaties have established cooperation requirements, from the standpoint of legal certainty, it should be determined whether German insolvency courts are legally able to authorize the cross-border insolvency protocols.

The common law style of equity-driven judicial discretion is not available under German law. Under German law, Article 20(3) of the Constitution (Grundgesetz) forces the judge to abide by statute law and restricts his power to develop the law, resulting in an absence of judicial discretion. Neither the new InsO nor other statute law deals expressly with ‘Protocols’. Judges generally have no discretion to embark upon legally unstructured communications with foreign judges in order to delineate each other’s jurisdiction and relief powers by way of a ‘Protocol’.

1. Proceeding by Analogy

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7 M Balz 'The European Union Convention on Insolvency Proceedings' [1996] 70 American Bankruptcy LJ 485, 489, who emphasises that the right of equity is alien to civil law thinking
8 M Büttner, Cross-Border Insolvency under English and German Law, [2002], Oxford U Comparative Law Forum 3.
Professor Christoph Paulus has suggested that such discretion be allowed by way of analogy.\(^9\) However, that suggestion should be rejected as an essential requirement for an analogy is lacking, namely an unintentional gap in the current law (*planwidrige Regelungslücke*). From a methodological point of view, such an exception can be permitted only if the existing law is incomplete. In other words, the courts can fill a gap in the law only if the legislators have overlooked the problem or deliberately left it open for the courts. Obviously, that is not the case if the existing law provides rules to deal with the problem. The fact that the existing law might be insufficient in terms of cooperation cannot justify courts developing a new way of cooperation, or to rely upon a discretion which they do not have as a matter of law.

2. **Issue: International Effect – The Mandate of Courts**

The limitation on the activities of national courts is defined by the *facultas jurisdictiones*. Under public international law, no country should have its courts or other judicial bodies act in the territory of another country unless it is expressly permitted. A country’s judicial sovereignty is part of its sovereignty as a whole. One might at least ask the question of whether the cooperation of procedural activities having an international and cross-border effect are covered by territorial principles and the *facultas jurisdictiones*. Until now there has been no specific and precise assessment of this issue. However, as long as insolvency courts act under the EU *Insolvency Regulation*\(^10\) this is of less interest since the strict application of the territorial principles within the EU is subject to several exemptions. The jurisprudence of the European Court of Justice has shown that in antitrust matters the territorial principle has been abolished when it comes to enterprise-units that operate in several jurisdictions.\(^11\)

Although antitrust issues are not directly applicable to insolvency law matters, the principles for exceptions to the territory principle must be taken into consideration. In both cases it is a matter of extraterritorial judicial action and decisions are to be made based upon extraterritorial facts.

In the case of a company that is located in various countries of the European Union, the question of extraterritorial judicial action is solved by Article 16 of the European Insolvency Regulation. This provision and the underlying acceptance of the universality principle require that the effects of foreign judicial sovereign acts must be recognized in other member states.

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\(^11\) ECJ-decisions, Collection 1972, 619.
It is difficult to organize the cooperation of a group of companies in a cross-border insolvency where such cooperation is not provided for in the EU Insolvency Regulation and where the exceptions to the territoriality principle are not provided in the Regulation. However, the economic unity of such a group of companies and the possible restructuring of that group, as well as the possibility of more effectively administrating such an insolvent group, requires that the handling of such insolvencies by the insolvency court not be excluded by the territorial boundaries. The cooperation of insolvency courts is based on a consensual element that results in extra territorial judicial action and the impairment of the sovereignty of other countries. It should also be noted that such impairment occurs on a minor level. Based on this assessment, the territorial principle should not hinder the cooperation of insolvency courts in the case of an insolvency involving several companies of a cross-border or international group.

3. Under Sec 21 InsO

Professor Paulus\(^{12}\) also suggests that one might overcome the lack of the court’s authority to enter into or approve Protocols, by arguing that the silence of the statute does not necessarily result in a prohibition. With an \textit{a fortiori} conclusion, he opines that § 21 Section 1 InsO provides for exactly that authority for provisional insolvency proceedings and is supposed to apply in proceedings that have been commenced as well. Paulus argues\(^{13}\) that under §21 InsO in connection with Art. 20 Section 3 of the Constitution (\textit{Grundgesetz}), that authority includes the instruction of the administrator by the court to enter into a Protocol.

Also, Professor Eidenmüller\(^{14}\) is of the opinion, that the German insolvency courts are authorized and obliged to cooperate under current German law, in particular §§ 21, 22 and 159 InsO.

The rule is designed to protect creditors’ rights. The court may order certain security measures intended to prevent the deterioration of the debtor’s assets between the date of filing a request for an insolvency and the date on which proceedings are opened. This is helpful considering that the investigations involving the opening, i.e. showing good cause for the request, may need some time. The regulations are highly detailed and provide a clear legal basis for this period of time.

\(^{12}\) Paulus, Verbindungslinien des modernen Insolvenzrecht, ZIP 2000, 2189, 2195.
\(^{13}\) Paulus, „Protokolle“ – ein anderer Zugang zur Abwicklung grenzüberschreitender Insolvenzen, ZIP 1998, 977, 981.
§ 21 Section 1 InsO constitutes a general clause. § 21 Section 2 lists the most important examples for provisional security measures. The provision also envisages measures for restricting the debtor’s authority over dispositions and transfers. These are linked to the appointment of a so-called “strong” insolvency administrator, i.e., one who has been vested with the power to administer and dispose of the assets, even though insolvency proceedings have not yet been finally commenced. On the other hand, the creditors’ rights of execution are restricted in order to safeguard the opportunity to restructure the debtor.

4. Under European Insolvency Regulation, Art 31 (Nortel)

A coordinated reorganization of the whole Nortel Group\textsuperscript{15} required the companies in the group to continue trading. However, it was the opinion of the administrators that the continued trading of the Nortel Group as a whole, would be difficult if secondary proceedings were opened with respect to a particular Nortel Group company. Accordingly, there was a desire to prevent secondary proceedings. The English administrators asked that the English court send letters of request to courts in other EU Member States asking that those courts give the administrators prior notice of any application in their local jurisdictions to open secondary proceedings, as well as an opportunity to be heard on any such application.

The court readily granted the administrators’ application, reasoning that it was highly desirable that the assistance of the foreign courts should be sought, with a view to enabling the administrators to be heard prior to the opening of any secondary insolvency proceedings in those jurisdictions. The court held that it had the power to send such letters under its inherent jurisdiction and under Art. 31 Section 2 of the EU Insolvency Regulation. Although Art. 31 Section 2 only requires that administrators cooperate with each other, the court considered that this should reflect a wider obligation concerning the cooperation between courts which exercise control of insolvency procedures in their respective jurisdictions. Furthermore, it was considered desirable for a court dealing with an application to open secondary proceedings, to be provided with the reasons why such proceedings might have an adverse impact on the main proceedings.

With reference to the Nortel case, an obligation upon the insolvency court to cooperate might be inferred from Art. 31 of the EU Insolvency Regulation. That provision, however, only states that the administrators have a duty to

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\textsuperscript{15} Commencement of insolvency proceedings under English law for Nortel Networks UK Ltd., High Court of Justice, Chancery Division, Order No. 00536 of 2009, dated 14\textsuperscript{th} January
\end{flushright}
cooperate. In the Nortel case, courts were included in the definition of administrators. However, the definition in Art. 2 of the EU Insolvency Regulation in its Exhibit C shows, at least for Germany, that only provisional and final insolvency administrators, as well as a trustee in consumer bankruptcy cases, are included. There are several comments in the academic literature suggesting that the definition of insolvency administrator be interpreted so as to include the insolvency court and that the courts fall under the scope of the application of Art. 31 of the EU Insolvency Regulation.\textsuperscript{16} The EU Regulation has resulted in a most effective and optimized administration of the assets of the debtor, through the coordination between the main and secondary proceedings. The outcome is the unified and equalized satisfaction of all creditors of one debtor.

However, other views in the academic literature consider that the fact that such an obligation to cooperate is needed cannot be the legal ground for its requirement. The precise and clear wording of Art. 31 of the EU Insolvency Regulation does not leave any room for interpretation. Furthermore, an extension of the definition would then also be applicable to the whole of European Insolvency Regulation, including those provisions that are expressly intended to rule on the rights and duties of the office holders and not the courts.\textsuperscript{17} The main task is with the administrator himself. In Germany, as previously mentioned, the function of the insolvency court is primarily to guarantee and protect the procedural framework of the insolvency proceedings. From a legal dogmatic standpoint it is therefore not possible to include the insolvency courts in the scope of the obligation to cooperate under Art. 31 of the European Insolvency Regulation. Cooperation of main and secondary proceedings under the EU Insolvency Regulation is not the duty of the court. Groups of companies are, however, not the target of Art. 31 of the EU Insolvency Regulation.

5. Non-European Cases

In cross-border insolvency cases that are not subject to the EU Insolvency Regulation, the German Insolvency Code provides for the cooperation of the foreign administrator and the German insolvency administrator appointed in the ancillary or secondary proceedings. §357 InsO stipulates the minimum standard of co-operation between both. As the German legislator cannot specify regulations which are binding upon the foreign insolvency administrator, § 357 InsO merely provides for obligations on the secondary insolvency administrators.

\textsuperscript{16} Vallender KTS 2005, 283, 321, Paulus, Commentary on EU Insolvency Regulation Art. 31 no. 5, Staak, NZI 2004, 480, 482.
\textsuperscript{17} Ehricke, ZIP 2007, 2395, 2400.
However, this provision does not prescribe any obligations or rules concerning the cooperation of the insolvency court or the insolvency judge in this respect. The cooperation by courts in international insolvency cases is, from a legal-dogmatic standpoint, problematic, and cannot serve as a reliable method for diminishing the risks to the administrator in utilizing protocols.

Another unanswered question concerns procedures. German insolvency courts do not have the power and authority to use their discretion ex officio. By virtue of the German legal system, a court needs the legal background and authority to exercise discretionary powers.

The discussion concerning these ideas is necessary and in the context of an ideal academic world, these theories sound promising. However, from the standpoint of an insolvency practitioner who requires legal certainty and fewer risks, reliance on a court approval is not advised.

III. Authorization per se

Some academic opinion is to the effect that the insolvency administrator is, by virtue of his office, authorized to enter Protocols and similar agreements. The argument is that if the court is enabled to authorize and instruct an administrator pursuant to § 21 InsO, and to enter into a Protocol even in opening/provisional insolvency proceeding in order to secure the assets and maximize and protect the estate, it could be argued that in commenced proceedings an administrator would be entitled to do the same. It would be part of the administrator’s duty to take custody of the debtor’s assets. Furthermore, the administrator’s job is to realize the assets in favor of the creditors. Therefore, Professor Paulus does not see any reason why administrators should not be permitted to enter into a Protocol.

IV. Authorization by Creditors

Provided that the administrator is entitled to enter a Protocol by virtue of his office, such an agreement would constitute a significant and important act under § 160 InsO and require the creditors’ approval.

§ 160 InsO requires that the creditors be involved in major decisions of the insolvency administrator because of their comprehensive autonomy. Accordingly, significant legal transactions require the consent of the creditors: § 160 Section 1 InsO, whereas § 160 Section 2 InsO only contains a list of examples for such legal transactions. The yardstick for special significance depends on the impact on the individual proceedings. The impact of an action on the corresponding item of the insolvent’s assets and the risk of liability for the administrator are decisive. Each fundamental business-related decision requires consent and the insolvency administrator must obtain the consent of the creditors’ committee (§ 160 Section 1 InsO).
s. 1 InsO) or the meeting of creditors (§ 160 Section 1 s. 2 InsO). If the case is a standard case under § 162 Section 2 InsO the consent is required irrespective of the question of significance.

In case of significant legal transactions, the insolvency administrator must obtain the consent of the creditors' committee prior to acting. If no creditors' committee has been appointed (such as in small-scale proceedings), or if none of the creditors attends the report meeting then the general or individual consent cannot be replaced by a court order. If the court, after having adjourned the report meeting, is still not capable of inciting a creditor to resolve the issue, the insolvency administrator will have to fulfill his realization obligation pursuant to § 159 InsO even without the consent of the creditors. In any case, his legal decision will be effective against external third parties pursuant to § 164 InsO. If the administrator does not obtain the required consent, or if he intends to obtain the consent later, he will have to bear the risk of refusal and thus the risk of potential liability for damages pursuant to § 60 InsO. Even if consent was obtained, the insolvency administrator is still not unconditionally released from his liabilities. He is particularly liable to the creditors' committee, or to the meeting of creditors, for circumstances and legal situations that were presented to the creditors in an incorrect or incomplete manner.

Sanctions may also be imposed for other actions or omissions of the administrator. These make advantageous decisions impossible for the creditors' committee, or for one or more of the parties concerned. Due to formalities and deadlines in the summons that must be adhered to, a consent at a meeting of creditors takes considerable time. Therefore, in practice, the administrator generally receives consent for foreseeable and future decisions at the report meeting. This means that general consent can be granted to the insolvency administrator to cover all foreseeable legal transactions as defined by § 160 InsO. If due to special circumstances a short-term decision should become necessary, and there is no time to obtain consent, the insolvency administrator may proceed with the legal transaction on the condition of the later approval by the competent creditors' body. However, if the creditors' committee later revokes its consent this will not impact the effectiveness of legal business concluded with external third parties.

1. Approval of Creditors Committee

The insolvency proceedings are intended to protect the creditors and are characterized by the concept of creditor autonomy. The creditors' committee and the creditors' assembly are bodies whose self-administration is exercised by the creditors. Their tasks and powers are regulated by §§ 167 et seq. InsO. At the creditors' assembly, all of the creditors are represented. As the highest ranking body, the assembly decides whether a creditors' committee is to be appointed.
During the important stage of the proceedings between opening the insolvency and the first creditors’ assembly, the effective participation of the creditors is not assumed. The insolvency court can therefore appoint a provisional creditors’ committee, § 67 InsO. The final decision on its implementation and composition lies with the creditors’ assembly itself. The court decides whether a creditors’ committee is to be appointed and how many members it will have. The court must ensure that there is an even balance of members from the different groups of creditors. Committee members need not be creditors, and may be appointed if their special expertise is beneficial to the insolvency proceedings.

The insolvency administrator and the debtor cannot be members of the creditors’ committee. In the opening proceedings, it is not permissible to appoint a so-called “provisional creditors’ committee”. This not covered by § 67 InsO. This phase of the proceedings is however, often decisive and the creditors need to be informed faster and in more detail, independently of any formal rights and controlling authority. In practice, a so-called “creditors’ council” is therefore generally appointed.

The creditors’ committee makes its decisions in accordance with the principles of § 72 InsO. No other regulations exist. The creditors’ committee is free to organize its work as it wishes. It can set up rules of procedure or decide on its working procedure on a case by case basis.

Meetings of the creditors’ committee can be convened by any of its members. The members of the committee decide whether non-members or the insolvency administrator should attend. If there are no rules of procedure, the committee makes its decisions by passing a resolution. A majority of the committee members constitutes a quorum for the meeting.

A member of the committee is not entitled to vote on a transaction involving the estate in which he has an interest. The same applies if the member represents a company in such circumstances, or where legal disputes are still ongoing. Each member of the creditors’ committee has one vote, regardless of the amount of their claim. Votes cannot be cast by telephone or in writing. However, if the facts and circumstances are of a simple nature, a decision can be reached by written consent in lieu of a live meeting if the committee has decided on another procedure.

A resolution is passed if it is supported by a majority of the members who voted on the resolution. At the creditors’ committee, votes are calculated according to the number of persons present, irrespective of the amount of their claims. Each member has one vote. As a result, members of the creditors’ committee can vote even if they are not creditors: § 67 Section 3 InsO. In this way, an
imbalance due to large claims is avoided. If there are an equal number of votes, on a resolution, it is rejected. The wording of the law is unambiguous.

2. Approval by Creditor’s Assembly

The creditors’ assembly is the creditors’ most important self-administrative body and the Insolvency Code has strengthened its importance. All of the essential decisions concerning the insolvency proceedings are to be made by the creditors themselves. The activities of the creditors’ assembly have no external effect as the assembly is an internal part of the proceedings. The law grants this body diverse rights, allowing it to participate in the administration and give its consent. This participation is generally observed in the meetings of the creditor groups. In order to prevent the exclusion of different groups of creditors, a formal convening by the insolvency court is required. The insolvency court stipulates the time, place and agenda. Convening is effected publicly. The obligation to convene a creditors’ assembly results from §§ 29 Section 1 No. 1, 2, 160 Section 1 s. 2, 163 Section 1, 197 Section 1, 235, 241 InsO. The obligation also exists if a justified motion is given in accordance with § 75 InsO.

The items on the agenda are to be sufficiently defined in order that the creditors can prepare themselves. If individual items are not contained in the agenda or not presented clearly enough, the respective resolutions are void. However, they are not void if all the creditors were present and none of them opposed the adoption of the resolution. It is not necessary for a separate order to be given by the insolvency court in order to repeal the motion if it becomes void. The requirement of precision in the agenda protects the right of the creditors to be heard. In the notice of the meeting, the items on the agenda have to be properly described. The law defines certain items on the agenda.

The insolvency administrator (§ 75 InsO) and the creditors’ committee can request the assembly to be convened, as can groups of at least five creditors in the insolvency which have a right to separate satisfaction and other non-lower-ranking creditors of the insolvency proceedings. A prerequisite is that the right to separate satisfaction requires that the claim amount to at least one fifth of both the total of all asserted rights to satisfaction and the claims of the non-lower-ranking claims of the insolvency proceedings (§ 39 InsO).

The law does not require that the request be substantiated. Nevertheless, it is recommended that the reasons for the request be stated. The same recommendation applies to information utilized by the creditors’ assembly. As a result of this information, the insolvency court can include the necessary information on the agenda in the publication. The provisions § 76 and § 77 InsO
are the sole provisions regulating the procedure of the creditors' assembly and the adoption of the resolutions. Within this legal framework there is enough flexibility to deal with a variety of individual circumstances.

The creditors' assembly is presided over by the insolvency court. The court is neutral and can express its opinion and intervene on a factual basis, in order to ensure that the procedure of the creditors' assembly is fair and correct.

A resolution can only be adopted if a quorum exists at the creditors' assembly, which requires the presence of at least one creditor with a right to vote (§ 77 InsO). The decisions of the creditors present have binding effect on all creditors. If a creditor does not appear, this is equivalent to a waiver of the right to participate. Measures taken by the administrator or the court are, or can become effective without the participation of the creditors' assembly.

A decisive starting point for a resolution is the amount of the claims. First, the total value of the claims must be determined by reference to all the creditors who are present and have a right to vote. The sum of the claims of the supportive creditors must be over 50% of the value of all the claims. Abstentions do not count as a cast vote. In the event of a tie, the resolution is not adopted and the motion is deemed to be rejected. It is difficult to verify a creditor's right to vote with the right to separate satisfaction.

Under its authority to conduct the meeting, the insolvency court determines the voting rights at the beginning of the creditors' assembly. They are recorded in the protocol taken at the assembly. Creditors with claims that have been registered are entitled to vote: § 77 Section 1, s.1 InsO. They cannot be disputed either by the insolvency administrator or by any other creditor with a voting right. Objections by the debtor have no relevance. If the claim remains undisputed, the claimant is given a voting right. Therefore, unverified claims can also allow for a voting right. If a claim is disputed by a creditor with a right to vote, the claimant can still take part in the voting at the creditors' assembly. A precondition is, that the insolvency administrator and creditors present agree by vote that the claimant should have the right to vote. The agreement can stipulate a differing extent of the vote. The criterion, "agreement" means that there should be no adverse votes. Abstentions have a "neutral" effect of being neither positive nor negative. If there is no "agreement", the insolvency court can grant claimant a right to vote. The right to vote can be granted to the full extent of the amount of the claim or for a partial amount. The entitlement to vote has no effect on the question of the validity of the claim. If resolutions adopted by the creditors' assembly contradict the common interest of the creditors in the insolvency, they can be overruled by the insolvency court, § 78 InsO.
The "common interest" of the creditors in the insolvency means the best possible satisfaction available for all the creditors. If individual resolutions give preference to individual creditors, the common interest is not safeguarded. Typically, the scope of application of § 78 InsO has the purpose of correcting resolutions of large-scale creditors with "powerful votes" if they "force" their interests. Since such an action relates to the creditors' autonomy, the power to repeal should only be used under special circumstances. If resolutions intentionally contradict the common interest, they can be challenged.

The court can only repeal the resolution on motion. It is not allowed to do so ex officio. Creditors with the right to separate satisfaction, the creditors in the insolvency and the insolvency administrator are entitled to bring such motions. The insolvency administrator's right to bring forth a motion safeguards the interests of the creditors who do not appear. The request must be made at the creditors' assembly itself. It can also be made in a continuation meeting, if one is held. Creditors who are not present cannot bring forth a motion, although they retain the right to lodge an appeal.

Creditors with disputed claims, who have been denied the right to vote, are also entitled to bring forth a motion. This compensates for the fact that they are unable to lodge either an immediate appeal or an objection against the restrictions on the right to vote under § 77 InsO.

Once the motion has been made, the court investigates whether the resolution adopted by the creditors' assembly contradicts the common interest of the creditors. It is generally reliant on the information provided by the insolvency administrator.

The court may not substitute the decision of the creditors' assembly with its own decision: § 76 InsO. However, the creditors' decision can be replaced by the decision of the court if the creditors' assembly does not change the result of its first vote. In this extreme case, the decision of the court is the ultima ratio, in order to safeguard the proper administration of the insolvency proceedings.

3. Approval as or through an Insolvency Plan

Under German law, if an insolvency administrator intends to amend or adjust the disposal rights for the estate's assets with the approval of the creditors', he may do so by virtue of an insolvency plan, a procedure that is inspired by the Chapter 11 Reorganization Plan.

If a Protocol would have a substantial effect on the insolvency estate, the form and formalities of the lodging of creditors' claims or to the distribution of the assets among the creditors, the insolvency administrator is required to seek authorization to enter into
the Protocol through the approval of an insolvency plan that mirrors the provisions and instructs the administrator on how to effectuate it.

A Protocol itself may be regarded as an insolvency plan under German law, being an agreement of the administrators on behalf of the creditors. Therefore, it would require the approval and authorization of the creditors just as any other insolvency plan.

It is therefore worth describing how an insolvency plan procedure works in Germany, and what an insolvency plan can do in this regard.

**a) Overview of German Insolvency Plans**

Insolvency plans can provide for a wide variety of different options. In practice, this has meant that special case groups have developed which specialize in insolvency plans. Statistically, proceedings involving insolvency plans account for only a small portion of all insolvency proceedings. Insolvency plans are often used where approvals or permits under public law or special contractual relations must be maintained because they cannot be reconstituted with the same content and within the required time, or because the current market conditions have changed. In cases such as these, preserving the indebted entity is advantageous for all parties involved because it is only through the continued existence of that indebted entity that the best possible outcome can be achieved in favor of all creditors.

**b) Power and scope of German Insolvency Plans**

The insolvency plan changes the financial, managerial and legal framework of the insolvency proceedings. The debtor is preserved as a legal entity and business activities are allowed to continue. The proponent of the plan is largely free to design the plan, with its success depending on the creditors’ consent. There is no specific design which the insolvency plan must adhere to. The basic types of plan which have evolved in practice include plans for liquidation, plans for sales, and plans for restructuring. Other designs and mixed forms are possible as well.

Another form of insolvency plan is known as the deferment plan. Under such a plan the creditors need not waive their claims with final effect. Instead, their claims are merely deferred. With the appropriate interest rate, this is the minimum concession creditors may make. Naturally, mixed forms from among the type of plans are also feasible. The business operations may be divided up, for instance. One business area is sold to a third party via an “asset deal”, while another is reorganized and continued via the insolvency plan.
c) Restrictions by the German Federal Court of Justice (Phoenix)

Phoenix was an insolvent German company that had been active as a financial services provider since 1977. It operated first as an intermediary for commodity futures transactions. These services were provided under the designation 'Tradable Options' and were provided until the end of 2004, although Phoenix had discontinued any meaningful activity in this field by the time of the formal opening of insolvency proceedings in Germany in 2005.

Around 1992, Phoenix launched a new product, the “PMA”. Customers were offered the opportunity to participate in the profits or losses of option trading transactions, through the medium of a so-called managed accounts. In these accounts Phoenix no longer carried out individual transactions, but did so in its own name on account of all such investors who participated in the PMA. In the light of investigations carried out after the opening of the insolvency proceedings in Germany, it appeared that no profits had been made in the PMA. The directors became aware of substantial losses in about 1992 or 1993, if not earlier.

Insolvency proceedings were commenced in 2005. Almost all of the derivative trades were found to be fictitious. Sham profits were paid to the first investors, from the contributions of new investors – a classic ponzi scheme.

Total claims filed against Phoenix were over €847,000,000 of which approximately €511,000,000 were approved by the Administrator. This resulted in a total disputed amount of over €335,000,000. The administrator could recover €236 million and was willing to distribute this amount in a first tranche of €200 million to the creditors. The administrator drafted an insolvency plan for that purpose, in which he assumed certain calculation methods in respect of pay-outs and interest to establish creditors’ claims. He decided to go this route since there were numerous legal uncertainties which would in the event of a case-by-case claim examination have to be clarified and might involve substantial litigation. The insolvency plan and approval of one specific calculation method would have brought legal certainty and a quick distribution for about 40,000 people.

Due to an opposing creditor, the required consent of the creditors was not achieved and the insolvency court rejected the request for formal approval of the plan.
An appeal was filed in response to the rejection of the plan and the German Federal Court of Justice rendered a decision on February 5, 2009 in which it stated that the insolvency plan can alter only those provisions of the insolvency proceedings law that are expressly allowed. Not all rules concerning the determination of creditors’ claims are disposable. The German Federal Court of Justice held that the procedural rules concerning the examination and determination of the claims lodged by creditors, have been prescribed for the benefit of the creditors. The insolvency plan cannot amend them and prevent creditors from conducting such formal claims procedures. Otherwise, a majority of creditors could prevent minor creditors from having their claims satisfied. Furthermore, the court held that the statutory right of objection could not be exercised by other creditors because the guaranteed legal process would be endangered.

d) Consequences of the Phoenix Case

One must conclude from this case that a Protocol that prescribes certain guidelines or rules concerning the lodging, examination, determination or any other part of the claims proving process, cannot be valid due to the fact that either (i) the Protocol as such is regarded as insolvency plan or, (ii) the administrator should seek instruction and approval before entering into a Protocol by way of an insolvency plan.

e) Another Lesson Learned – No Right to Appeal

The German Federal Court of Justice in the Phoenix case also decided that the insolvency administrator had no right to file an appeal against the non-approval of the insolvency plan by the insolvency court. According to the court, only creditors and the debtor are entitled to appeal against the rejection of the plan by the insolvency court to the Higher District Court. The insolvency administrator is not entitled to file an appeal. This is in line with the opinion of the majority of academics. The administrator’s right to submit a plan is not affected by it. The fact that the insolvency proceedings would take longer and be more complex, does not mean the administrator has a right to appeal the decision of the insolvency court. The court held that administration of the insolvency proceedings, is the primary task of the administrator. He has no right to have the proceedings organized by way of an insolvency plan.

Another consequence of the court’s decision is that provided an administrator seeks court approval to sign a Protocol, and assuming the court refuses to grant it, the administrator has no right to appeal against this decision. The administrator might be better off seeking the creditors’ consent through an insolvency plan procedure.
V. Summary and Consequences for Practitioners

An insolvency administrator in Germany cannot rely on the insolvency court alone to allow, authorize or instruct him to execute a cross-border insolvency protocol.

Insolvency administrators and practitioners are entitled to enter non-binding, voluntary Protocols that address issues of information and communication.

Even in the case of binding Protocols concerning communication and cooperation without any monetary or estate-related effect, the administrator might seek the creditors’ consent (or at least the committee’s consent) to act as a party thereof.

Protocols that affect the estate and creditors’ rights directly, and thereby differ from the statutory procedural law, require authorization by virtue of an insolvency plan procedure. If all requirements are met, the insolvency court will approve the protocol as an insolvency plan in the respective procedure or approve the plan which authorizes the administrator to sign the protocol.

An interesting question is whether the administrator is permitted to enter into a Protocol that affects non-disposable creditors’ rights, such as those relating to procedure or claims processing. Applying the jurisprudence of the German Federal Court of Justice in the Phoenix case, a binding protocol, such as that in the Lehman case (which is not binding) that provides (i) that the office holder shall decide where the creditor shall lodge his claim, in the main or the secondary proceedings, (ii) that the pooling of assets must be done in a certain way, or (iii) that there will be a joint assessment of the intercompany claims, would potentially be invalid.

To state the obvious, a German insolvency administrator must not enter into a protocol which amends or affects mandatory German insolvency law provisions, even with court approval or the consent of the creditors.

VI. Consequences for Legislators

Consequently, the future use of 'Protocols' in Germany depends upon an enabling Act of Parliament. It is certainly one disadvantage of a codified law system that German courts, unlike English courts, cannot simply act upon the maxim that 'what is not expressly forbidden may, if reasonable, be done'. It is therefore suggested that the German Legislators should enact the necessary rules to allow the use of Protocols in all multinational insolvency cases as soon as possible.